2 The Negotiable Instruments Act, 1881

Question 1

Explain the meaning of negotiable instruments?

Answer

It is an instrument which is transferable (by customs of trade) by delivery, like cash, and is also capable of being sued upon by the person holding for the time being. The property in such an instrument passes to a *bona fide* transferee for value. The attribute of negotiability is acquired by certain documents by custom.

Section 13 of the Negotiable Instruments Act, 1881 does not define a negotiable instrument although it mentions only three kinds of negotiable instruments namely, bills, notes and cheques. But it does not necessarily follow that there can be no other negotiable instruments than those enumerated in the Act. Section 17 of the Transfer of Property Act, 1882 speaks of instruments which are for the time being, by law of custom, negotiable, implying thereby that the Courts in India may follow the practice of the English Courts in extending the character of Negotiable Instruments Act. Thus in India, Government promissory notes, Shah Jog Hundis, delivery orders and railway receipts for goods have been held to be negotiable by usage or custom.

Question 2

Explain the essential elements of a promissory note. State, giving reasons, whether the following instruments are valid promissory notes:

(i) X promises to pay Y, by a promissory note, a sum of ₹ 5,000, fifteen days after the death of B.

(ii) X promises to pay Y, by a promissory note, ₹ 5000 and all other sums, which shall be due.

Answer

Essential Elements of a Promissory Note:

1. *Must be in writing*.
2. *Promise to pay*: The instrument must contain an express promise to pay.

3. *Definite and unconditional*: The promise to pay must be definite and unconditional. If it is uncertain or conditional, the instrument is invalid.
4. *Signed by the maker*: The instrument must be signed by the maker, otherwise it is incomplete and of no effect. Even if it is written by the maker himself and his name appears in the body of the instrument, his signature must be there.
5. *Certain parties*: The instrument must point out with certainty as to who the maker is and who the payee is. When the maker and the payee cannot be identified with certainty from the instrument itself, the instrument, even if it contains an unconditional promise to pay, is not a promissory note.
6. *Certain sum of money*: The sum payable must be certain and must not be capable of contingent additions or subtractions.
7. *Promise to pay money only*: The payment must be in the legal tender money of India.

Answer to Problem: In the case number 1, the payment to be made in fifteen days after the death of B. Though the date of death is uncertain, it is certain that B shall die. Therefore the instrument is valid.

In the second case- the sum payable is not certain within the meaning of Section 4 of the Negotiable Instruments Act, 1881- Hence the Promissory Note is not a valid one.

Question 3

Explain the meaning of 'Holder' and 'Holder in due course' of a negotiable instrument. The drawer, 'D' is induced by 'A' to draw a cheque in favour of P, who is an existing person. 'A' instead of sending the cheque to 'P', forgoes his name and pays the cheque into his own bank. Whether 'D' can recover the amount of the cheque from 'A's banker. Decide.

Answer

Meaning of 'Holder' and the 'Holder in due course' of a negotiable instrument:

'Holder': Holder of negotiable instrument means as regards all parties prior to himself, a holder of an instrument for which value has at any time been given.

'Holder in due course': (i) In the case of an instrument payable to bearer means any person who, for consideration became its possessor before the amount of an instrument payable. (ii) In the case of an instrument payable to order, 'holder in due course' means any person who became the payee or endorsee of the instrument before the amount mentioned in it became payable. (iii) He had come to possess the instrument without having sufficient cause to believe that any defect existed in the title of transferor from whom he derived his title.

The problem is based upon the privileges of a 'holder in due course'. Section 42 of the Negotiable Instrument Act, 1881, states that an acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relieved from liability to any holder in due cause claiming under an endorsement by the same hand as the drawer's signature, and purporting to be made by the drawer. In this problem, P is

not a fictitious payee and D, the drawer can recover the amount of the cheque from A's bankers *[North and South Wales Bank B. Macketh (1908) A.C. 137; Town and Country Advance Co. B, Provincial Bank (1917) 2 Ir. R.421].*

Question 4

Referring to the provisions of the Negotiable Instruments Act, 1881, examine the validity of the following Promissory Notes:

(i) I owe you a sum of ₹ 1,000. 'A' tells 'B'.

(ii) 'X' promises to pay 'Y' a sum of ₹ 10,000, six months after 'Y's marriage with 'Z'

Answer

Promissory Note: A Promissory Note is an instrument in writing containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of certain person, or the bearer of the Instrument. (Section 4, The Negotiable Instruments Act, 1881).

Essential elements: ***(refer answer no. 2 on the page no. 2.1- 2.2)***

Based on the above conditions in accordance with the definition of a promissory note, the answers to the two problems is as under:

(i) It is not a promissory note in the first case, since there is no promise to pay.

(ii) In the second case also it is not a promissory note since as there is probability that Y may not marry.

Question 5

What are the essential elements of a valid acceptance of a Bill of Exchange? An acceptor accepts a "Bill of Exchange" but write on it "Accepted but payment will be made when goods delivered to me is sold." Decide the validity.

Answer

Essentials of a valid acceptance of a Bill of Exchange:

The essentials of a valid acceptance are as follows:

1. *Acceptance must be written*: The drawee may use any appropriate word to convey his assent. It may be sufficient acceptance even if just signatures are put without additional words. An oral acceptance is not valid in law. '
2. *Acceptance must be signed*: A mere signature would be sufficient for the purpose. Alternatively, the words 'accepted' may be written across the face of the bill with a signature underneath; if it is not so signed, it would not be an acceptance.
3. *Acceptance must be on the bill*: The acceptance should be on the face of the bill normally but it is not necessary. An acceptance written on the back of a bill has been held to be

sufficient in law. What is essential is that must be written on the bill; else it creates no liability as acceptor on the part of the person who signs it.

4. *Acceptance must be completed by delivery*: Acceptance would not be complete and the drawee would not be bound until the drawee has either actually delivered the accepted bill to the holder or tendered notice of such acceptance to the holder of the bill or some person on his behalf.

5. Where a *bill is drawn in sets,* the acceptance should be put on one part only. Where the drawee signs his acceptance on two or more parts, he may become liable on each of them separately.

6. *Acceptance may be either general or qualified:* An acceptance is said to be general when the drawee assents without qualification order of the drawer. The qualification may relate to an event, amount, place, time etc. (Explanation to Section 86 of the Negotiable Instruments Act, 1881). In the given case, the acceptance is a qualified acceptance since a condition has been attached declaring the payment to be dependent on the happening of an event therein stated.

   As a rule, acceptance must be general acceptance and therefore, the holder is at liberty to refuse to take a qualified acceptance. Where, he refuse to take it, the bill shall be dishonoured by non-acceptance. But, if he accepts the qualified acceptance, even then it binds only him and the acceptor and not the other parties who do not consent thereto (Section 86).

Question 6

Examining the provisions of the Negotiable Instruments Act, 1881, distinguish between a 'Bill of Exchange' and a 'Promissory Note'.

Answer

Distinction between a Promissory Note and a Bill of Exchange:

The distinctive features of these two types of negotiable instruments are tabulated below:-

Sl. No.	Promissory Note	Bill of Exchange
1.	It contains a promise to pay	It contains an order to pay
2.	The liability of the maker of a note is primary and absolute	The liability of the drawer of a bill is secondary and conditional. He would be liable if the drawee, after accepting the bill fails to pay the money due upon it provided notice of dishonor is given to the drawer within the prescribed time.

3.	It is presented for payment without any previous acceptance by maker	If a bill is payable sometime after sight, it is required to be accepted either by the drawee himself or by someone else on his behalf, before it can be presented for payment.
4.	The maker of a promissory note stands in immediate relationship with the payee and is primarily liable to the payee or the holder.	The maker or drawer of an accepted bill stands in immediate relationship with the acceptor and the payee
5.	It cannot be made payable to the maker himself, that is the maker and the payee cannot be the same person	In the case of bill, the drawer and payee or the drawee and the payee may be the same person.
6.	In the case of a promissory note there are only two parties, viz. the maker (debtor) and the payee (creditor).	In the case of a bill of exchange, there are three parties, viz., drawer, drawee and payee, and any two of these three capacities can be filled by one and the same person.
7.	A promissory note cannot be drawn in sets	The bills can be drawn in sets
8.	A promissory note can never be conditional	A bill of exchange too cannot be drawn conditionally, but it can be accepted conditionally with the consent of the holder. It should be noted that neither a promissory note nor a bill of exchange can be made payable to bearer on demand.

Question 7

What do you mean by an acceptance of a negotiable instrument? Examine validity of the following in the light of the provisions of the Negotiable Instruments Act, 1881:

(i) An oral acceptance

(ii) An acceptance by mere signature without writing the word "accepted".

Answer

Meaning of Acceptance: It is only the bill of exchange which requires acceptance. A bill is said to be accepted when the drawee (i.e. the person on whom the bill is drawn), after putting his signature on it, either delivers it or gives notice of such acceptance to the holder of the bill or to some person on his behalf. After the drawee has accepted the bill he is known as the acceptor (Section 7 para 3 of the Negotiable Instruments Act,1881).

Acceptance may be either general or qualified. The acceptance is qualified when the drawer does not accept it according to the apparent term of the bill but attaches some condition or qualification which have the effect of either reducing his (acceptor's) liability or acceptance of his liability subject to certain conditions. A general acceptance is the acceptance where the acceptor assents without qualification to the order of the drawer.

Validity of Acceptance: (i): It is one of the essential elements of a valid acceptance that the acceptance must be written on the bill and signed by the drawee. An oral acceptance is not sufficient in law. Therefore, an oral acceptance of the bill does not stand to be a valid acceptance.

(ii): The usual form in which the drawee accepts the Instrument is by writing the word 'accepted', across the face of the bill and signing his name underneath. The mere signature of the drawee without the addition of the words 'accepted' is a valid acceptance. As the law prescribes no particular form for acceptance, there can be no difficulty in construing acknowledgement as an acceptance but it must satisfy the requirements of Section 7 of the Negotiable Instruments Act, 1881 i.e. it must appear on the bill and must be signed by the drawee. *(Manakchand v. Chartered Bank).*

Question 8

Is there any difference in the protection available to a banker in respect of a cheque being 'crossed' or 'uncrossed'?

Answer

If a cheque is uncrossed, the banker is exonerated for the failure to direct either the genuineness, or the validity of the endorsement on the cheque purporting to be that of the payee or is authorised agent.

In case a cheque is crossed, the banker who pays the cheque drawn by his customer, he can debit the drawer's account so paid even though the amount of cheque does not reach true owner. The protection that can be availed are if the payment has been made in due course in good faith and without negligence too any person in possession thereof in the circumstances which do not excite any suspicion that is not entitled to receive the payment of the cheque. In other words, the condition of good faith and without negligence would be the criteria applied for judging the conduct of a collecting banker. Even though the banker is protected for having made payment of the cheque to a wrong person, the true owner of the cheque is entitled to recover the amount of the cheque from the person who had no title to the cheque.

Question 9

State whether the following statement is correct or incorrect:

A cheque marked "Not-Negotiable" is not transferable

Answer

Incorrect

Question 10

Define "cheque", under the Negotiable Instruments Act, 1881. What are the difference between a cheque and a bill of exchange?

Answer

A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

Essentials:

1. Cheque is always drawn on a bank.
2. Cheque is always payable on demand.

   Since a cheque is a species of a bill of exchange, it must satisfy all the requirements of a bill of exchange, i.e.

   (i) it must be in writing and signed by the drawer;

   (ii) it must contain an unconditional order to pay;

   (iii) the order must be to pay a certain sum of money to or to the order of a certain person, or to the bearer of the instrument.

Distinction between a cheque and a bill of exchange

1. In a cheque the drawee is always a bank, whereas in a bill the drawee may be a 'bank' or any other person.
2. In a cheque days of grace are not allowed, whereas in a bill three days of grace are allowed for payment.
3. Notice of dishonour is not needed in a cheque, whereas notice of dishonour is usually required in case of a bill.
4. A cheque can be drawn to bearer and made payable on demand, whereas a bill cannot be bearer, if it is made payable on demand.
5. Cheque does not require presentment for acceptance. It needs presentment for payment. Bill, sometimes, require presentment for acceptance and it is advisable to present them for acceptance even when it is not essential to do so.
6. Cheque does not require to be stamped in India, whereas bill must be stamped according to the law.
7. A cheque may be crossed, whereas a bill cannot be crossed.
8. A cheque being a revocable mandate, the authority may be revoked by countermanding payment, and is determined by notice of the customer's death or insolvency. This is not so in the case of a bill.

9. The drawer of a bill is discharged from liability, if it is not duly presented for payment but the drawer of a cheque is not discharged by delay of the holder in presenting the cheque for payment unless the drawer has suffered some loss due to delay.

Question 11

Who is holder in due course? How he is differing from a Holder?

Answer

Holder in Due Course: It means any person who, for consideration became its possessor before the amount mentioned in it became payable. In the case of an instrument payable to order, 'holder in due course' means any person who became the payee or endorsee of the instrument before the amount mentioned in it became payable. In both the cases, he must receive the instrument without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. In other words, holder in due course means a holder who takes the instrument bona fide for value before it is overdue, and without any notice of defects in the title of the person, who transferred it to him. Thus, a person who claims to be 'holder in due course' is required to prove that:

1. on paying a valuable consideration, he became either the possessor of the instrument if payable to order;
2. he had come into the possession of the instrument before the amount due there under became actually payable; and
3. he had come to possess the instrument without having sufficient cause to believe that any defect existed in the title of transferor's from whom derived his title.

Distinction between Holder and Holder in Due Course:

1. A holder may become the possessor or payee of an instrument even without consideration, whereas a holder in due course is one who acquires possession for consideration.
2. A holder in due course as against a holder must become the possessor payee of the instrument before the amount thereon become payable.
3. A holder in due course as against a holder must have become the payee of the instrument in good faith i.e., without having sufficient cause to believe that any defect existed in the transferor's title.

Question 12

State the privileges of a 'Holder in due course" under the Negotiable Instruments Act, 1881.

A induced B by fraud to draw a cheque payable to C or order. A obtained the cheque, forged C's endorsement and collected proceeds to the cheque through his Bankers. B the drawer wants to recover the amount from C's Bankers. Decide in the light of the provisions of Negotiable Instruments Act, 1881-

(i) Whether B the drawer, can recover the amount of the cheque from C's Bankers?

(ii) Whether C is the Fictitious Payee?

Would your answer be still the same in case C is a fictitious person?

Answer

Privileges of a "Holder in Due Course": According to the provisions of the Negotiable Instruments Act, 1881, a holder in due course has the following privileges:

(i) A person signing and delivering to another a stamped but otherwise inchoate instrument is debarred from asserting, as against a holder in due course, that the instrument has not been filled in accordance with the authority given by him, the stamp being sufficient to cover the amount (Section 20).

(ii) In case of bill of exchange is drawn payable to drawer's order in a fictitious name and is endorsed by the same hand as the drawer's signature. It is not permissible for acceptor to allege as against the holder in due course that such name is fictitious (Section 42).

(iii) In case a bill or note is negotiated to a holder in due course, the other parties to the bill or note cannot avoid liability on the ground that the delivery of the instrument was conditional or for a special purpose only (Section 42 and 47).

(iv) The person liable in a negotiable instrument cannot set up against the holder in due course the defences that the instrument had been lost or obtained from the former by means of an offence or fraud or far an unlawful consideration (Section 58).

(v) No maker of a promissory note, and no drawer of a bill or cheque and no acceptor of a bill for the honour of the drawer shall, in a suit thereon by a holder in due course be permitted to deny the validity of the instrument as originally made or drawn (Section 120).

(vi) No maker of a promissory note and no acceptor of a bill payable to order shall, in a suit thereon by a holder in due course, be permitted to deny the payee's capacity, at the rate of the note or bill, to endorse the same (Section 121).

In brief, it is clear that a holder in due course gets a good title in many respects. Answer to problem

According to Section 42 of the Negotiable Instruments Act, 1881 an acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relieved from liability to any holder in due course claiming under an instrument by the same hand as the drawer's signature, and purporting to be made by the drawer.

The word "fictitious payee' means a person who is not in existence or being in existence, was never intended by the drawer to have the payment. Where drawer intends the payee to have the payment, then he is not a fictitious payee and the forgery of his signature will affect the validity of the cheque.

Applying the above, answers to the questions asked can be as under:

I. In this case B, the drawer can recover the amount of the cheque from C's bankers because C's title was derived through forged endorsement.

II. Here C is not a fictitious payee because the drawer intended him to receive payment.

III. The result would be different if C is not a real person or is a fictitious person or was not intended to have the payment.

Question 13

A draws and B accepts the bill payable to C or order, C endorses the bill to D and D to E, who is a holder-in-due course. From whom E can recover the amount? Examining the right of E, state the privileges of the holder-in-due course provided under the Negotiable Instruments Act, 1881.

Answer

Section 36 of the Negotiable Instruments Act, 1881 describes the liabilities of prior parties to the holder in due course. This section says that a holder in due course has privilege to hold every prior party to a negotiable instrument liable on it until the instrument is duly satisfied. Here the holder in due course can hold all the prior parties liable jointly and severally. Prior parties includes the maker or drawer, the acceptor and endorsers. Accordingly in the given problem, E, a holder in due course can recover the amount from all the prior parties i.e., D & C (the endorsers), B (an acceptor) and A (the drawer).

Privileges of a "Holder in Due Course": According to the provisions of the Negotiable Instruments Act, 1881, a holder in due course has the following privileges:-

i. A person signing and delivering to another a stamped but otherwise inchoate instrument is debarred from asserting, as against a holder in due course, that the instrument has not been filled in accordance with the authority given by him, the stamp being sufficient to cover the amount (Section 20).

ii. In case a bill of exchange is drawn payable to drawer's order in a fictitious name and is endorsed by the same hand as the drawer's signature, it is not permissible for acceptor to allege as against the holder in due course that such name is fictitious (Section 42).

iii. In case a bill or note is negotiated to a holder in due course, the other parties to the bill or note cannot avoid liability on the ground that the delivery of the instrument was conditional or for a special purpose only (Sections 42 and 47).

iv. The person liable in a negotiable instrument cannot set up against the holder in due course the defences that the instrument had been lost or obtained from the former by means of an offence or fraud or for an unlawful consideration (Section 58).

v. No maker of a promissory note, and no drawer of a bill or cheque and no acceptor of a bill for the honour of the drawer shall, in a suit thereon by a holder in due course be permitted to deny the validity of the instrument as originally made or drawn (Section 120).

vi. No maker of a promissory note and no acceptor of a bill payable to order shall, in a suit thereon by a holder in due course, be permitted to deny the payee's capacity to endorse the same (Section 121).

Question 14

A cheque payable to bearer is crossed generally and marked "not negotiable". The cheque is lost or stolen and comes into possession of B who takes it in good faith and gives value for it. B deposits the cheque into his own bank and his banker presents it and obtains payment for his customer from the bank upon which it is drawn. The true owner of the cheque claims refund of the amount of the cheque from B.

Answers

The cheque in the given case was crossed generally and marked 'Not Negotiable'. Thereafter, the cheque was lost or stolen and came into the possession of B, who takes it in good faith and gives value for it. Section 130 of the Negotiable Instruments Act, 1881 provides that a person taking a cheque crossed generally or specially, bearing in either case the words 'not negotiable', shall not have, and shall not be capable of giving a better title to the cheque than that which the person from whom he took it had. In view of these provisions, B, even though he was a holder in due course, did not acquire any title to the cheque as against its true owner. The addition of the words 'not negotiable' entirely takes away the main feature of negotiability, which is, that a holder with a defective title can give a good title to a subsequent holder in due course. B did not obtain any better title than his immediate transferor, who had either stolen or found the cheque and was not the true owner of the cheque. Therefore, as regards the true owner, B was in no better position than the transferor. B is also liable to repay the amount of the cheque to the true owner. He can, however, proceed against the person from whom he took the cheque.

In the given case, both the collecting banker and the paying bankers would be exonerated. Since the collecting banker, in good faith and without negligence, had received payment for B, who was its customer of the cheque which was crossed generally, the banker would not be liable, in case the title proved to be defective, to the true owner by reason only of having received the payment of the cheque for his customer (Section 131). Since the paying banker on whom the crossed cheque was drawn, had paid the same in due course, the banker would also not be liable to the true owner. (Section 128).

Question 15

Referring to the provisions of the Negotiable Instruments Act, 1881, examine the validity of the following:

(i) A Bill of Exchange originally drawn by M for a sum of ₹ 10,000, but accepted by R only for ₹ 7,000.

(ii) A cheque marked 'Not Negotiable' is not transferable.

Answer

(i) As per the provisions of the Negotiable Instruments Act 1881, acceptance may be either general or qualified. It is qualified when the drawee does not accept the bill according to the apparent tenor of the bill but attaches some condition or qualification which have the effect of either reducing his (acceptor's) liability or acceptance of this liability is subject to certain condition. The holder of the bill is entitled to require an absolute and unconditional acceptance, otherwise he will treat it as dishonoured however, he may agree to qualified acceptance but he does so at his own peril, since he discharges all parties prior to himself, unless he has obtained their consent.

Thus in this given case in accordance with the Explanation to Section 86 of the Act, when the drawee undertakes the payment of part only of the sum ordered to be paid, it is a qualified acceptance and the drawer may treat it as dishonoured unless agreed by him. If the Drawer (M) agrees to acceptance, the drawee (R) is responsible for a sum of ₹ 7000 only.

(ii) It is wrong statement. A cheque marked "not negotiable" is a transferable instrument. The inclusion of the words 'not negotiable' however makes a significant difference in the transferability of the cheques. The holder of such a cheque cannot acquire title better than that of the transferor.

Question 16

What are the essential elements of a "Promissory note" under the Negotiable Instruments Act, 1881? Whether the following notes may be considered as valid Promissory notes:

(i) "I promise to pay ₹5,000 or 7,000 to Mr. Ram."

(ii) I promise to pay to Mohan ₹500, if he secures 60% marks in the examination.

(iii) I promise to pay ₹3,000 to Ravi after 15 days of the death of A.

Answer

A promissory note is an instrument (not being a bank note or currency note) in writing containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to or the holder of, a certain person or to the bearer of the instrument, (Section 4 of the Negotiable Instruments Act, 1881).

In view of the above provision of the said Act, following are the essential elements of a promissory note-

1. It must be in writing.
2. The promise to pay must be unconditional.
3. The amount promised must be a certain and a definite sum of money.
4. The instrument must be signed by the maker.
5. The person to whom the promise is made must be a definite person.

Thus:

(i) In case (i), it is not a valid promissory note because the amount is not certain.

(ii) In case (ii), it is not a valid promissory note because it is conditional.

(iii) In case (iii), it is a valid promissory note because death of A is a certainty even if time of death is not certain.

Question 17

Discuss with reasons, whether the following persons can be called as a 'holder' under the Negotiable Instruments Act, 1881:

(i) X who obtains a cheque drawn by Y by way of gift.

(ii) A, the payee of the cheque, who is prohibited by a court order from receiving the amount of the cheque.

(iii) M, who finds a cheque payable to bearer, on the road and retains it.

(iv) B, the agent of C, is entrusted with an instrument without endorsement by C, who is the payee.

(v) B, who steals a blank cheque of A and forges A's signature.

Answer

Person to be called as a holder: As per section 8 of the Negotiable Instruments Act, 1881 'holder' of a Negotiable Instrument means any person entitled in his own name to the possession of it and to receive or recover the amount due thereon from the parties thereto.

On applying the above provision in the given cases-

(i) Yes, X can be termed as a holder because he has a right to possession and to receive the amount due in his own name.

(ii) No, he is not a 'holder' because to be called as a 'holder' he must be entitled not only to the possession of the instrument but also to receive the amount mentioned therein.

(iii) No, M is not a holder of the Instrument though he is in possession of the cheque, so is not entitled to the possession of it in his own name.

(iv) No, B is not a holder. While the agent may receive payment of the amount mentioned in the cheque, yet he cannot be called the holder thereof because he has no right to sue on the instrument in his own name.

(v) No, B is not a holder because he is in wrongful possession of the instrument.

Question 18

Give the answer of the following:

(a) A draws a cheque in favour of M, a minor. M endorses the same in favour of X. The cheque is dishonoured by the bank on grounds of inadequate funds. Discuss the rights of X.

(b) A promissory note was made without mentioning any time for payment. The holder added the words "on demand" on the face of the instrument. Does this amount to material alteration?

(c) A draws a cheque for ₹ 100 and hands it over to B by way of gift. Is B a holder in due course? Explain the nature of his title, interest and right to receive the proceeds of the cheque.

(d) A cheque is drawn payable to "B or order". It is stolen and the thief forges B's endorsement and endorses it to C. The banker pays the cheque in due course. Can B recover the money from the banker.

Answer

(a) As per Section 26, a minor may draw, endorse, deliver and negotiate the instrument so as to bind all parties except himself. Therefore, M is not liable. X can, thus, proceed against A.

(b) As per the provision of the Negotiable Instruments Act,1881 this is not a material alteration as a promissory note where no date of payment is specified will be treated as payable on demand. Hence adding the words "on demand" does not alter the business effect of the instrument.

(c) B is a holder but not a holder in due course as he does not get the cheque for value and consideration. His title is good and bonafide. As a holder he is entitled to receive ₹ 100 from the bank on whom the cheque is drawn.

(d) According to Section 85, the drawee banker is discharged when he pays a cheque payable to order when it is purported to be endorsed by or on behalf of the payee. Even though the endorsement of Mr. B is forged, the banker is protected and he is discharged. The true owner, B, cannot recover the money from the drawee bank.

Question 19

M drew a cheque amounting to ₹ 2 lakh payable to N and subsequently delivered to him. After receipt of cheque N endorsed the same to C but kept it in his safe locker. After sometime, N died, and P found the cheque in N's safe locker. Does this amount to Indorsement under the Negotiable Instruments Act, 1881?

Answer

No, P does not become the holder of the cheque as the negotiation was not completed by delivery of the cheque to him. (Section 48, the Negotiable Instruments Act, 1881)

Question 20

M owes money to N. Therefore, he makes a promissory note for the amount in favour of N, for safety of transmission he cuts the note in half and posts one half to N. He then changes his mind and calls upon N to return the half of the note which he had sent. N requires M to send the other half of the promissory note. Decide how a rights of the parties are to be adjusted.

Answer

The question arising in this problem is whether the making of promissory note is complete when one half of the note was delivered to N. Under Section 46 of the N.I. Act, 1881, the making of a P/N is completed by delivery, actual or constructive. Delivery refers to the whole of the instrument and not merely a part of it. Delivery of half instrument cannot be treated as constructive delivery of the whole. So the claim of N to have the other half of the P/N sent to him is not maintainable. M is justified in demanding the return of the first half sent by him. He can change his mind and refuse to send the other half of the P/N.

Question 21

P draws a bill on Q for ₹ 10,000. Q accepts the bill. On maturity the bill was dishonored by non-payment. P files a suit against Q for payment of ₹ 10,000. Q proved that the bill was accepted for value of ₹ 7,000 and as an accommodation to the plaintiff for the balance amount i.e. ₹ 3,000. Referring to the provisions of the Negotiable Instruments Act, 1881 decide whether P would succeed in recovering the whole amount of the bill?

Answer

As per Section 44 of the Negotiable Instruments Act, 1881, when the consideration for which a person signed a promissory note, bill of exchange or cheque consisted of money, and was originally absent in part or has subsequently failed in part, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionally reduced.

[Explanation- The drawer of a bill of exchange stands in immediate relation with the acceptor. The maker of a promissory note, bill of exchange or cheque stands in immediate relation with the payee, and the endorser with his endorsee. Other signers may by agreement stand in immediate relation with a holder].

On the basis of above provision, P would succeed to recover ₹ 7,000 only from Q and not the whole amount of the bill because it was accepted for value as to ₹ 7,000 only and an accommodation to P for ₹ 3,000.

Question 22

A Bill is drawn payable at No. A-17 CA apartments, Mayur Vihar, New Delhi, but does not contain drawee's name. Mr. Vinay who resides at the above address accepts the bill. Is it a valid Bill?

Answer

Yes, it is a valid Bill and Mr. Vinay is liable thereon. The drawee may be named or otherwise indicated in the Bill with reasonable certainty. In the present case, the description of the place of residence indicates the name of the drawee and Mr. Vinay, by his acceptance, acknowledges that he is the person to whom the bill is directed (*Gray vs. Milner 1819*).

Question 23

Pick out the correct answer from the following and give reason.

P, obtains a cheque drawn by M by way of gift. Here P is a :

1. *holder in due course*
2. *holder for value*
3. *holder*
4. *None of the above*

Answer

Holder: Yes, P can be termed as a holder because he has a right to possession and to receive the amount due in his own name.

Question 24

J accepted a bill of exchange and gave it to K for the purpose of getting it discounted and handing over the proceeds to J. K having failed to discount it returned the bill to J. J tore the bill in two pieces with the intention of cancelling it and threw the pieces in the street. K picked up the pieces and pasted the two pieces together, in such manner that the bill seemed to have been folded for safe custody, rather than cancelled. K put it into circulation and it ultimately reached L, who took it in good faith and for value. Is J liable to pay the bill under the provisions of the Negotiable Instruments Act, 1881 ?

Answer

The problem is based upon the privileges of a 'holder in due course', Section 120 of the Negotiable Instruments Act, 1881 provides that No..... drawer of a bill shall in a suit thereon by a holder in due course be permitted to deny the validity of the instrument as originally drawn. ..... A holder in due course gets a good title of the bill.

Therefore in the given problem J is liable to pay for the bill. L is a holder in due course, who got the bill in good faith and for value. (*Ingham v Primrose*)

Question 25

Distinguish between 'Bearer instrument' and 'Order instrument' under the Negotiable Instruments Act, 1881.

Answer

Bearer and Order instruments: An instrument may be made payable: (1) to bearer; or (2) to a specified person or to his order.

An instrument is said to be payable to bearer when it is expressed to be so payable to its bearer or when the only or last endorsement on it is an endorsement in blank.(Explanation 2 to section13)

An instrument is payable to order, (1) when it is payable to the order of a specified person or (2) when it is payable to a specified person or his order or, (3) when it is payable to a specified person without the addition of the words "or his order" and does not contain words prohibiting transfer or indicating an intention that it should not be transferable. When an instrument, either originally or by endorsement, is made payable to the order of a specified person and not to him or his order, it is payable to him or his order, at his option.

When an instrument is not payable to bearer(i.e., in case of order instrument), the payee must be indicated with reasonable certainty.

Question 26

State briefly the rules laid down under the Negotiable Instruments Act for determining the date of maturity of a bill of exchange. Ascertain the date of maturity of a bill payable hundred days after sight and which is presented for sight on 4th May, 2000.

Answer

Calculation of maturity of a Bill of Exchange: The maturity of a bill, not payable on demand, at sight, or on presentment, is at maturity on the third day after the day on which it is expressed to be payable (Section 22, para 2 of Negotiable Instruments Act, 1881). Three days are allowed as days of grace. No days of grace are allowed in the case of bill payable on demand, at sight, or presentment.

When a bill is made payable at stated number of months after date, the period stated terminates on the day of the month which corresponds with the day on which the instrument is dated. When it is made payable after a stated number of months after sight the period terminates on the day of the month which corresponds with the day on which it is presented for acceptance or sight or noted for non-acceptance or protested for non-acceptance. When it is payable a stated number of months after a certain event, the period terminates on the day of the month which corresponds with the day on which the event happens (Section 23).

When a bill is made payable a stated number of months after sight and has been accepted for honour, the period terminates with the day of the month which corresponds with the day on which it was so accepted.

If the month in which the period would terminate has no corresponding day, the period terminates on the last day of such month (Section 23).

In calculating the date a bill made payable a certain number of days after date or after sight or after a certain event is at maturity, the day of the date, or the day of presentment for acceptance or sight or the day of protest for non-accordance, or the day on which the event happens shall be excluded (Section 24).

Three days of grace are allowed to these instruments after the day on which they are expressed to be payable (Section 22).

When the last day of grace falls on a day which is public holiday, the instrument is due and payable on the next preceding business day (Section 25).

Answer to Problem: In this case the day of presentment for sight is to be excluded i.e. 4th May, 2000. The period of 100 days ends on 12th August, 2000 (May 27 days + June 30 days + July 31 days + August 12 days). Three days of grace are to be added. It falls due on 15th August, 2000 which happens to be a public holiday. As such it will fall due on 14th August, 2000 i.e. the next preceding business day.

Question 27

In what way does the Negotiable Instruments Act, 1881 regulate the determination of the 'Date of maturity' of a Bill of Exchange. Ascertain the 'Date of maturity' of a bill payable 120 days after the date. The Bill of exchange was drawn on 1st June, 2005.

Answer

Calculation of maturity of a Bill of Exchange: The maturity of a bill, not payable on demand, at sight or on presentment, is at maturity on the third day after the day on which it is expressed to be payable (Section 22, para 2 of Negotiable Instruments Act, 1881). Three days are allowed as days of grace. No days of grace are allowed in the case of a bill payable on demand, at sight, or presentment.

When a bill is made payable as stated number of months after date, the period stated terminates on the day of the month, which corresponds with the day on which the instrument is dated. When it is made payable after a stated number of months after sight the period terminates on the day of the month which corresponds with the day on which it is presented for acceptance or sight or noted for non-acceptance on protested for Non-acceptance when it is payable a stated number of months after a certain event, the period terminates on the day of the month which corresponds with the day on which the event happens. (Section 23).

When a bill is made payable a stated number of months after sight and has been accepted for honour, the period terminates on the day of the month which corresponds with the day on which it was so accepted.

If the month in which the period would terminate has no corresponding day, the period terminates on the last day of such month (Section 23).

In calculating the date a bill made payable a certain number of days after date or after sight or after a certain event is at maturity, the day of the date, or the day of protest for non-acceptance, or the day on which the event happens, shall be excluded (Section 24).

Three days of grace are allowed to these instruments after the day on which they are expressed to be payable. (Section 22).

When the last day of grace falls on a day, which is public holiday, the instrument is due and payable on the next preceding business day (Section 25).

Answer to Problem: In this case the day of presentment for sight is to be excluded i.e. 1st June, 2005. The period of 120 days ends on 29th September, 2005 (June 29 days + July 31 days + August 31 Days + September 29 days = 120 days). Three days of grace are to be added. It falls due on 2nd October, 2005, which happens to be a public holiday. As such it will fall due on 1st October, 2005 i.e., the next preceding Business Day.

Question 28

Bharat executed a promissory note in favour of Bhushan for ₹ 5 crores. The said amount was payable three days after sight. Bhushan, on maturity, presented the promissory note on 1st January, 2008 to Bharat. Bharat made the payments on 4th January, 2008. Bhushan wants to recover interest for one day from Bharat. Advise Bharat, in the light of provisions of the Negotiable Instruments Act, 1881, whether he is liable to pay the interest for one day?

Answer

Claim of Interest: Section 24 of the Negotiable Instruments Act, 1881 states that where a bill or note is payable after date or after sight or after happening of a specified event, the time of payment is determined by excluding the day from which the time begins to run.

Therefore, in the given case, Bharat will succeed in objecting to Bhushan's claim. Bharat paid rightly "three days after sight". Since the bill was presented on 1st January, Bharat was required to pay only on the 4th and not on 3rd January, as contended by Bharat.

Question 29

What do you mean by an endorsement. Briefly explain the types of an endorsement.

Answer

The endorsement consists of the signature of the holder made on the back of the negotiable instrument with the object of transferring the instrument. If there is no space on the instrument, the endorsement may be made on a slip of paper attached to it. This attachment is known as "Allonge".

According to Section 15 of the Negotiable Instruments Act, 1881 " when the maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiation, on the back or face therefore or on slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as negotiable instrument, he is said to endorse the same, and is called the endorser."

Types of Indorsements.

1. Endorsement in Blank

2. Endorsement in Full
3. Restrictive Endorsement
4. Endorsement sans recourse
5. Conditional Endorsement
6. Facultative Endorsement
7. Partial Endorsement
8. Sans frais Endorsement

Question 30

X by inducing Y obtains a Bill of Exchange from him fraudulently in his (X) favour. Later, he enters into a commercial deal and endorses the bill to Z towards consideration to him (Z) for the deal. Z takes the bill as a Holder-in-due-course. Z subsequently endorses the bill to X for value, as consideration to X for some other deal. On maturity the bill is dishonoured. X sues Y for the recovery of the money.

With reference to the provisions of the Negotiable Instruments Act, decide whether X will succeed in the case ?

Answer

The problem stated in the question is based on the provisions of the Negotiable Instruments Act, 1881 as contained in Section 53. The section provides: 'Once a negotiable instrument passes through the hands of a holder in due course, it gets cleansed of its defects provided the holder was himself not a party to the fraud or illegality which affected the instrument in some stage of its journey. Thus any defect in the title of the transferor will not affect the rights of the holder in due course even if he had knowledge of the prior defect provided he is himself not a party to the fraud. (Section 53).

Thus applying the above provisions it is quite clear that X who originally induced Y in obtaining the bill of exchange in question fraudulently, cannot succeed in the case. The reason is obvious as X himself was a party to the fraud.

Question 31

What is a 'Sans Recours' endorsement? A bill of exchange is drawn payable to X or order. X endorses it to Y, Y to Z, Z to A,A to B and B to X. State with reasons whether X can recover the amount of the bill from Y, Z, A and B, if he has originally endorsed the bill to Y by adding the words 'Sans Recours..

Answer

Meaning of Sans Recours Endorsement: It is a type of endorsement on a Negotiable Instrument by which the endorser absolves himself or declines to accept any liability on the instrument of any subsequent party. The endorser signs the endorsement putting his-signature along with the words, "SANS RECOURS".

In the problem X, the endorser becomes the holder after it is negotiated to several parties. Normally, in such a case, none of the intermediate parties is liable to X. This is to prevent 'circuitry of action'. But in this case X's original endorsement is 'sans recours' and therefore, he is not liable to Y, Z, A and B. But if the bill is negotiated back to X, all of them are liable to him and he can recover the amount from all or any of them (Section 52 para 2).

Question 32

B obtains A's acceptance to a bill of exchange by fraud. B endorses it to C who is a holder in due course. C endorses the bill to D who knows of the fraud. Referring to the provisions of the Negotiable Instruments Act, 1882, decide whether D can recover the money from A in the given case.

Answer

Section 53 of the Negotiable Instruments Act, 1881 provides that a holder of negotiable instrument who derives title from a holder in due course has the right thereon of that holder in due course. Such holder of the bill who is not himself a party to any fraud or illegality affecting it, has all the rights of that holder in due course as regards to the acceptor and all parties to the bill prior to that holder. In this case, it is clear that though D was aware of the fraud, he was himself not a party to it. He obtained the instrument from C who was a holder in due course. So D gets a good title and can recover from A.

Question 33

X, a major, and M, a minor, executed a promissory note in favour of P. Examine with reference to the provisions of the Negotiable Instruments Act, the validity of the promissory note and whether it is binding on X and M.

Answer

Minor being a party to negotiable instrument: Every person competent to contract has capacity to incur liability by making, drawing, accepting, endorsing, delivering and negotiating a promissory note, bill of exchange or cheque (Section 26, para 1, Negotiable Instruments Act, 1881).

As a minor's agreement is void, he cannot bind himself by becoming a party to a negotiable instrument. But he may draw, endorse, deliver and negotiate such instruments so as to bind all parties except himself (Section 26, para 2).

In view of the provisions of Section 26 explained above, the promissory note executed by X and M is valid even though a minor is a party to it. M, being a minor is not liable; but his immunity from liability does not absolve the other joint promisor, namely X from liability *[Sulochana v. Pandiyan Bank Ltd., AIR (1975) Mad. 70].*

Question 34

A draws a bill on B. B accepts the bill without any consideration. The bill is transferred to C without consideration. C transferred it to D for value. Decide-.

(i) Whether D can sue the prior parties of the bill, and

(ii) Whether the prior parties other than D have any right of action inter se?

Give your answer in reference to the Provisions of Negotiable Instruments Act, 1881.

Answer

Problem on Negotiable Instrument made without consideration: Section 43 of the Negotiable Instruments Act, 1881 provides that a negotiable instrument made, drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction. But if any such party has transferred the instrument with or without endorsement to a holder for consideration, such holder, and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or any prior party thereto.

(i) In the problem, as asked in the question, A has drawn a bill on B and B accepted the bill without consideration and transferred it to C without consideration. Later on in the next transfer by C to D is for value. According to provisions of the aforesaid section 43, the bill ultimately has been transferred to D with consideration. Therefore, D can sue any of the parties i.e. A, B or C, as D arrived a good title on it being taken with consideration.

(ii) As regards to the second part of the problem, the prior parties before D i.e., A, B, and C have no right of action inter se because first part of Section 43 has clearly lays down that a negotiable instrument, made, drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction prior to the parties who receive it on consideration.

Question 35

Briefly explain the circumstances of dishonour of a Negotiable Instrument. What are the consequences of a 'cheque being dishonoured for insufficiency of funds' in the account?

Answer

Dishonour by non-acceptance (Section 91, the Negotiable Instruments Act, 1881): A bill may be dishonoured either by non-acceptance or by non-payment. A dishonour by non-acceptance may take place in any one of the following circumstances:

(i) when the drawee either does not accept the bill within forty-eight hours of presentment or refuse to accept it;

(ii) when one of several drawees, not being partners, makes default in acceptance;

(iii) when the drawee gives a qualified acceptance;

(iv) when presentment for acceptance is excused and the bill remains unaccepted; and

(v) when the drawee is incompetent to contract.

An instrument is dishonoured by non-payment when the party primarily liable e.g., the acceptor of a bill, the maker of a note or the drawee of a cheque, make default in payment. An instrument is also dishonoured for non-payment when presentment for payment excused and the instrument, when overdue, remains unpaid, under section 76 of the Act.

Dishonour of cheque for insufficiency, etc. of funds in the account: Where any cheque drawn by a person on an account maintained by him with a banker for payment is dishonoured due to insufficiency of funds, he shall be punished with imprisonment for a term which may extend to one year or with fine which may extend to twice the amount of the cheque or with both [Section 138 of the Negotiable Instruments Act, 1881].

Provided that nothing in this section shall apply unless:

(i) such cheque should have been presented to the bank within a period of 3 months of the date of drawn or within the period of its validity, whichever is earlier.

(ii) The payee or holder in due course of such cheque had made a demand in writing for the payment of the said amount of money from the drawer 30 days of the receipt of information by him from the bank regarding the return of the cheque unpaid; and

(iii) The drawer of the cheque had failed to pay the money to the payee or holder in due course of the cheque within 15 days for the written demand for payment.

Question 36

A promoter who has borrowed a loan on behalf of company, who is neither a director nor a person-in-charge, sent a cheque from the companies account to discharge its legal liability. Subsequently the cheque was dishonoured and the compliant was lodged against him. Does he is liable for an offence under section 138?

Answer

According to Section 138 of the Negotiable Instruments Act, 1881 where any cheque drawn by a person on an account maintained by him with a banker for payment of any amount of money to another person from/out of that account for discharging any debt or liability, and if it is dishonoured by banker on sufficient grounds, such person shall be deemed to have committed an offence and shall be liable. However, in this case, the promoter is neither a director nor a person-in-charge of the company and is not connected with the day-to-day affairs of the company and had neither opened nor is operating the bank account of the company. Further, the cheque, which was dishonoured, was also not drawn on an account maintained by him but was drawn on an account maintained by the company. Therefore, he has not committed an offence under section 138.

Question 37

J, a shareholder of a Company purchased for his personal use certain goods from a Mall (Departmental Store) on credit. He sent a cheque drawn on the Company's account to the Mall (Departmental Store) towards the full payment of the bills. The cheque was dishonoured by the Company's Bank. J, the shareholder of the company was neither a Director nor a person in-charge of the company. Examining the provisions of the Negotiable Instruments Act, 1881 state whether J has committed an offence under Section 138 of the Act and decide whether he (J) can be held liable for the payment, for the goods purchased from the Mall (Departmental Store).

Answer

The facts of the problem are identical with the facts of a case known as *H.N.D. Mulla Feroze Vs. C.Y. Somaya Julu, J(2004) 55 SCL (AP)* wherein the Andhra Pradesh High Court held that although the petitioner has a legal liability to refund the amount to the appellant, petitioner is not the drawer of the cheque, which was dishonoured and the cheque was also not drawn on an account maintained by him but was drawn on an account maintained by the company. Hence, it was held that the petitioner J could not be said to have committed the offence under Section 138 of the Negotiable Instruments Act, 1881. Therefore X also is not liable for the cheque but legally liable for the payments for the goods.

Question 38

X draws a cheque in favour of Y. After having issued the cheque he informs Y not to present the cheque for payment. He also informs the bank to stop payment. Decide, under provisions of the Negotiable Instruments Act, 1881, whether the said acts of X constitute an offence against him?

Answer

Offence under the Negotiable Instruments Act, 1881: This problem is based on the case of *Modi Cements Ltd. Vs. Kuchil Kumar Nandi, 1998*. In this case the Supreme Court held that once a cheque is issued by the drawer, a presumption under Section 139 of the Negotiable Instruments Act, 1881 follows and merely because the drawer issues a notice thereafter to the drawee or to the bank for stoppage of payment, it will not preclude an action under Section 138. The object of Sections 138 to 142 of the Act is to promote the efficacy of the banking operations and to ensure credibility in transacting business through cheques. Section 138 is a penal provision in the sense that once a cheque is drawn on an account maintained by the drawer with his banker for payment of any amount of money to another person from out of that account for the discharge in whole or in part of any debt or other liability, is informed by the bank unpaid either because of insufficiency of amount to honour the cheques or the amount exceeding the arrangement made with the bank, such a person shall be deemed to have committed an offence.

Question 39

State, in brief, the grounds on the basis of which a banker can dishonor a cheque under the provisions of the Negotiable Instruments Act, 1881.

Answer

Dishonour of Cheque – Grounds: A banker will be justified or bound to dishonor a cheque in the following cases, viz;

- If a cheque is undated, if it is stale, that is if it has not been presented within reasonable period, which may vary three months to a year after its issue dependent on the circumstances of the case
- If the instrument is inchoate or not free from reasonable doubt
- If the cheque is post-dated and presented for payment before its ostensible date
- If the customer's funds in the banker's hands are not 'properly applicable' to the payment of cheque drawn by the former. Thus, should the funds in the banker's hands be subject to a lien or should the banker be entitled to a set-off in respect of them, the funds cannot be said to be "properly applicable" to the payment of the customer's cheque, and the banker would be justified in refusing payment.
- If the customer has credit with one branch of a bank and he draws a cheque upon another branch of the same bank in which either he has account or his account is overdrawn.
- If the bankers receive notice of customer's insolvency or lunacy
- If the customer countermands the payment of cheque for the banker's duty and authority to pay on a cheque ceases
- If a garnishee or other legal order from the Court attaching or otherwise dealing with the money in the hand of the banker, is served on the banker
- If the authority of the banker to honor a cheque of his customer is undermined by the notice of the latter's death. However, any payment made prior to the receipt of the notice of death is valid.
- If notice in respect of closure of the account is served by either party on the other.
- If it contains material alterations, irregular signature or irregular endorsement**.**

Question 40

State whether the following statements are correct or incorrect:

The validity period of a cheque is three months.

Answer

The validity period of a cheque is three months. This statement is correct

Question 41

X draws a bill on Y but signs it in the fictitious name of Z. The bill is payable to the order of Z. The bill is duly accepted by Y. M obtains the bill from X thus becoming its holder in due course. Can Y avoid payment of the bill? Decide in the light of the provisions of the Negotiable Instruments Act, 1881.

Answer

Bill drawn in fictitious name: The problem is based on the provision of Section 42 of the Negotiable Instruments Act, 1881. In case a bill of exchange is drawn payable to the drawer's order in a fictitious name and is endorsed by the same hand as the drawer's signature, it is not permissible for the acceptor to allege as against the holder in due course that such name is fictitious. Accordingly, in the instant case, Y cannot avoid payment by raising the plea that the drawer (Z) is fictitious. The only condition is that the signature of Z as drawer and as endorser must be in the same handwriting.

Question 42

A cheque was dishonoured at the first instance and the payee did not initiate action. The cheque was presented for payment for the second time and again it was dishonoured. State in this connection whether the payee can subsequently initiate prosecution for dishonour of cheque.

Answer

Supreme Court in *Sadanandan Bhadran v. Madhavan Sunil Kumar (1998) 4 CLJ 228* held that on a careful analysis of section 138 of the Negotiable Instruments Act, 1881 it is seen that the main part creates an offence when a cheque is returned by the bank unpaid for any of the reasons mentioned therein. The said proviso lays down three conditions precedent to the applicability of the above section and the conditions are:

(1) the cheque should have been presented to the bank within three months of its issue or within the period of its validity whichever is earlier;

(2) the payee should have made a demand for payment by registered notice after the cheque is returned unpaid; and

(3) the drawer should have failed to pay the amount within 15 days of the receipt of notice. It is only when all the above three conditions are satisfied that a prosecution can be launched for the offence under section 138.

So far as the first condition is concerned clause (a) of the proviso to section 138 does not put any embargo upon the payee to successively present a dishonoured cheque during the period of validity. It is not uncommon for a cheque being presented again and again within its validity

period in the expectation that it would be encashed. The question whether dishonour of the cheque on each occasion of its presentation gives rise to a fresh cause of action, the following facts are required to be proved to successfully to prosecute the drawer for an offence under section 138:-

(1) that the cheque was drawn for payment of an amount of money for discharge of a debt/liability and the cheque was dishonoured;

(2) that the cheque was presented within the prescribed period;

(3) that the payee made demand for payment of the money by giving a notice in writing to the drawer within the stipulated period;

(4) that the drawer failed to make the payment within 15 days of the receipt of the notice.

If one has to proceed on the basis of the generic meaning of the terms "cause of action", certainly each of the above facts would constitute a part of the cause of action, but it is significant to note that clause (b) of section 142(1) gives a restrictive meaning in that it refers to only one fact which will give rise to the cause of action and that is failure to make the payment within 15 days from the date of receipt of the notice.

Besides the language of section 138 and section 142 which clearly postulates only one cause of action, there are other formidable impediment which negates the concept of successive causes of action. The combined reading of sections 138 and 142 leave no room for doubt that cause of action within the meaning of section 142(1)(c) arises and can arise only once.

The final question as how apparently conflicting provisions of the Act, one enabling the payee to repeatedly present the cheque and the other giving him only one opportunity to file a complaint for its dishonour and that too within one month from the date of cause of action arises can be reconciled, the Court held that the two provisions can be harmonized with the interpretation that on each presentation of the cheque and its dishonour, a fresh right and not initiate such prosecution on the earlier cause of action.

[Note: As per the Negotiable Instruments (Amendment) Act, 2015, amendment in section 142 has been made. Section 142 have been divided into two sub-sections (1) & (2) stating the provisions related to the cognizance of offences committed under section 138]

Question 43

A, a broker draws a cheque in favour of B, a minor. B indorses the cheque in favour of C, who in turn indorses it in favour of D. Subsequently, the bank dishonoured the cheque. State the rights of C and D and whether B, can be made liable?

Answer

According to Section 26 of the Negotiable Instruments Act, 1881 a minor may draw, endorse, deliver and negotiate a negotiable instrument to bind all parties except himself. Therefore, C and D cannot claim from B, who being a minor does not incur any liability on the cheque. C

can claim payment from A, the Drawer, only and D can claim against C, the endorser and A, the drawer.

Question 44

X draws a bill on Y for ₹ 10,000 payable to his order. Y accepts the bill but subsequently dishonours it by non-payment. X sues Y on the bill. Y proves that it was accepted for value as of ₹ 8,000 and as accommodation to X for ₹ 2,000. How much can X recover from Y ? Decide with reference to the provisions of the Negotiable Instruments Act, 1881.

Answer

According to the provisions of Section 44 of the Negotiable Instruments Act,1881, when there is a partial absence or failure of money consideration for which a person signed a bill of exchange, the same rules as applicable for total absence or failure of consideration will apply. Thus, the parties standing in immediate relation to each other cannot recover more than the actual consideration. Accordingly, X can recover only ₹, 8000.

Question 45

What is the extent of liability of the company and the person(s) in charge of the company in respect of an offence for dishonour of cheques?

Answer

From a perusal of Section 141, it is apparent that in case where a company committed an offence under Section 138, then not only the company, but also every person who at the time when the offence was committed, was in charge of and was responsible to the company shall deemed to be guilty of the offence and liable to be proceeded against under those provisions, only if that person was in charge of and was responsible to the company for the conduct of its business. *[K.P.G. Nair vs. Jindal Menthol Indian Ltd. (2001) 2CLJ 258 SC]*

Question 46

For cognizance of offence for the dishonour of cheque, should the cheque necessarily be presented to the drawee's (payee's) bank or can it be presented before any bank within the stipulated period?

Answer

"The bank" referred to in clause (a) to the proviso to Section 138 of the Negotiable Instruments Act, 1881, mean the drawee-bank on which the cheque is drawn and not all banks where the cheque is presented for collection including the bank of the payee, in whose favour the cheque is issued. It, however, does not mean that the cheque is always to be presented to the drawer's bank on which the cheque is issued. The payee of the cheque has the option to present, the cheque in any bank including the collecting bank where he has his account, but to attract the criminal liability of the drawer of the cheque, such collecting bank is obliged to present the cheque in the drawee or payee bank on which the cheque drawn within the period of three months from the date on which it is shown to have been issued. The non presentation

of the cheque to the drawee-bank within the period specified in the Section would absolve the person issuing the cheque, of his criminal liability under Section 138 or the Act, who shall otherwise may be liable to pay the cheque amount to the payee in a civil action initiated under the law. A combined reading of Sections 2, 72 and 138 of the Act would leave no doubt that the law mandates the cheque to be presented at the bank on which it is drawn, if the drawer is to be held criminally liable. Such presentation is necessarily to be made within three months at the bank on which the cheque is drawn whether presented personally, or through another bank, namely, the collecting bank of the payee [*Shri Ishar Alloy Steels Ltd. (v) Jayaswals Neco. Ltd. (2001) LCLI 18 (SC)*]

Question 47

Whether giving of notice of dishonour itself constitute receipt of notice for constituting offence under section 138 of the Negotiable Instruments Act, 1881?

Answer

The above matter was considered by the Supreme Court in *Oalmia Cement (Bharat) Ltd v.Galaxy Traders and Agencies Ltd., (2001) 5 CLJ 26 SC.* The Court observed that, the payee has to make a demand by giving notice in writing to the drawer within 30 days of the receipt of information from bank reqarding the return of the cheque as unpaid. and it is a failure on the part of the drawer to pay the amount within 15 days of the receipt of the said notice in writing, is a process of which receipt is the accomplishment. It is therefore clear that 'giving' notice is not the same as 'receipt' of notice.

Question 48

Whether demand draft is a cheque?

Answer

Section 131 of the Negotiable Instruments Act, 1881 is intended to widen the scope of a crossed draft as to contain all incidences of a crossed cheque. This is for the purpose of foreclosing a possibility of holding the view that a draft cannot be crossed. Even if it is possible to construe the draft either as a Promissory note or as a bill of exchange, the law has given the option to the holder to treat it as he chooses. This can be determined from the Section 137 which says that where an instrument may be construed either as a promissory note or bill of exchange, the holder may, at his discretion, treat it as either and the instrument shall thence forward be treated accordingly. This means, once the holder has elected to treat the instrument as a cheque, it cannot but be treated as a cheque thereafter. This is an irretrievable corollary of exercising such an election by the holder himself. A pay order was accordingly held to be a cheque entitling the bank holding the instrument to lodge a complaint under Section 138. [*Punjab* & *Sind Bank v Vinkar Sahakari Bank Ltd., (2001)* 4 *CLJ* 188 *(SC)*]

Question 49

Mr. Clever obtains fraudulently from J a cheque crossed 'Not Negotiable'. He later transfers the cheque to D, who gets the cheque encashed from ABC Bank, which is not the Drawee Bank. J, comes to know about the fraudulent act of Clever, sues ABC Bank for the recovery of money. Examine with reference to the relevant provisions of the Negotiable Instruments Act, 1881, whether J will be successful in his claim. Would your answer be still the same in case Clever does not transfer the cheque and gets the cheque encashed from ABC Bank himself?

Answer

According to Section 130 of the Negotiable Instruments Act, 1881 a person taking cheque crossed generally or specially bearing in either case the words 'Not Negotiable' shall not have or shall not be able to give a better title to the cheque than the title the person from whom he took it had. In consequence, if the title of the transferor is defective, the title of the transferee would be vitiated by the defect.

Thus based on the above provisions, it can be concluded that if the holder has a good title, he can still transfer it with a good title, but if the transferor has a defective title, the transferee is affected by such defects, and he cannot claim the right of a holder in due course by proving that he purchased the instrument in good faith and for value. As Mr. Cleaver in the case in question had obtained the cheque fraudulently, he had no title to it and could not give to the bank any title to the cheque or money; and the bank would be liable for the amount of the cheque for encashment. (*Great Western Railway Co. v. London and Country Banking Co.)*

The answer in the second case would not change and shall remain the same for the reasons given above.

Thus J in both the cases shall be successful in his claim from ABC bank.

Question 50

A owes a certain sum of money to B. A does not know the exact amount and hence he makes out a blank cheque in favour of B, signs and delivers it to B with a request to fill up the amount due, payable by him. B fills up fraudulently the amount larger than the amount due, payable by A and endorses the cheque to C in full payment of dues of B. Cheque of A is dishonoured. Referring to the provisions of the Negotiable Instruments Act, 1881, discuss the rights of B and C.

Answer

Section 44 of the Negotiable Instruments Act, 1881 is applicable in this case. According to Section 44 of this Act, B who is a party in immediate relation with the drawer of the cheque is entitled to recover from A only the exact amount due from A and not the amount entered in the cheque. However the right of C, who is a holder for value, is not adversely affected and he can claim the full amount of the cheque from B.

Question 51

What do you understand by "Material alteration" under the Negotiable Instruments Act, 1881? State whether the following alterations are material alterations under the Negotiable Instruments Act, 1881?

(i) The holder of the bill inserts the word "or order" in the bill,

(ii) The holder of the bearer cheque converts it into account payee cheque,

(iii) A bill payable to ' is converted into a bill payable to X and Y

Answer

As per the Negotiable Instruments Act, 1881, an alteration can be called a material alteration if it alters or attempts to alters the character of the instrument and affects or is likely to affect the contract which the instrument contains or is evidence of. Thus, it totally alters the business effect of the instrument. It makes the instrument speak a language other than that was intended.

The following materials alterations have been authorised by the Act and do not require any authentication:

(a) filling blanks of inchoate instruments [Section 20]

(b) Conversion of a blank endorsement into an endorsement in full [Section 49]

(c) Crossing of cheque [Section 125]

The important material and non-material alternation are:

Material alteration	Non-material alteration
1. Alteration of date of instrument (e.g. if a bill dated 1st may, 1998) is changed to a bill dated 1st June, 1998.	1. Conversion of instrument payable to bearer.
2. Alteration of time of payment (e.g. if a bill payable three months after date is changed to bill payable four months payable after date).	2. Conversion of instrument payable to bearer into order.
3. Alteration of place of payment (e.g., if a bill payable at Delhi is changed to bill payable at Mumbai).	3. Elimination of the words ‘or order' from an endorsement.
4. Alteration of amount payable (e.g., if bill for ₹ 1,000 is changed to a bill for ₹ 2000	4. Addition of the words ‘or demand’ to a note in which no time or payment is expressed.
5. Conversion of blank endorsement into	

special endorsement.	
6. Addition of a new party to an instrument.	
7. Alteration of one of the clauses of the instrument containing a penal action	

As per the above sections the changes of serial numbers (i) is non-material and changes of serial numbers (ii) (iii) are material changes in the given problem.

Question 52

Do the following alteration of a negotiable instrument render the instrument void?

(a) The holder of a bill alters the date of the instrument to accelerate or postpone the time of payment.

(b) The drawer of a negotiable instrument draws a bill but forgets to write the words "or order". Subsequently, the holder of the instrument inserts these words.

(c) A bill payable three months after date is altered into a bill payable three months after sight.

(d) A bill was dated 2002 instead of 2003 and subsequently the agent of the drawer corrected the mistake.

(e) A bill is accepted payable at the Union Bank, and the holder, without the consent of the acceptor, scores out the name of the Union Bank and inserts that of the Syndicate Bank.

Answer

(a) Yes.

(b) No.

(c) Yes.

(d) No.

(e) Yes.

According to Section 87 of the Negotiable Instruments Act, 1881, any material alteration of a Negotiable Instrument renders the same void as against any one who is party thereto at the time of making such alteration and does not consent thereto, unless it was made in order to carry out the common intention of the original parties and any such alteration, if made by an endorsee discharges endorser from all liability to him in respect of the consideration thereof. The alteration must be so material that it alters the character of the instrument, to a great extent. Alterations of the date, amount payable, time, place of payment are regarded as material alterations.

Question 53

On a Bill of Exchange for ₹ 1 lakh, X's acceptance to the Bill is forged. 'A' takes the Bill from his customer for value and in good faith before the Bill becomes payable. State with reasons

whether 'A' can be considered as a 'Holder in due course' and whether he (A) can receive the amount of the Bill from 'X'.

Answer

According to section 9 of the Negotiable Instruments Act, 1881 'holder in due course' means any person who for consideration becomes the possessor of a promissory note, bill of exchange or cheque if payable to bearer or the payee or endorsee thereof, if payable to order, before the amount in it became payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

As 'A' in this case *prima facie* became a possessor of the bill for value and in good faith before the bill became payable, he can be considered as a holder in due course.

But where a signature on the negotiable instrument is forged, it becomes a nullity. The holder of a forged instrument cannot enforce payment thereon. In the event of the holder being able to obtain payment in spite of forgery, he cannot retain the money. The true owner may sue on tort the person who had received. This principle is universal in character, by reason where of even a holder in due course is not exempt from it. A holder in due course is protected when there is defect in the title. But he derives no title when there is entire absence of title as in the case of forgery. Hence 'A' cannot receive the amount on the bill.

Question 54

A banker made payment of a cheque in which the drawers signature was forged. Can the banker claim protection in respect of such payment? What would be the protection if it was a case of forgery of endorsee's signature?

Answer

In case of cheques, the paying banker is given statutory protection against the payment of cheques having forged endorsements. And the banker cannot be held liable if it makes payment in good faith and without any negligence (Section 85, the Negotiable Instruments Act, 1881). But the banker will not be protected where the payment of a cheque is made on which the drawer's signature was forged. The reason for the same is that the banker is protected only in case of forgery of endorser's signature and not in case of forgery of drawer's signature.

Question 55

X drew a cheque payable to 'Y or on order'. Unfortunately it was lost and Y's endorsement was forged. Subsequently, the banker pays for the cheque. Is the banker discharged from liability? What will be the consequences if the drawer's signatures were forged?

Answer

The paying banker is discharged from liability, despite the forged Indorsement in favour of the payee, because of special protection granted by section 85(1) of the Negotiable Instruments Act, 1881.

In another instance, where the drawer's signature is forged, a banker remains liable to the drawer even by a payment in due course and cannot debit the drawer's account.

Question 56

How do you distinguish between discharge of instrument and discharge of party under the Negotiable Instruments Act, 1881?

Answer

An instrument is said to be discharged only when the party who is ultimately liable thereon is discharged from liability. Therefore, discharge of a party to an instrument does not discharge the instrument itself. Consequently, the holder in due course may proceed against the other parties liable for the instrument. On the other hand, when a bill has been discharged by payment, all rights there under are extinguished even a holder in due course cannot claim any amount under the bill.

Question 57

What will be the effect of the following alterations on the validity of a bill?

(i) A bill payable with 'lawful interest' is altered into one payable with 12% interest.

(ii) A bill is accepted payable at the Indian Bank, Sarita Vihar, New Delhi. The holder without the consent of the acceptor scores out Sarita Vihar and inserts Chandni Chowk instead.

Answer

(i) The following alterations are material, i.e., the alteration of –

(1) the date,

(2) the sum payable,

(3) the time of payment,

(4) the place of payment,

(5) inclusion of place of payment,

(6) the rate of interest.

These alterations vitiate the instrument. So, in the given case alteration in the interest rate vitiates the validity of the bill, since lawful interest is 18% under the Banking, Public Financial Institutions & Negotiable Instruments (Amendment) Act, 1988.

(ii) In this case, the alteration is material. It renders the instrument void against persons who were parties thereto before such alteration, unless they have consented to the alteration (Sec. 87)

Question 58

Raman is the payee of an order cheque. John steals the cheque and forges Raman's signatures and endorses the cheque in his own favour. John then further endorses the cheque to Anil, who takes the cheque in good faith and for valuable consideration.

Examine the validity of the cheque as per provisions of the Negotiable Instruments Act, 1881 and also state whether Anil can claim the privileges of a Holder in Due course.

Answer

Forgery confers no title and a holder acquires no title to a forged instrument. A forged document is a nullity. The property in the instrument remains vested in the person who is the holder at the time when the forged signatures were put on it. Forgery is also not capable of being ratified. In the case of forged endorsement, the person claiming under forged endorsement even if he is purchaser for value and in good faith, cannot acquire the rights of a holder in due course. Therefore, Anil acquires no title on the cheque *(Mercantile Bank vs. D'Silva,30 Bom.L.R.1225*).

Question 59

Is notice of dishonour necessary in the following cases:

(a) X having a balance of ₹ 1,000 with his bankers and having no authority to over draw, drew a cheque for ₹ 5,000/-. The cheque was dishonoured when duly presented for repayment.

(b) X, drawer of a Bill informs Y, the holder of the bill that the bill would be dishonoured on the presentment for payment.

Answer

Notice of dishonour is not necessary in both the cases. [Section 98 of the Negotiable Instruments Act, 1881].

Question 60

Ram has ₹ 2,000/- in his bank account and he has no authority to overdraw. He issued a cheque for ₹ 5,000/- to Gopal which was dis-honoured by the bank. Point out whether Gopal must necessarily give notice of dishonor to Ram under the Negotiable Instruments Act, 1881?

Answer

As per the provision given under the Negotiable Instruments Act, 1881, in a suit against the drawer on an instrument being dishonored, notice of dishonor is a material part of the cause of action. However, there are certain cases where notice of dishonor is not necessary, when the party charged could not suffer damage for want of a notice. In such a case, it is sufficient if it is shown that at the time of drawing the instrument, there were no funds belonging to the drawer in the hands of the drawee. Thus, it is not necessary for Gopal to give notice of

dishonor to Ram under section 98 of the Act *[Subrao vs. Sitaram 2 Bom. L.R. 891]*.

Question 61

A Bill of Exchange is dishonoured by the acceptor. Explain the provisions of "Noting" and "Protest" under the Negotiable Instruments Act, 1881.

Answer

The law related to the noting and protest of negotiable instruments is enshrined in Section 99 to 104A of the Negotiable Instruments Act, 1881.

Noting: According to section 99, when a promissory note or bill of exchange has been dishonoured by non-acceptance, or non-payment the holder may cause such dishonour to be noted by a notary public upon the instrument, or on a paper attached thereto, or partly upon each. Such note must be made within a reasonable time after dishonour, and must specify the date of dishonour, the reason for the dishonour or if the instrument has not been expressly dishonoured, the reason why the holder treats it as dishonour and the notary's charges.

Protest: According to section 100, when a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may within a reasonable time, cause such dishonour to be noted and certified by a notary public. Such certificate is called a protest.

The contents of a protest are laid down in section 101 of the Act. According to section 102, when a promissory note or bill of exchange is required to be protested, notice of such protest must be given instead of notice of dishonour, in the same manner and subject to the same conditions, but the notice may be given by the notary making the protest. Under section 103, all bills of exchange drawn payable at some other place than the place mentioned as the residence of the drawee, and which are dishonoured by non-acceptance, may, without further presentation to the drawee, be protested for non-payment in the place specified for payment, unless paid before or at maturity.

Neither noting nor protesting is compulsory in the case of inland bills. But under section 104, every foreign bill must be protested for dishonour, when such protest is required by law of the country where the bill was drawn. The merit of protest and noting is that it would become good prima-facie evidence in a court of law that the instrument has been dishonoured. It is pertinent to note that as per section 119 the court is bound to recognise a protest, but it may or not recognise noting.

Question 62

Explain the terms 'Acceptance for Honour' and 'Drawee in case of need' as used in the Negotiable Instruments Act, 1881.

Answer

Acceptance for Honour (Section 108): It is an unusual kind of acceptance done by any person not being a party already liable thereon bill, to accept the bill for the honour of any

party thereto. This acceptance by such party is allowed when the original drawee refuses to accept or refuses to give better security when demanded by the notary. Such a bill is kept until its maturity and the holder is given an additional person whom the holder may fall back upon if the bill is not paid when due.

Drawee in case of need : As per section 7, when in the bill or in any endorsement thereon the name of any person is given in addition to the drawee to be resorted to in case of need, such person is called a "drawee in case of need". Such a person is resorted to in the event of the bill being dishonoured by non-acceptance or non-payment. According to section 115, the bill will not consider to be dishonoured until it has been dishonoured by such drawee in case of need. Thus, it is obligatory on the holder to present the bill to such drawee and non-presentment of the bill to such drawee absolves the drawer from liability.

Question 63

What is meant by 'Payment for Honour' in respect of a Bill of Exchange? When can the 'Payment for Honour' be made? What are the rights of the 'Payer for Honour'?

Answer

Payment for honour: It means a payment which is made by any person for the honour of any party liable on the bill after it has been protested for non-payment**.**

The following conditions are essential for the payment of honour:

(1) The bill must have been noted or protested for non-payment.

(2) The person paying or his agent declares before Notary Public the party for whose honour he pays.

(3) Such declaration must have been recorded by the Notary Public.

(4) Payment must be made for the honour of any party liable on the bill or not (Section 113).

The drawee in case of need may, however, accept and pay the bill of exchange without previous protest. (Section 110).

Right of the payer for honour: Any person making payment for honour is entitled to all the rights, in respect of the bill, of the holder at the time of such payment. He may recover from the party for whose honour he pays all sums so paid with interest thereon and all expenses properly incurred in making such payment (Section 114).

Question 64

Promissory note dated 1st February, 2001 payable two months after date was presented to the maker for payment 10 days after maturity. What is the date of Maturity? Explain with reference to the relevant provisions of the 'Negotiable Instruments Act, 1881 whether the endorser and the maker will be discharged by reasons of such delay.

Answer

Delay in presentment for payment of a promissory note: If a promissory note is made payable on a stated number of months after date, it becomes payable three days after the corresponding date of months after the stated number of months (Section 23 read with Section 22 Negotiable Instruments Act 1881). Therefore, in this case the date of maturity of the promissory note is 4th April, 2001.

In this case the promissory note was presented for payment 10 days after maturity. According to Section 64 of Negotiable Instruments Act read with Section 66, a promissory note must be presented for payment at maturity by on behalf of the holder. In default of such presentment, the other parties of the instrument (that is, parties other than the parties primarily liable) are not liable to such holder. The endorser is discharged by the delayed presentment for payment. But the maker being the primary party liable on the instrument continues to be liable.

Question 65

A issues a cheque for ₹ 25,000/- in favour of B. A has sufficient amount in his account with the Bank. The cheque was not presented within reasonable time to the Bank for payment and the Bank, in the meantime, became bankrupt. Decide under the provisions of the Negotiable Instruments Act, 1881, whether B can recover the money from A?

OR

'A' issued a cheque for ₹ 5,000/- to 'B'. 'B' did not present the cheque for payment within reasonable period. The Bank fails. However, when the cheque was ought to be presented to the bank, there was sufficient fund to make payment of the cheque. Now, 'B' demands payment from 'A'. Decide the liability of 'A' under the Negotiable Instruments Act, 1881.

Answer

The problem as asked in the question is based on the provisions of the Negotiable Instruments Act, 1881 as contained in Section 84. The section provides that where a cheque is not presented by the holder for payment within a reasonable time of its issue and the drawer suffers actual damage through the delay because of the failure of the bank, he is discharged from liability to the extent of such damage. In determining what is reasonable time, regard shall be had to the nature of the instrument, the usage of trade and bankers, and the facts of the particular case.

Accordingly, in the given case, the drawer is discharged from the liability to pay the amount of cheque to B. However, B can sue against the bank for the amount of the cheque applying the above provisions.

Question 66

'A' draws a cheque for ₹ 50,000. When the cheque ought to be presented to the drawee bank, the drawer has sufficient funds to make payment of the cheque. The bank fails before the

cheque is presented. The payee demands payment from the drawer. What is the liability of the drawer.

Answer

Section 84 of the Negotiable Instruments Act, 1881 provides that where a cheque is not presented for payment within a reasonable time of its issue and the drawer or person on whose account it is drawn had the right at the time when presentation ought to have been made, as between himself and the banker, to have the cheque paid and suffers actual damage through the delay, he is discharged from the liability, that is to say, to the extent to which such drawer or person is a creditor of the banker to a larger amount than would have been if such cheque had been paid. In determining what is a reasonable time, regard shall be had to the nature of the instrument, the usage of trade and of banker, and the facts of the particular case.

Applying the above provisions to the given problem since the payee has not presented the cheque to the drawer's bank within a reasonable time when the drawer had funds to pay the cheque, and the drawer has suffered actual damage, the drawer is discharged from the liability.

Question 67

(i) What is meant by 'Sans Recours Endorsement' of a bill of exchange? How does it differ from 'Sans Frais Endorsement'?

(ii) 'P', a major and 'Q', a minor executed a promissory note in favour of 'R', Examine with reference to the provisions of the Negotiable Instruments Act, 1881, the validity of the promissory note and whether it is binding on 'P' and 'Q'.

Answer

(i) Sans Recourse: Sans Frais (The Negotiable Instruments Act, 1881):

Sans Recourse: By adding the words 'Sans Recourse' after the endorsement the endorser declines to accept any liability on the instrument of any subsequent party. Sometimes, when an endorser who so excludes his liability as an endorser afterwards becomes the holder of the same instrument. In such a case, all intermediate endorsers are liable to him.

Sans Frais: These words when added at the end of the endorsement, indicate that no expenses should be incurred on account of the bill.

Difference: Any endorser can exclude personal liability by endorsing "sans recourse" i.e. without recourse. However, "Sans Frais" endorsement, indicate that no expenses should be incurred on account of the bill.

(ii) Liability of a Minor: According to Section 26 of the Negotiable Instruments Act, 1881, every person competent to contract (according to the law to which he is subject to) has capacity to bind himself and be bound by making, drawing, accepting, endorsing delivering and negotiating an instrument. A party having

such capacity may himself put his signature or authorize some other person to do so.

A minor may draw, endorse, deliver and negotiate an instrument so as to bind all the parties except himself. A minor may be a drawer where the instrument is drawn or endorsed by him. In that case he does not incur any liability himself although other parties to the instrument can be made liable and the holder can receive payment from any other party thereto.

Therefore, in the instant case, the promissory note is valid and it is binding on 'P' but not on 'Q', a minor.

Question 68

(i) Mr. A is the payee of an order cheque. Mr. B steals the cheque and forges Mr. A signatures and endorses the cheque in his own favour. Mr. B then further endorses the cheque to Mr. C, who takes the cheque in good faith and for valuable consideration. Examine the validity of the cheque as per the provisions of the Negotiable Instruments Act, 1881 and also state whether Mr. C can claim the privileges of a Holder-in-Due course?

(ii) Explain the concept and different forms of Restrictive and Qualified endorsement.

Answer

(i) Title to forged cheque under the Negotiable Instruments Act, 1881: Forgery confers no title and a holder acquires no title to a forged instrument. A forged document is a nullity. The property in the instrument remains vested in the person who is the holder at the time when the forged signatures were put on it. Forgery is also not capable of being ratified. In the case of forged endorsement, the person claiming under forged endorsement even if he is purchaser for value and in good faith, cannot acquire the rights of a holder in due course. Therefore, Mr. C acquires no title on the cheque (Mercantile Bank vs. D'Silva,30 Bom.L.R.1225). Such a holder is not a holder in due course and hence no privilege is available.

(ii) (1) Restrictive Endorsement: Such an endorsement has the effect of restricting further negotiation and transfer of the instrument.

Example:	*(1)*	*Pay to A only*	*S. Mukerjee*
	(2)	*For the account of A only*	*N. Aiyar*

(2) Conditional or qualified endorsement: Such an endorsement combines an order to pay with condition.

Example:	*Pay to A on safe receipt of goods.*	*V. Chopra*

Question 69

State whether the following statements are correct or incorrect:

(i) A cheque marked "Not negotiable" is not transferable.

(ii) A promissory note duly executed in favour of a minor, is valid.

Answer

(i) A cheque marked "Not Negotiable" is not transferable.

Incorrect. A cheque marked "not negotiable" is a transferable instrument. The inclusion of the words 'not negotiable' however makes a significant difference in the transferability of the cheques. The holder of such a cheque cannot acquire title better than that of the transferor.

(ii) A promissory note duly executed in favour of a minor, is valid.

Correct. As a minor's agreement is void, he cannot bind himself by becoming a party to a negotiable instrument. But he may draw, endorse, deliver and negotiate such instruments so as to bind all parties except himself (Section 26 of the Negotiable Instruments Act, 1881).

Exercise

1. *A draws a bill on B for ₹ 500 payable to his order. A accepts the bill but subsequently dishonours it by non-payment. A sues B on the bill. B proves that it was accepted for value as to ₹ 400 and as accommodation to A as to the balance. How much can A recover from B?*

   [**Hint:** ₹ 400 as per Section 44 of the Negotiable Instruments Act,1881]

2. *A executed a promissory note in favour of B. Without B's demanding payment, A paid the money due on the note but left the note in his hands. Subsequently B indorsed it to C for consideration. C had knowledge of the payment made by A. C brings a suit against A and B for recovery of money on the note. Will he succeed against either or both?*

   [**Hint:** He can succeed against A as well as against both as per Sections 9 and 58 of the N.I. Act,1881]

3. *A bill is drawn "Pay to A or order the sum of one thousand rupees". In the margin, the amount stated is ₹ 10, 000 in figures. (a) Is this a valid bill? (b) If so, for what amount?*

   [**Hint:** (a) Yes; (b) For ₹ 1000 as per section 18 of the N.I.Act,1881]

4. *X draws a bill of exchange payable at 1, Pitampura, New Delhi. It does not contain the name of any drawee, although Y lives at the stated address. Y accepts the bill. Would Y be liable under the bill?*

   [**Hint**: The bill is valid and Y shall be liable. By his acceptance, Y acknowledged that he was the intended drawee in the bill]

3 The Payment of Bonus Act, 1965

Question 1

Examine whether the Payment of Bonus Act, 1965 be applicable to the following cases:

(i) J, who is working in a social welfare organization.

(ii) D, an employee employed by an establishment engaged in an industry carried on by a department of the Central Government.

Answer

(i) As per the provisions contained in Section 32 (v) (c) of the Payment of Bonus Act, 1965, 'J' is not entitled to any bonus as the said Act is not applicable to institutions (including hospitals, chambers of commerce and social welfare institutions) established not for purposes of profit..

(ii) Similarly the Payment of Bonus Act, 1965 is not applicable to the employees of an establishment which is engaged in an industry carried on by or under the authority of a department of the Central Government or the state government or a local authority under section 32 (iv) of the said Act.

Question 2

Briefly state the categories of employees who are excluded from the operation of the Payment of Bonus Act, 1965

Answer

Under section 32 of the Payment of Bonus Act, 1965 the following are the categories of employees who are excluded from the operation of the Payment of Bonus Act, 1965:

(i) Employees employed by an insurer carrying on the business of general insurance and the employees employed by the Life Insurance Corporation of India.

(ii) Seamen as defined under Section 3(42) of the Merchant Shipping Act, 1958.

(iii) Employees registered or listed under any scheme made under the Dock Workers (Regulation of Employment) Act, 1948 and employed by the registered or listed employers.

(iv) Employees employed by an establishment engaged in any industry carried on by or under the authority of any department of the Central Government or State Government or a local authority.

(v) Employees employed by-

(a) The Indian Red Cross Society or any other institution of a like nature (including its branches);

(b) Universities and other educational Institutions;

(c) Institutions (including hospitals, chambers of commerce and social welfare institutions) established not for purposes of profit;

(vi) Employees employed by the Reserve Bank of India;

(vii) Employees employed by the financial and other institutions such as;

(a) the Industrial Finance Corporation of India;

(b) any Financial Corporation established under Section 3, or any Joint Financial Corporation established under Section 3A, of the State Financial Corporations Act, 1951;

(c) the Deposit Insurance Corporation;

(d) the National Bank for Agriculture and Rural Development;

(e) the Unit Trust of India;

(f) the Industrial Development Bank of India;

(g) the Small Industries Development Bank of India established under Section 3 of the Small Industries Development Bank of India Act,1989;

(h) the National Housing Bank ;

(i) any other financial institution (other than a banking company) being an establishment in public sector, which the Central Government may, by notification in the Official Gazette, specify; having regard to its capital structure, its objectives and the nature of its activities and the nature and extent of financial assistance or any concession given to it by the Government and any other relevant factor;

(viii) Employees employed by inland water transport establishment operating on routes passing through any other country.

Question 3

Who is an 'Employee' and 'Employer' under the Payment of Bonus Act,1965?

Answer

Employee [Section 2(13)]: It means any person other than an apprentice employed on a salary or wage not exceeding ₹ 21,000/- per month in any industry to do any skilled or unskilled, manual, supervisory, managerial, administrative, technical or clerical work for hire or reward, whether the terms of employment be express or implied. From the above definition it is clear that an employee under the Act can be at managerial level, clerical level or workmen level. The criterion is the salary or wage limit of ₹ 21,000 per month. Employees who draw more than ₹ 21,000 per month do not fall within the definition of employee under this Act and hence are not eligible for bonus.

Employer [Section 2(14)]: The expression 'employer' under the Payment of Bonus Act, 1965 includes:

(i) **in relation to an establishment which is a factory**, the owner or occupier of the factory, including the agent of such owner or occupier, the legal representative of a deceased owner or occupier, and where a person has been named as a manager of the factory under Section 7 of the Factories Act, 1948 the person so named; and

(ii) **in relation to any other establishment,** the person, who, or the authority which, has the ultimate control over the affairs of the establishment and where the said affairs are entrusted to a manager or managing director or managing agent, such manager or managing director or managing agent.

From the above definition it may be understood that the employer does not necessarily mean the owner but the person who is under the control of affairs of the establishment. In case of a factory, the occupier will be the employer in case he is different from the owner. In case there is no occupier of a factory, the owner shall be the employer.

[Note: As per the Payment of Bonus (Amendment) Act, 2015, the eligibility limit for payment of bonus to the employees under the section 2(13) has been enhanced from ₹10, 000 to ₹21,000 per mensem]

Question 4

Prakash Chandra is working as a salesman in a company on salary basis. The following payments were made to him by the company during the previous financial year –

(i) overtime allowance,

(ii) dearness allowance

(iii) commission on sales

(iv) employer's contribution towards pension fund

(v) value of food.

Examine as to which of the above payments form part of "salary" of Prakash Chandra under the provisions of the Payment of Bonus Act, 1965.

Answer

Computation of Salary / Wages: According to Section 2(21) of the Payment of Bonus Act, 1965 salary and wages means all remuneration other than remuneration in respect of overtime work, capable of being expressed in terms of money, which would if the terms of employment, express or implied, were fulfilled, be payable to an employee in respect of his employment, or of work done in such employment and includes dearness allowance, i.e. all cash payment by whatever name called, paid to an employee on account of a rise in the cost of living. But the term excludes:

(i) Any other allowance which the employee is for the time being entitled to;

(ii) The value of any house accommodation or of supply of light, water, medical attendance or other amenities of any service or of any concessional supply of food grains or other articles;

(iii) Any traveling concession;

(iv) Any bonus including incentive, production or attendance bonus;

(v) Any contribution paid or payable by the employer to any pension fund or for benefit of the employee under any law for the time being in force.

(vi) Any retrenchment compensation or any gratuity or other retirement benefit payable to the employee or any ex-gratia payment made to him; and

(vii) Any commission payable to the employee.

It has been clarified in the explanation to the section that where an employee is given, in lieu of the whole or part of the salary or wage payable to him, free food allowance or free food by his employer, such food allowance or the value of such food shall be deemed to form part of the salary or wage for such employee.

In view of the provisions of Section 2(21) explained above, the payment of dearness allowance and value of free food by the employer forms part of salary of Prakash Chandra while remaining three payments i.e. payment for overtime, commission on sales and employer's contribution towards pension funds shall not form part of his salary.

Question 5

Referring the provisions of the Payment of Bonus Act, 1965, state whether the following persons are entitled to bonus under the Act:

(i) An apprentice;

(ii) An employee dismissed on the ground of misconduct;

(iii) A temporary workman;

(iv) A piece-rated worker.

(v) An employee getting a salary of ₹ 22,000 per month

Answer

(i) An Apprentice is not entitled to bonus within the meaning of "Employee" under section 2(13) of the Payment of Bonus Act, 1965 and as also decided in the case *[Wheel RIM Co. Vs. Govt. of Tamil Nadu (1971)]*

(ii) An employee dismissed on the ground of misconduct shall be disqualified for any bonus under section 9 of the Payment of Bonus Act, 1965 only if the misconduct falls within the meaning of:

a. Fraud; or

b. Riotous or violent behaviour while on the premises of the establishment; or

c. Theft, misappropriation or sabotage of any property of the establishment.

It may be noted from the above grounds of disqualification, that "misconduct" is not mentioned. Misconduct is a broad term and can be interpreted to mean many things such as "insubordination", "misbehavior" or even "deliberate sub standard performance or negligence", but none of these will disqualify an employee from receiving bonus. Therefore, an employee dismissed on the ground of misconduct will be disqualified only if the conditions in a, b or c above can be established. *[Pandian Roadways Corporation Ltd. Vs. Presiding Officer (1996)]*

(iii) A temporary workman is entitled to bonus on the basis of the total number of days worked by him.

(iv) A piece-rated worker is entitled to bonus. *[Mathuradas Kanji Vs. L.A. Tribunal (1958)]*

(v) Under section 2 (13) of the Payment of Bonus Act, 1965 a person drawing a monthly salary of an amount in excess of ₹ 21,000, shall not fall within the meaning of an employee and consequently not eligible to receive bonus under the Act.

[Note: As per the Payment of Bonus (Amendment) Act, 2015, the eligibility limit for payment of bonus to an employee under section 2(13) has been enhanced from ₹10, 000 to ₹21,000 per mensem]

Question 6

Who is entitled to Bonus? Is there any disqualifications in claiming it? Give examples.

Answer

Who is entitled to Bonus: Every employee of an establishment covered under the Act is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than thirty working days in the year and draws a salary of less than ₹ 21,000/- per month. [Section 2(13) read with Section 8].

If an employee is prevented from working and subsequently reinstated in service, employee's statutory right for bonus cannot be said to have been lost. Nor can the employer refuse to pay such bonus. *[ONGC(V) Sham Kumar Sahegal* (1995) *ILLJ].*

There are, however, certain disqualifications of an employee to claim bonus in an accounting year. An employee who has been dismissed from service for (a) fraud; or (b) riotous or violent behaviour while on the premises of the establishment; or (c) Theft, misappropriation or sabotage of any property of the establishment is not entitled for bonus. [Section 9).

An employee, under the Payment of Bonus Act, 1965 in the following cases is not entitled to bonus:

1. An apprentice is not entitled to bonus as he is not included in the definition of an employee under the Act as decided in the case *[Wheel* & *RIM Co. v. Govt. of TN. (1971)]*.
2. An employee who is dismissed from service on the ground of misconduct as mentioned in Section 9, is disqualified for bonus of the accounting year in which he is dismissed *(Pandian Roadways Corporation Ltd. v. Presiding Officer* (1996) 2 *CLR* 1175 *(Mad).*

[Note: As per the Payment of Bonus (Amendment) Act, 2015, the eligibility limit for payment of bonus to an employee under section 2(13) has been enhanced from ₹10, 000 to ₹21,000 per mensem]

Question 7

X, a temporary employee drawing a salary of ₹ 3,000 per month, in an establishment to which the Payment of Bonus Act, 1965 applies was prevented by the employers from working in the establishment for two months during the financial year 2001-2002, pending certain inquiry. Since there were no adverse findings 'X' was re-instated in service, later, when the bonus was to be paid to other employees, the employers refuse to pay bonus to 'X', even though he has worked for the remaining ten months in the year. Referring to the provisions of the Payment of Bonus Act, 1965 examine the validity of employer's refusal to pay bonus to 'X'.

Answer

Entitlement for bonus under the Payment of Bonus Act, 1965: Every employee of an establishment covered under the Act is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than 30 working days in the year and he draws a salary less than ₹ 21,000 per month. *[Section 2(13) read with Section 8]* In the given case, X has worked in the establishment for 10 months and draws a salary of ₹ 3,000/-, hence his entitlement to bonus is established. However, the point here is, whether he is entitled to receive bonus for the period of 2 months during which he was suspended pending certain inquiry against him. Subsequently, he was exonerated from the charges and was taken back on work.

Section 14 of the Payment of Bonus Act, 1965 lays down the days in a year when an employee is deemed to have worked in the establishment even though he did not actually attend the place of work. Under the said section, an employee is deemed to have worked also on the following days during the accounting year:

(a) He has been laid off under an agreement or as permitted by standing orders under the Industrial Employment (Standing Orders) Act, 1946, or under the Industrial Disputes Act, 1947 or under any other law applicable to the establishment;

(b) he has been on leave with salary or wage;

(c) he has been absent due to temporary disablement caused by accident arising out of and in the course of his employment; and

(d) the employee has been on maternity leave with salary or wage,

In the given case, X was suspended pending an inquiry; hence he did not attend office for 2 months. These 2 months shall be treated as days worked as it can be reasonably assumed that his suspension was under the Industrial Disputes Act, 1947.

Hence, X will be entitled to receive bonus for the full year and his employer is wrong to deny him bonus.

[Note: As per the Payment of Bonus (Amendment) Act, 2015, the eligibility limit for payment of bonus to an employee under section 2(13) has been enhanced from ₹10, 000 to ₹21,000 per mensem]

Question 8

Decide with reasons in the light of the Payment of Bonus Act, 1965 whether the following persons are entitled for bonus:

(i) A University teacher,

(ii) An employee of the 'NABARD',

(iii) A retrenched employee who worked for 45 days in a year on a salary of ₹ 4,000 per month.

(iv) An apprentice.

Answer

Every employee of an establishment covered under the Payment of Bonus Act, 1965 is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than thirty working days in the year and has drawn a salary of less that ₹ 21,000 per month. [Section 2(13) and Section 8] .

(i) University Employee: Under section 32 of the Payment of Bonus Act, 1965 various employees are listed to whom the Payment of Bonus Act, 1965 does not apply. Under this section persons employed by universities and other educational institutions are not eligible for bonus as the Payment of Bonus Act, 1965 does not apply to them. Therefore, a university teacher shall not be entitled to bonus under the Payment of Bonus Act, 1965.

(ii) An employee of "NABARD": NABARD is National Bank for Agricultural & Rural Development. Under section 32 the Payment of Bonus Act, 1965 does not apply also to employees of NABARD, hence they will not be entitled to bonus under the Act;

(iii) Retrenched Employee: A retrenched employee who worked for 45 days in a year on a salary of ₹ 4,000 per month is entitled for bonus as he has worked for more than 30 days and drawn a salary of less than ₹ 21,000 per month. He shall therefore, be paid bonus for the period he has worked;

(iv) An apprentice is not included within the meaning of "employee" and hence not entitled for bonus under the Act.

[Note: As per the Payment of Bonus (Amendment) Act, 2015, the eligibility limit for payment of bonus to an employee under section 2(13) has been enhanced from ₹10, 000 to ₹21,000 per mensem]

Question 9

State with reasons whether the following persons are entitled to receive bonus under the Payment of Bonus Act, 1965:

(i) An employee employed through contractors on building operations

(ii) A retrenched employee

(iii) A dismissed employee reinstated with back wages.

Answer

Entitlement to Bonus

(i) An employee employed through contractors on building operations is entitled to bonus as according to the Payment of Bonus (Amendment) Act, 2007, an employee employed through contractors on building operations had been removed from the purview of the Section 32 of the Payment of Bonus Act,1965. Hence, the Act after the amendment Act came into force became applicable to such employees.

(ii) Retrenched Employee**:** He is eligible to get bonus provided he has worked for minimum qualifying period of 30 days in the accounting year and who has drawn a salary of less than ₹ 21,000 per month in the year. *(East Asiatic Co. (P) Ltd. Vs Industrial Tribunal)*

[Note: As per the Payment of Bonus (Amendment) Act, 2015, the eligibility limit for payment of bonus to an employee under section 2(13) has been enhanced from ₹10, 000 to ₹21,000 per mensem]

(iii) Under section 9 of the Payment of Bonus Act, 1965 an employee who is dismissed from service for fraud or riotous or violent behaviour on the premises of the establishment or who is guilty of theft, mis appropriation or sabotage of the property of any establishment, is disqualified from receiving bonus for the accounting year. A dismissed employee who has been reinstated with back wages is clearly not guilty of the above crimes nor has he been dismissed. Hence, he is entitled to bonus *(Gammon India Ltd Vs Niranjan Das)*

Question 10

Examine with reference to Payment of Bonus Act, 1965 if an employee drawing a salary of ₹ 15,000 and who joined duty on January 20th, 2008 and who availed maternity leave for premature delivery from February 8th, 2008 till April 4, 2008, is eligible for bonus for the year 2007-08.

Answer

According to Section 2(13) every employee of an establishment covered under this Act is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than thirty days in the year and has drawn a salary of less than ₹ 21, 000 per month.

Further, under Section 14, the days when an employee has been on maternity leave with salary or wages during the accounting year will be included in calculating the total number of days the employee has worked during the accounting year, for the purpose of payment of bonus.

In the given case, the salary is falling within the limit. Also, her maternity leave period will be treated as days worked. Hence, the days worked will be from the date of joining i.e. 20th Jan 2008 to 31st March 2008 = 12+29+31 = 72 days. Therefore, she is eligible for bonus for the accounting year 2007-08.

Question 11

Examine the entitlement of the following persons to receive bonus under the Payment of Bonus Act, 1965:

(1) a probationer;

(2) an apprentice,

(3) an employee who had been laid –off for 20 days and had attended work for only 22 days in an entire accounting year;

(4) an employee who is found guilty of misconduct causing financial loss to the employer.

Answer

(1) A probationer is an employee within the meaning under section 2 (13) and as such is entitled to bonus per Section 8 of the Payment of Bonus Act *[Bank of Madura Ltd. vs. Employee's Union, 1970]*. It is important to understand the difference between a probationer and an apprentice. A probationer is an employee who is not yet permanent but is under the probation. If he performs well, he will get to be permanent in his employment. On the other hand an apprentice is a person who is a trainee in a factory learning work on a machine and he is excluded from the definition of "employee".

(2) An apprentice, is not included in the definition of "employee" under section 2 (13) and hence is not entitled to bonus per Section 8 of the Payment of Bonus Act. *[Wheel & RIM Co. vs. Government of T.N. (1971) 2 LLJ 299 40 FJR 18]*

(3) According to Section 14, when an employee had been laid off under:

i. an agreement; or

ii. as permitted by the standing orders under the Industrial Employment (Standing Orders) Act; or

iii. under the Industrial Disputes Act, or

iv under any other applicable law

then the days on which he has been laid-off shall be deemed to be the days on which the employee has worked during the accounting year.

In the given case, the employee had been laid off for 20 days and had attended work for 22 days in the entire accounting year equaling to 42 total working days. An employee is entitled to bonus when he has worked in the establishment for not less than thirty working days in the year (Section 13). So, in this case, the employee is entitled to get bonus provided his lay off is covered in one of the above mentioned grounds.

(4) Where in any accounting year, an employee is found guilty of misconduct, causing financial loss to the employer, the employer can deduct the amount of loss from the amount of bonus payable by him to the employee under this Act in respect of that accounting year only. Therefore, in this case employee shall be entitled to receive the balance amount only, if any (Section 18). Thus, the employee is entitled to bonus, but amount of loss to employer can be deducted from such bonus.

Question 12

Mr. 'E' joined as supervisor on monthly salary of ₹ 13,400 on 1. 02. 2007 and resigned from his job on 28. 02. 2007. The company declared a bonus of 20% to all eligible employees and paid it on time. Mr. 'E' knowing the facts made a claim to HRD, which in turn rejected the claim. Examine the validity in the light of the provisions of the Payment of Bonus Act, 1965.

Answer

Under section 8 of the Payment of Bonus Act, 1965 an employee is entitled for bonus in an accounting year if he has worked in the establishment for not less than thirty working days in that year. Under section 2 (13) an employee is defined to include an employee drawing a salary of less than ₹ 21,000 per month.

In the given case, Mr E was an eligible employee within the meaning of the term under section 2 (13) but became ineligible to receive bonus as he worked in the accounting year only for 28 days and hence will not be entitled to receive bonus.

[Note: As per the Payment of Bonus (Amendment) Act, 2015, the eligibility limit for payment of bonus to an employee under section 2(13) has been enhanced from ₹10, 000 to ₹21,000 per mensem]

Question 13

ABC Textiles Ltd. employed 20 full–time and 5 part-time employees who were drawing salary of less than ₹ 21,000 per month. After completing service of 28 days, in an accounting year, 10 full-time employees submitted their resignations and left the service of the company. The Board of directors of this company decided not to give the bonus to the employees, who resigned, to the remaining full-time employees and to the part-time employees. Against the decision, all the employees applied to the authorities for relief.

Decide, stating the provisions of the Payment of Bonus Act, 1956, whether the employees, who resigned, the remaining full-time employees and part-time employees will get relief.

Answer

In accordance with the provisions of Section 2(13) of the Payment of Bonus Act, 1965 any person other than an apprentice employed on a salary or wage not exceeding ₹ 21,000 per month in any industry to do any skilled or unskilled, manual, supervisory, managerial, administrative, technical or clerical work for hire or reward whether the terms of employment be express or implied is eligible for bonus.

Further, in accordance with the provisions of Section 8 of the Payment of Bonus Act, 1965 every employee of an establishment covered under the Act is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than thirty working days in the year.

The problem as asked is based on the above provisions of the Act and the answer may be given as follows:

(a) **As regards the employees who resigned** : The employees who have resigned are not entitled to bonus because they worked only for 28 days in an accounting year although they are drawing salary less than ₹ 21,000 per month.

(b) **As regards full time remaining employees:** These employees are entitled to get the bonus as they fulfil both the requirements as stated under Sections 2 (13) and 8 of the Act. Although the employees in this case have been reduced to 10, once the Act is applicable, it continues to apply even if number of employees fall below 20.

(c) **As regards part time employees:** Even a part time employee is entitled to bonus on the basis of total number of days worked by him in an accounting year. The definition of an employee under the Act does not exclude part time employees from the definition of employee. Therefore, if such employees work for over 30 days in the accounting year and have drawn salary of less than ₹ 21,000 per month, they shall be entitled to receive bonus for that accounting year. The Payment of Bonus Act, 1965 does not prohibit such employees as long as they fulfill all the requirements stated above [*Automobile Karmachari Sangh vs. Industrial Tribunal (1971*)].

Question 14

During the financial year 2010-2011 Mr. Ram who was a temporary employee in Ayurved Products Limited and was drawing a salary of ₹ 6000/- per month . On the basis of charge of violent behavior within the premises of the company, he was prevented from working in the company for 60 days pending inquiry. Since there was no adverse conclusion against him, he was reinstated in the service with back salary. He worked for the remaining ten months in that financial year and thereafter resigned from the service. Afterwards, when bonus was paid to others employees, the company refused to pay bonus to Mr. Ram. Decide, whether Mr. Ram will be entitled to bonus under the provisions of the Payments of Bonus Act, 1965?

Answer

As per Section 9 of the Payment of Bonus Act, 1965, an employee shall be disqualified from receiving bonus under this Act, if he is dismissed from service for -

(a) fraud; or

(b) riotous or violent behavior while on the premises of the establishment; or

(c) theft, misappropriation or sabotage of any property of the establishment.

The above provision involves the following legal process:

(i) When an employee is charged for any of the above acts, an inquiry is essential;

(ii) The allegedly guilty employee is suspended for the period of the inquiry till submission of the inquiry report. In case he is found guilty, he may be dismissed or reinstated after warning but without wages for the period of suspension. On the other hand if he is found innocent, he will have to be reinstated with back wages as per the various labour laws including the Industrial Disputes Act.

(iii) It makes no difference whether the employee is temporary or permanent

It is clear from the above provision that if an employee is reinstated with back wages, it means he did not commit the disqualifying act and hence his disqualification does not arise. Therefore, he is entitled to receive bonus for the full year. *[Gammon India Ltd. Vs. Niranjan Das (1984)].*

Therefore, refusal of company is not valid and Mr. Ram will be entitled to the bonus under the Payment of Bonus Act, 1965.

Question 15

Under the provisions of the Payment of Bonus Act, 1965 decide whether the following employees are entitled for bonus:

(i) Employee employed by educational institutions;

(ii) A reinstated employee without wages for the period of dismissal.

Answer

The Payment of Bonus Act, 1965- According to Section 2 (13) and Section 8, every employee of an establishment covered under the Payment of Bonus Act, 1965 is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than thirty working days in the year and on a salary less than ₹ . 21,000 per month.

i. Employee employed by Universities and other Educational Institutions are not entitled for bonus because the employees of such institutions are excluded from the operation of the Act as per section 32 of the Payment of Bonus Act, 1965.

ii. According to section 14 of the Payment of Bonus Act, 1965, an employee shall be deemed to have worked in an establishment in any accounting year in the following cases:

- being laid off under an agreement or under the Industrial Disputes Act, 1947, or any other applicable law
- on leave with salary / wages
- absent due to temporary disablement caused by an accident in the course of employment
- on maternity leave with salary / wages

Since an employee reinstated without wages for the period of dismissal does not fall in any of the aforementioned cases, infact, use of word dismissal here presumes that he was not laid off but terminated and so he is not entitled to bonus for the period of dismissal.

[Note: As per the Payment of Bonus (Amendment) Act, 2015, the eligibility limit for payment of bonus to an employee under section 2(13) has been enhanced from ₹10, 000 to ₹21,000 per mensem]

Question 16

What are the conditions upon which unit-wise profitability is the basis for payment of bonus by an establishment?

Answer

Under section 3 of the Payment of Bonus Act, 1965 where an establishment consists of different departments or undertakings or has branches whether situated at the same place or in different places, all such departments or undertakings or branches shall be treated as parts of the same establishments for the purpose of computation of bonus under this Act.

However, the Proviso to section 3 states that where for any accounting year a separate balance-sheet and profit and loss account are prepared and maintained in respect of any such department or undertaking or branch, then, such department or undertaking or branch shall be

treated as a separate establishment for the purpose of computation of bonus under this Act for that year except when such department or undertaking or branch was, immediately before the commencement of that accounting year treated as part of the establishment for the purpose of computation of bonus.

Question 17

Nimbaheda Textiles Limited has three separate units at three separate places in the country. Every unit of the said company prepares and maintains separate Balance Sheet and Profit and Loss Account. One of these units is incurring continuous losses and hence bonus is not paid to the employees of this unit. Decide, under the Payment of Bonus Act, 1965, whether the employees of the said unit can claim bonus on the ground that the unit incurring loss is a part of one single establishment?

Answer

According to Section 3 of the Payment of Bonus Act, 1965, where an establishment consists of departments or undertakings or has branches irrespective of whether they are situated in the same place or in different places, all such departments or undertakings or branches are to be treated as part of the same establishment for the purpose of computation of bonus under the Act. But proviso to the section states that where for any accounting year a separate balance sheet and profit and loss account are prepared and maintained in respect of any such department or undertaking or branch, then , such department or undertaking or branch shall be treated as a separate establishment for the purpose of computation of bonus under this Act for that year, unless such department or undertaking or branch was, immediately before the commencement of that accounting year treated as part of the establishment for the purpose of computation of bonus.

Referring to the provisions of Section 3, Nimbaheda Textiles Ltd., is engaged at three different units located at three separate places in the country where separate balance sheet and profit & loss account are being maintained for the three units separately and hence the proviso to Section 3 will be applicable in this case. For the purpose of Bonus under the Act, the units will be treated as three separate establishments and accordingly, the employees of the unit incurring losses cannot claim bonus on the ground that the unit incurring loss is a part of one single establishment. However, the employees of the loss making unit can claim the minimum bonus as per section 10 of the Payment of Bonus Act, 1965.

Question 18

The employer is a banking company. Mention the items which are required to be added to the "Net Profit" by the employer for calculating the "Gross Profit" in accordance with the First Schedule of the Payment of Bonus Act, 1965.

Answer

Under section 4 (a) of the Payment of Bonus Act, 1965 the calculation of gross profit in case of banking company shall be in accordance with the first schedule of the Payment of Bonus Act, 1965;

The following are to be added to the Net Profit as shown in the Profit and Loss Account after making usual and necessary provisions:

1. Provision for Bonus to employees, Depreciation, Development Rebate Reserve, and any other Reserve.
2. Bonus paid to employees in respect of previous year, amount debited in respect of gratuity paid or payable to employees in excess of the aggregate of:
   (a) the amount, if any, paid or provided for payment, to an approved gratuity fund; and
   (b) the amount actually paid to employees on their retirement or on termination of their employment for any reason.
3. Donations in excess of the amount admissible for income tax.
4. Capital expenditure (other than capital expenditure on scientific research which is allowed as deduction under any law for the time being in force relating to direct taxes) and capital losses other than losses on sale of capital assets on which depreciation has been allowed for income tax).
5. Any amount certified by the Reserve Bank in terms of Section 34A(2) of the Banking Regulation Act, 1949.
6. Losses of, or expenditure relating to any business situated outside India.
7. Add also income, profit or gains (if any) credited directly to published or disclosed reserves, other than:
   (i) capital receipts and capital profits (including profits on the sale of capital assets on which depreciation has not been allowed for income tax).
   (ii) profits of, and receipts relating to any business situated outside India.
   (iii) income of foreign banking companies from investment outside India.

Question 19

What deductions are allowed under the Third Schedule of the Payment of Bonus Act, 1965 in determining the 'Available Surplus', in case of a non-banking company?

Answer

Deduction allowed under Third Schedule under the Payment of Bonus Act, 1965: According to Section 6 of Payment of Bonus Act, 1965 the available surplus in respect of any accounting year shall be the gross profits for that year after deducting therefrom the sums referred to the section. The third Schedule of the Act states the prior charges to be deducted

from gross profits in respect of a company other than a banking company (a non-banking company) as follows:

1. The dividends payable on its preference share capital for the accounting year calculated at the actual rate at which such dividend are payable;
2. 8.5% of its paid-up equity share capital as at the commencement of the accounting year.
3. 6% of its reserves shown in the balance sheet as at the commencement of the accounting year, including any profits carried forward from the previous accounting year.

Where the employer is a foreign company within the meaning of section 2(42) of the Companies Act, 2013, the total amount to be deducted under this item shall be 8.5% of the aggregate of the value of the net fixed assets and the current assets of the company in India after deducting the amount of its current liabilities (other than any amount shown as payable by the company to its Head Office whether towards any advance made by the Head Office or otherwise or any interest paid by the company to its Head Office) in India.

Question 20

What matters may not be taken into account while calculating direct tax payable by the employer under the Payment of Bonus Act, 1965 .

Answer

Under section 7 of the Payment of Bonus Act, 1965 in calculating the direct tax payable by an employer (excluding a religious or a charitable institution or an individual or HUF) for any accounting year, no account shall be taken on the following, namely:

(i) *any loss incurred by the employer in respect of any previous accounting year* and carried forward under any law for the time being in force relating to direct taxes;

(ii) *any arrears of depreciation* which the employer is entitled to add to the amount of the allowance for depreciation for any following accounting year or years under Section 32(2) of the Income-tax Act;

(iii) *any exemption* conferred on the employer under Section 84 of the Income Tax Act or of any deduction to which he is entitled under Section 101(1) of the Income-tax Act, as in force immediately before the commencement of the Finance Act,1965.

Question 21

In an accounting year, a company to which the Payment of Bonus Act, 1965 applies, suffered heavy losses. The Board of Directors of the said company decided not to give bonus to the employees. The employees of the company move to the Court for relief. Decide in the light of the provisions of the said Act whether the employees will get relief?

Answer

Section 10 of the Payment of Bonus Act, 1965 provides that subject to the other provisions of this Act, every employer shall be bound to pay to every employee in respect of the accounting

year commencing on any day in the year 1979 and in respect of any subsequent year, a minimum bonus which shall be 8.33 % of the salary or wage earned by the employee during the accounting year or ₹ 100, whichever is higher. The minimum bonus is payable whether or not the employer has any allocable surplus in the accounting year.

Therefore based on the above provision (Section 10) in the given case the employees will get relief minimum bonus as above is payable.

Question 22

Skypark Wooden Toys Limited was established at Kolkota in the year 2005 employing 100 workmen. Since then, the company suffered losses, but minimum bonus was paid in the accounting years of 2006 and 2007. In the accounting year 2008 the company earned huge profits. After mitigating the previous losses the company is having surplus profits and wants to pay the bonus to its workmen. Skypark Wooden Toys Limited wants legal advice on the following issues:

(a) How much minimum and maximum bonus may be paid to the workmen?

(b) Whether the company may adjust the puja bonus already paid to the workmen while calculating the amount of bonus payable to workmen for that accounting year.

(c) Company wants to give wooden toys as bonus instead of cash. Whether the company can do so?

Advise Skypark Wooden Toys Limited, stating the provisions of the Payment of Bonus Act, 1965.

Answer

Payment of bonus: In accordance with the provisions of Section 10 of the Payment of Bonus Act, 1965, every employer shall be bound to pay to every employee in respect of any accounting year, a minimum bonus which shall be 8.33 percent of the salary or wage earned by the employee during the accounting year or hundred rupees, whichever is higher, whether or not the employer has any allocable surplus in the accounting year. Therefore, even in the case of loss, the minimum bonus has to be paid.

Further, in accordance with the provisions of Section 11(1) the maximum bonus payable to an employee is 20% of the salary or wage earned by him in any accounting year. Bonus at a rate higher than the minimum bonus of 8.33% is payable only when the allocable surplus computed in accordance with the provisions of the Payment of Bonus Act, 1965 exceeds the amount of minimum bonus payable subject to the maximum limit of 20%.

Section 17 of the Act provides for the adjustment of any customary or puja bonus or any advance bonus against the bonus payable under this Act for an accounting year and pay only the balance bonus after such deduction / adjustment to the employee.

Bonus should be paid only in cash by the employer.

The legal advice in the given case may be given on the basis of the provisions of the Act accordingly:

(a) **As regards minimum and maximum bonus:** The company has surplus profits after setting off past losses. It appears therefore, that the allocable surplus is higher than the minimum bonus payable under the Act which is 8.33%. Hence, the company is bound ot pay bonus at a rate higher than the minimum bonus rate but upto a maximum of 20%. Therefore, Skypark Wooden Toys Ltd is bound to pay bonus at a rate higher than 8.33% depending on its allocable surplus but upto a maximum of 20%.

(b) **As regards adjustment of Puja Bonus:** In accordance with the provisions of Section 17 of the Payment of Bonus Act, 1965 where, in an accounting year an employer has paid any puja bonus or other customary bonus to an employee, the employer shall be entitled to deduct (adjust) the amount of bonus so paid from the amount of bonus payable to the employee in respect of that accounting year and the employee shall be entitled to receive only the balance. Therefore Skypark Wooden Toys Ltd. may adjust the puja bonus already paid from the amount of bonus payable to the workmen and the workmen shall be entitled to receive only the balance.

(c) The amount payable to an employee by way of bonus under the Payment of Bonus Act, 1965, shall be paid only in cash by the employer. Therefore, Skypark Wooden Toys Ltd. cannot distribute wooden toys, instead of cash, as bonus. It is against the statutory provisions.

Question 23

Can an employer be exempted from paying minimum bonus? What does the law say of such exemption?

Answer

Though the Act creates liability on the part of employer to pay the minimum bonus and confers a right to the workmen, as mentioned in Section 10, the obligation and right is subject to exemption under Section 36. Under section 36 if the appropriate Government having regard to the financial position and other relevant circumstances of any establishment or class of establishment is of opinion that it will not be in public interest to apply all or any of the provisions of this Act thereto, it may by notification in the Official Gazette, exempt for such period as may be specified therein and subject to such conditions as it may think fit to impose, such establishment or class of establishments from all or any of the provisions of this Act.

There are two preconditions to the granting of exemption under section 36:

(1) The Government shall consider the financial position and other relevant circumstances of an establishment or class of establishments; AND

(2) It should be of the opinion that it would not be in the public interest to apply all or any of the provisions of the Act.

The expression 'financial position' includes loss suffered by the establishment during the accounting year. The expression 'other relevant circumstances' will include every consideration as to whether the workmen had principally contributed to the financial loss of the company during that accounting year.

If the bonus liability is negligible compared to the loss suffered, company will not be relieved of the liability of paying the minimum bonus.

If the losses sustained by the employer is not due to any misconduct on the part of employees, the employer is liable to pay statutory minimum bonus. [*J.K. Chemicals Ltd. vs. Govt. of Maharashtra* (1996) Bombay H.C.].

Question 24

State whether the following statements are true or false and give reasons therefor with reference to the Payment of Bonus Act, 1965.

i. The maximum bonus payable to employees is limited to the available surplus.

ii. "Salary or wage" does not include dearness allowance.

iii. Accounting year in relation to a corporation means the year commencing on 1st of April.

iv. A part-time employee engaged on regular basis is eligible for bonus.

v. If any interim bonus has been paid it may be adjusted against the statutory bonus that is payable under the Payment of Bonus Act, 1965.

Answer

i. The statement is false as the maximum bonus payable to employees under Section 11 is 20% of salary, irrespective of the available surplus being more.

ii. The statement is false as under Section 2(21), "salary or wage" includes dearness allowance.

iii. The statement is false as under Section 2(1), the accounting year in relation to a corporation means the year ending on the day on which the books and accounts of the corporation are to be closed and balanced. It does not mean therefore, the year commencing on 1st of April.

iv. The statement is true as a part-time employee is engaged on regular basis and thus is eligible for bonus [*Automobile Karmchari Sangh Vs. Industrial Tribunal* (1970) 38 FJR 268].

v. The statement is true as per Section 17 of the Payment of Bonus Act, 1965.

Question 25

State with reason whether the following statements are correct or incorrect.

"Employees can relinquish their right to receive minimum bonus by an agreement with employer".

Answer

The given statement is Incorrect. According to Section 31A of the payment of Bonus Act, 1965 any such agreement whereby the employees relinquish their right to receive minimum bonus under Section 10, shall be null and void in so far as it purports to deprive the employees of the right to receiving minimum bonus.

Question 26

What is the amount of minimum bonus to be paid to the employees under the provisions of the Payment of Bonus Act, 1965?

Answer

Minimum Bonus under the Payment of Bonus Act, 1965: In accordance with the provisions of section 10 of the Payment of Bonus Act, 1965, every employer shall be bound to pay to every employee in respect of every accounting year, minimum bonus which shall be 8.33% of the salary or wage earned by the employee during the accounting year or ₹ 100, whichever is higher, whether or not the employer has any allocable surplus in the accounting year.

Even if the employer suffers losses during the accounting year he is bound to pay minimum bonus as prescribed by Section 10 of the Payment of Bonus Act,1965[*State vs. Sardar Dalip Singh Majithia, 1979, Lab. I.C. (913) (All)*].

Question 27

*A limited company earned super profits during financial year. It intends to give maximum bonus to its employees. In this regard you are asked to advice the company on permissible maximum bonus under the Payment of Bonus Act, 1965***.**

Answer

Where, in respect of any accounting year referred to in Section 10 of the Payment of Bonus Act,1965, the allocable surplus exceeds the amount of minimum bonus payable to the employees under that section, the employer shall, in lieu of such minimum bonus, be bound to pay to every employee in respect of that accounting year bonus which shall be an amount in proportion to the salary or wage earned by the employee during the accounting year subject to a maximum 20% of such salary or wage.

In the given case therefore, the company will be free to give bonus at any rate exceeding 8.33% upto a maximum of 20% of the salary or wage earned by the employees during the accounting year. From the facts given, it may be presumed that the bonus at 20% may be payable.

However, in relation to the maximum bonus payable the most important term to understand is “allocable surplus”. The eligibility for maximum bonus arises from the “allocable surplus” but is not limited by it, as the allocable surplus may justify a bonus at a rate higher than 20% but bonus will still be limited to 20%.

Question 28

Briefly explain the procedure for calculation of number of working days and proportionate reduction in bonus under the Payment of Bonus Act, 1965.

Answer

Section 14 of the Payment of Bonus Act, 1965 provides computation of number of working days for the purposes of Section 13. Under Section 14, following days shall be deemed to be the working days of an employee and shall be counted while calculating the total working days on which he has been on work for the purpose of bonus:

(*i*) day when he has been laid off under an agreement or by a standing order under Industrial Employment (Standing orders) Act, 1946 or Industrial Disputes Act, 1947 or any other law.

(*ii*) he has been on leave with salary or wage.

(*iii*) he has been absent due to temporary disablement caused by accident arising out of and in the course of his employment and

(iv) the employee has been on maternity leave with salary or wages during the accounting year.

Section 13 in turn prescribes a scale whereby bonus can be proportionately reduced in certain cases. Under section 13 where an employee has not worked for all the working days in an accounting year, the minimum bonus of rupees 100 or , as the case may be , of ₹ . 60, if such bonus is higher than 8.33% of his salary/ wage for the days he has worked in that accounting year shall be proportionately reduced.

Question 29

Explain the special provisions with respect to newly set up establishments.

Answer

Section 16 of the Payment of Bonus Act, 1965 deals with the special provisions regarding payment of bonus of newly set up establishments. Under section 16, where an establishment is newly set up, the employees of such an establishment shall be entitled to be paid bonus in accordance with the provisions of sub-sections (1A), (1B) and (1C).

Under section 16 (1A) in the first five accounting years following the accounting year in which the employer sells the goods produced or manufactured by him or renders services, as the case may be, to such establishment, bonus shall be payable only in respect of the accounting year in which the employer derives profit from such establishment. Such bonus shall be calculated in accordance with the provisions of this Act relating to that year but without applying the provisions of Section 15

It has been clarified by the second explanation to section 16 that an employer shall not be deemed to have derived profit in accounting year unless:

(a) he has made provision for that year's depreciation to which he is entitled under the Income-tax Act or as the case may be, under the Agricultural Income Tax law; and

(b) the arrears of such depreciation and losses incurred by or in respect of the establishment for the previous accounting years have been fully set off against his profits.

Sub section 1B of section 16 further states that in the sixth and seventh accounting year, the provisions of Section 15 for the purpose of computing bonus, shall apply subject to the following modifications, namely:

(i) for the sixth accounting year, set on or set off, as the case may be, shall be made in the manner illustrated in the Fourth Schedule, taking into account the excess or deficiency, if any, as the case may be, of the allocable surplus set on or set off in respect of the 5th and 6th accounting years;

(ii) for the seventh accounting year, the same principle is to be followed but the excess or deficiency of the allocable surplus set on or set off in respect of the 5th, 6th, and 7th accounting year has to be taken into account;

In term of section 16 (1C) from the eighth accounting year following the accounting year in which the employer sells the goods produced or manufactured by him or renders services, as the case may be, from such establishment, the provisions of Section 15, shall apply in relation to such establishment as they apply in relation to any other establishment.

Explanation 1 to section 16 has clarified that a newly set up establishment does not mean one which has been set up merely by reason of a change in its location, management, name or ownership.

Question 30

A is an employee of a company. The amount of the bonus payable to A during the year 2006-07 is ₹ 10,000, but the company paid him ₹ 7,000 only and a sum of ₹ 3,000 was deducted from bonus against the loss suffered by the company due to misconduct of A during the same accounting year. A files a suit against the company for recovery of the deducted amount. Decide whether A would be given any relief by the court under the provisions of the Payment of Bonus Act, 1965? What will be your answer, if the losses are related to the accounting year 2005-06?

Answer

Under section 18 of the Payment of Bonus Act, 1965, where in an any accounting year, an employee is found guilty of misconduct causing financial loss to the employer, then the employer can lawfully deduct the amount of loss from the amount of bonus payable by him to the employee in respect of that accounting year only. In this case, and the employee shall get only the balance, if there be any.

After application of the above provision it is clear that 'A' will not get any relief from the court because employer has the right to deduct the said losses from the bonus of employee.

In the second case, A will get relief from the Court because the losses are related to the accounting year 2005-06. According to section 18 the employer can deduct the loss suffered from the bonus payable to an employee only in the accounting year in which such loss was incurred due to the misconduct of the employee.

Question 31

Explain with reference to the provisions of the Payment of Bonus Act, 1965 the possibility of a non-banking company relying on its Balance Sheet and Profit and Loss Account in the case of a dispute with its employees relating to bonus payable under the Act and the limitations, if any, in this regard.

Answer

Under section 22 of the Payment of Bonus Act, 1965 any dispute between an employer and his employees regarding bonus payable under this Act shall be deemed to be an industrial dispute within the meaning of the Industrial Disputes Act, 1947 or any corresponding law relating to investigation and settlement of industrial disputes in force in a state and the provisions of that Act shall apply accordingly.

Section 23 of the Payment of Bonus Act, 1965 further provides that where, during the proceedings before any arbitrator or Tribunal under the Industrial Disputes Act, 947, or under any corresponding law relating to investigation and settlement of industrial disputes in force in a State, the balance-sheet and the profit and loss account of an employer, being a corporation or a company (other than a banking company), duly audited by the Comptroller and Auditor-General of India or by auditors duly qualified to act as auditors of companies under the Companies Act, are produced before it, then, the said authority may presume the statements and particulars contained in such balance-sheet and profit and loss account to be accurate and it shall not be necessary for the corporation or the company to prove the accuracy of such statements and particulars by the filing of an affidavit or by any other mode.

Provided that where the said authority is satisfied that the statements and particulars contained in the balance-sheet or the profit and loss account of the corporation or the company are not accurate, it may take such steps as it thinks necessary to find out the accuracy of such statements and particulars.

Further, the trade union and if there is no trade union, employees being a party to the dispute may apply to the specified authority seeking clarification relating to any item in the balance sheet or profit and loss account. On receipt of such application the specified authority is to satisfy itself as to the necessity of such clarification. On being thus satisfied, the specified authority may direct the corporation or the company to furnish to the trade union or the employees such clarifications within such time as may be specified in the direction. Thereupon, the company or the corporation must comply with such direction [Section 23(2)].

Question 32

X is an employee in a Company. The amount of bonus payable to him during the year 2007-08 is ₹ 14,000. The company deducted a sum of ₹ 4,000 against the "Puja Bonus" already paid to him during the said year and paid the remaining amount. X files a suit against the company for recovery of the deducted amount. Decide, under the Payment of Bonus Act, 1965, whether X would be given any relief by the Court?

Or

Is the employer entitled to deduct or adjust any interim bonus paid to the employees?

Answer

Deduction of Bonus: The problem as given in the question is based on the provisions of section 17 of the Payment of Bonus Act, 1965. As per Section 17, if in any accounting year, an employer has paid any puja bonus or other customary bonus or any advance against bonus, to any employee, then the former shall be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to the employee under this Act in respect of that accounting year. The employee shall be entitled to receive only the balance. The employer can do the same thing even in a case where he has paid off the bonus payable under this Act to an employee before the date on which such bonus payable becomes payable.

In the instant case therefore, X would not get any relief from the court because employer is empowered to deduct ₹ 4,000/- from the total bonus (₹ 14,000) of Mr. X.

Question 33

In 2009, the Electronics Corporation, a Public Sector establishment under the Department of Science and Technology, Government of Rajasthan starts to sell mobile sets manufactured by it, in addition to T.V. sets, so as to compete with private sector establishments of mobile sets in the market. The income from sale of mobile sets is 30 percent of the gross income of the Corporation. The employees of the Corporation went to strike for demand of Bonus.

Decide, whether the demand of the employees is tenable under the provisions of the Payment of Bonus Act, 1965. Would your answer be different if the income from sale of mobile sets is only 10 percent of the gross income of the Corporation?

Answer

In terms of section 20(2), the provisions of the Payment of Bonus Act, 1965 do not apply to an establishment in public sectors, except as provided under sub section 1 of section 20.

Section 20 of the Payment of Bonus Act, 1956 provides that, if in any accounting year, an establishment in public sector sells any goods produced or manufactured by it or if it renders any services in competition with an establishment in private sector and if the income from such sale or service or both is not less than 20% of the gross income of such establishment, then the provisions of the Payment of Bonus Act, 1956 shall apply in relation to establishment in private Sector.

In the given problem therefore, the demand of the employees is tenable in first case but it is not tenable in second case.

Question 34

State the provisions relating to the following items under the Act:

(a) Time Limit for Payment of Bonus.

(b) Recovery of Bonus due from an employer.

OR

Explain the provisions of the Payment of Bonus Act, 1965 relating to the time limit within which an employer must pay the amount of bonus due to an employee.

Answer

(a) Time Limit for Payment of Bonus: Section 19 of the Payment of Bonus Act, 1965 prescribes the time limit for the payment of bonus under the following conditions:

1. Under Section 19 (1) (a) of the said Act, where the dispute is between the employer and the employees regarding the payment of bonus and such dispute is under reference to the prescribed authority, the employer is bound to pay his employee bonus in cash within one month from the date on which the award becomes enforceable or the settlement comes into operation, in respect of such dispute.
2. Under Section 19 (1) (b) of the said Act, in all other cases, the payment of bonus is to be made within a period of 8 months from closing of the accounting year.

But this period of 8 months may be extended up to a maximum of 2 years by the Appropriate Government or by any authority prescribed by the Appropriate Government only on an application to it by the employer and is satisfied that sufficient reasons exist for granting extension. Moreover, the extension can be made only by an order.

(b) Recovery of the bonus due from an employer (Section 21): It may so happen that an amount to bonus is due to an employee from his employer under a settlement or an award or agreement and it is not paid by the employer. In such a case, the employee is required to make an application for the recovery of the amount to the Appropriate Government. This application can be made even by his assignee or heirs when the employee is dead.

The application is required to be made within one year from the date on which the money (Bonus) becomes due but it may be entertained even after the expiry of the said period of one year, if the Appropriate Government is satisfied that the applicant had sufficient cause for not making the application within the said period.

If on the receipt of the aforesaid application for the recovery of the bonus amount, the appropriate Government or such authority as it may specify in this connection is satisfied

that the money is so due, it shall issue a certificate for that amount to the Collector who shall proceed to recover the same in the same manner as an arrear of land revenue.

Question 35

X was an employee of Universal Limited. He retired from the company on 31st March, 2010 and died after few months. Y, the heir of X, applied within the prescribed time to the company for payment of due bonus of X. The company refused to pay the bonus. Examine the validity of the company's refusal and also state the procedure to recover the bonus under the provisions of the Payment of Bonus Act, 1965.

Answer

In the given case, the key point to be evaluated is whether X was eligible for bonus for the accounting year ending 31st March 2010. If we presume that it was so, then Y is eligible to claim the bonus as the legal heir of X.

Under section 19 of the Payment of Bonus Act, 1965 the employer is bound to pay in cash the bonus payable to an employee within eight months from the close of the accounting year, which in this case should be 30th November 2010.

The company's refusal is illegal under the Act.

The remedy available to Y the heir of X lies in section 21 of the Payment of Bonus Act under which an employee, his assigns or his heirs, can make an application for the recovery of the amount to the Appropriate Government within one year from the date on which the bonus becomes due. If the appropriate government or the prescribed authority is satisfied that any money is so due, it shall issue a certificate for that amount to the Collector who shall proceed to recover the same in the same manner as an arrear of land revenue.

Question 36

Explain the provisions relating to appointment, powers and functions of an Inspector under the Payment of Bonus Act, 1965?

Answer

Appointment of powers and functions of the Inspectors: Section 27 of the Payment of Bonus Act, 1965 provides that the Appropriate Government may, by notification in the Official Gazette, appoint such persons as it thinks fit to be inspectors for the purposes of this Act and may define the limits within which they shall exercise jurisdiction.

An inspector thus appointed has to ascertain whether any of the provisions of this Act has been complied with. And for this purpose, he may:-

(i) Require an employer to furnish such information as he may consider necessary;

(ii) At any reasonable time and with assistance, if any, as he thinks fit, enter any establishment or any promises connected there with and require any one found in charge thereof to produce before him for examination any account books, register and other

documents relating to the employment of persons or the payment of salary or wage or bonus in the establishment;

(iii) Examine, with respect to any matter relevant to any of the purpose aforesaid, the employer, his agent or servant or any other person found in charge of the establishment or any premises connected therewith or any person whom the inspector has reasonable cause to believe to be or to have been reasonable cause to believe to be or to have been an employee in the establishment;

(iv) Make copies of or take extract from, any book, register or other document maintained in relation to the establishment; and

(v) Exercise such other powers as may be prescribed.

The inspector appointed as aforesaid is deemed to be a public servant under the Indian Penal Code.

Any person, whom an Inspector calls upon to produce any accounts, book, register or other document or to give information, shall be legally bound to do so.

The provisions of Section 27 do not empower an inspector to require a banking company to furnish or disclose any statement or information or to produce or give inspection of, any of its books of accounts or other documents, which a banking company cannot be compelled to furnish, disclose, produce or give inspection of, under Section 34A of the Banking Regulation Act, 1949.

Question 37

What are the penalties for contravention of the provisions of the Act by a person and offences by companies?

Answer

Penalty (Section 28): A person shall be liable for punishment: (i) if he contravenes any of the provisions of this Act or any rules framed thereunder; or (ii) if he fails to comply with any direction or requisition which may have been given or made to him under this Act. The punishment may be imprisonment for a term extending up to 6 months or of fine extending up to ₹ 1,000 or both.

Offences by Companies (Section 29): If any person committing an offence under this Act is a company, and it is proved that such offence has been committed in connivance or consent of any director, manager or secretary or other officer of the company, then such persons shall also be guilty of such offence and shall be liable to be proceeded against and punished accordingly.

Question 38

On 1st January 2002, Aryan Textiles Ltd. agreed with the employees for payment of an annual bonus linked with production or productivity instead of bonus based on profits subject to the

limit of 30% of their salary wages during the relevant accounting year. It was also agreed by the employees that they will not claim minimum bonus stated under Section 10 of the Payment of Bonus Act, 1965. As per the agreement the employees of Aryan Textiles Ltd claimed annual bonus linked with production or productivity in the relevant accounting year. On refusal of the company the employees of the company moved to the court for relief.

Decide in reference to the provisions of the Payment of Bonus Act, 1965 whether the employees will get the relief? Inspite of the aforesaid agreement whether the employees are still entitled to receive minimum bonus.

Answer

As per Section 31 (A) of the Payment of Bonus Act, 1965, there may be an agreement or settlement by the employees with their employer for payment of an annual bonus linked with production or productivity in lieu of bonus based on profits, payable under the Act. when such an agreement has been entered into the employees are entitled to receive bonus as per terms of the agreement/settlement, subject to the following restrictions imposed by Section 31A;

(a) any such agreement/settlement whereby the employees relinquish their right to receive minimum bonus under Section 10, shall be null and void in so far as it purports to deprive the employees of the right of receiving minimum bonus.

(b) If the bonus payable under such agreement exceed 20% of the salary/wages earned by the employees during the relevant accounting year, such employees are not entitled to the excess over 20% of salary/wages.

In the given case Aryan Textile Ltd. agreed with the employees for payment of an annual bonus linked with production or productivity instead of based on profits subject to the limit of 30% of their salary/ wages during the relevant accounting year. According to Section 31A the maximum bonus under this provision which can be given should not exceed 20% of the salary/wages earned by the employee during the relevant accounting year. Hence, the maximum bonus may be paid upto 20% of the salary/wages.

If the company, in the agreement, agrees to pay more than 20% then it it is going against the provisions of the Payment of Bonus Act, 1965 and cannot be enforced.

The employees of Aryan Textiles also agreed not to claim minimum bonus stated in Section 10 of the Payment of Bonus Act, 1965 such an agreement shall be null and void as it purports to deprive the employees of their right of receiving minimum bonus.

Hence, the relief may be given by the court, by enforcing the payment of bonus to the employees, based on the production or productivity, as agreed, plus the minimum bonus payable under the Payment of Bonus Act, 1965, subject to a maximum of 20%.

Question 39

The management of Shakthi Mills Ltd. entered into an agreement with their employees to pay them bonus based on production in lieu of Bonus based on profits, from the accounting year 2007. The employees further agreed to forego their right to receive minimum bonus and

instead accept 25% of their salary/wage as bonus based on productivity. Is such an agreement valid? Examine in the light of the provisions of the Payment of Bonus Act, 1965.

Answer

No, such an agreement is null and void to the extent to which it purports to deprive the employees from claiming the minimum bonus payable under the Payment of Bonus Act, 1965 as laid down in section 31A read with the Proviso thereto, of the said Act.

The given case is based on Section 31A of the Payment of Bonus Act, 1965 which allows an agreement between employers and employees for payment of bonus linked with productivity and the binding of such agreement but subject to two restrictions:

(i) That such agreement whereby the employees relinquish their right to receive minimum bonus under Sec.10, shall be null and void to that extent, and

(ii) The bonus payable under such agreement together with the minimum bonus payable under the Act, shall not exceed 20% of the salary/wages earned by the employees during the relevant accounting year.

Accordingly, in the given problem, the agreement to forego the right of receiving minimum bonus is null and void to that extent only and not fully. The employees shall not be entitled to receive the total bonus over 20% of salary/wages comprising of the bonus payable linked with productivity and the minimum bonus payable under the Act. Thus if the productivity bonus exceeds 20% of the salary earned by employees during the accounting year, he shall not be able to claim minimum bonus in addition to the productivity bonus.

Question 40

Standard Airways Limited was incorporated at Chennai in the year 2005, employing 125 workmen. Due to strike of workers, mismanagement in the company and accidental loss of the assets, the company suffered heavy losses continuously since its incorporation, resulting in a large part of the capital and assets getting wiped out. Consequently, the company moved an application to the Government of Tamil Nadu requesting to exempt the company fully from the application of the provisions of the Payment of Bonus Act, 1965.

Decide, whether the Government of Tamil Nadu may grant exemption to the Company. State the provisions of law in this regard as stated under the Payment of Bonus Act, 1965.

Answer

An employer who is unable to comply with the provisions of the Payment of Bonus Act, due to paucity of funds or for other reasons, can make an application to the Appropriate Government for exemption fully or partly from the provisions of the Payment of Bonus Act, 1965 as laid down in Section 36 of the Payment of Bonus Act, 1965. If the Appropriate Government having regard to the financial position and other relevant circumstances of any establishment or class of establishments, is of the opinion that it will not be in public interest to apply all or any of the provisions of the Act thereto, it may, by notification in official Gazette, exempt for such period

as may be specified therein and subject to such conditions as it may think fit to impose, such establishment or class of establishments from all or any of the provisions of the Act. Such relevant considerations for granting exemptions are industrial peace, law and order situation, effect on production of consumer goods, difficulties of management, etc.

Decision under Section 36 must be an objective one. If the employer establishes that losses were being incurred continuously and entire capital and assets have been wiped out, the State Government can not refuse to grant exemption under Section 36 [*Nav Bharat Potteries vs. State (1987) ILLN117 (Bombay)*]. Employees should be heard before granting such exemption.

The facts of the problem meet the criteria spelt out in Section 36 and hence, Standard Airways may be allowed exemption.

Exercise

1. *State whether the following establishment are entitled to payment of bonus under the Payment of Bonus Act, 1965.*

   (i) Defense canteen

   (ii) Institutions engaged in Social or welfare activities

   (iii) Delhi Development authority

   [**Hints:** (i) Not entitled for bonus as per Section 32(iv),

   (ii) Not entitled for bonus as per section 32(v),

   (iii) Not entitled as per section 32(iv)

2. *A company was engaged in three separate ventures under three different units. Separate accounts were prepared in each unit. One of the units was not doing well. Its employees wanted to be paid bonus along with the employees of the other two units as part of one single establishment. Decide.*

   [**Hint:** No, as per the proviso of the Section 3 of the Payment of Bonus Act,1965]

3. *The limit of salary of a worker entitled to get bonus is*

   (a) 5000/- per month.

   (b) 7,000 rupees or the minimum wage for the scheduled employment, as fixed by the appropriate Government, whichever is higher

   (c) 2,500/- per month.

   (d) None of the above.

   [**Hint**: Option (b) as per the amendment to section 12 by the Payment of Bonus (Amendment) Act, 2015,]

4. *Ordinarily, the Payment of Bonus Act, 1965 cannot apply on an establishment employing less than 20 persons.*

   (a) True.

   (b) False.

   [Hint: True as per section 1 (3)(b) of the Payment of Bonus Act,1965]

5. *Once the Bonus Act is applicable on an establishment, the Act will continue to apply even if the number of employees comes below the required minimum.*

   (a) True.

   (b) False.

   [Hint: True, as per section 1(5) of the Payment of Bonus Act,1965]

4 The Employees' Provident Funds and Miscellaneous Provisions Act, 1952

Question 1

State whether the following statement is true or false and give reason therefor with reference to the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

"Basic wages include the cash value of food concessions"

Answer

This statement is false because in terms of section 2 (b) clause (i) basic wages do not include the cash value of food concessions.

Section 2(b) of the EPF & Misc Provisions Act, 1952 defines basic wages as all emoluments which are earned by an employee while on duty or on leave or on holidays with wages in either case in accordance with the terms of the contract of employment and which are paid or payable in cash to him, but does not include among other things the cash value of food concessions.

While the non inclusion of cash value of food concessions in basic wages is included in the definition of basic wages, it may however, be pointed out that any subsidy or concession is a benefit of reducing the cost of a commodity to the employee and hence cannot be construed as having been paid in cash to him. Therefore, it is not part of basic wage even as per the specific definition (without even considering exceptions).

Question 2

Define the term 'Employer' under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

Answer

Section 2(e) read with Section 2(k) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 defines employer as –

(i) **in relation to an establishment which is a factory,** the owner or occupier of the factory, including the agent of such owner or occupier, the legal representative of a deceased owner or occupier and where a person has been named as a manager of the factory, the person so named; and

(ii) **in relation to any other establishment**, the person who, or the authority which has ultimate control over the affairs of the establishment, and where the said affairs are entrusted to a Manager, Managing Director, Managing Agent, such Manager, MD or Managing Agent shall be treated as employer.

It is interesting to note that employer does not mean the owner but the person in charge. Generally the term is often used in relation to an owner but it is not so.

Question 3

Vimal is an employee in a Company. The following payments were made to him during the previous year:

(i) Piece rate wages

(ii) Productivity bonus

(iii) Additional dearness allowance

(iv) Value of Puja gift.

Examine as to which of the above payments form part of "Basic Wage"' of Vimal under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

OR

Explain clearly the meaning of the term 'Basic wages' as defined under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. State also what is not included in the term 'Basic Wages'.

Answer

Basic Wages: As per Section 2(b) of the Employees' Provident Funds and Miscellaneous Provision Act, 1952, "Basic Wages" mean all emoluments which are earned by an employee while on duty or on leave or on holidays with wages in either case in accordance with the terms of the contract of employment and which are paid or payable in cash to him, but does not include:

(i) the cash value of any food concessions;

(ii) any dearness allowance (that is to say all cash payments, by whatever name called, paid to an employee on account of a rise in the cost of living), house rent allowance, overtime allowance, bonus commission or any other similar allowance payable to the employee in respect of his employment or of work done in such employment; or

(iii) any presents made by the employer.

The key characteristics of basic wages are:

(a) All emoluments (of whatever nature) earned during duty or during paid leave or during paid holidays;

(b) The above emoluments are in accordance with the terms of employment of the employee;

(c) The above emoluments are paid or payable in cash.

Therefore, emoluments or benefits of a non cash nature or any payment not in accordance with the terms of employment shall not form part of basic wage. Thus if an employer pays any amount as a reward to the employee out of his own will without being under the obligation to do so under the terms of employment of the employee, such payment shall not be basic wage under this Act.

Applying the above provisions of this Act to the given problem, the Basic wages of Vimal will include only piece rate wages but will exclude the Productivity bonus, additional dearness allowance and value of puja gift.

Question 4

What is the meaning of 'factory' under the EPF & MP Act, 1952? Examine, with reference to case laws.

Answer

Under section 2(g) of the EPF & Misc Provisions Act, 1952 "factory" means any premises, including the precincts thereof, in any part of which a manufacturing process is being carried on or is ordinarily so carried on, whether with the aid of power or without the aid of power. Hence, for any premises to be designated as a "factory" the carrying on of manufacturing process in any part thereof is of the essence. It is not necessary that such activity is carried on with or without the aid of power.

As per Section 2 sub section (i) clause (ic), 'manufacture' or 'manufacturing process' means any process for making, altering, repairing, ornamenting, finishing, packing, oiling, washing, cleaning, breaking up, demolishing or otherwise treating or adapting any article or substance with a view to its use, sale, transport, delivery or disposal.

Thus, this definition of the manufacturing process is very wide.

However, under section 1 (3) clause (a) the Employees' Provident Funds & Miscellaneous Provisions Act, 1952 applies to only those factories:

a. which are engaged in any industry specified in schedule 1 of the Act; and

b. in which 20 or more persons are employed.

The repairing and servicing of cars is included in the definition of the manufacturing process and any establishment doing such work will fall within the meaning of "factorty". [*Lawly Sen v. RPFC (1959) 1 LabLJ 272 & AIR 1959 Pat 271].*

Similarly a printing press of a university is 'factory' within the meaning of Section 2(g), although it is run by a larger organisation carrying on other activities falling outside the PF Act. [*Andhra University v. RPFC(1985) 4 SCC 509 & AIR 1986 SC 463.]*

Industries as per Schedule I: The industries to which the Act applies are specified in Schedule I to the EPF & Miscellaneous Provisions Act. Under Section 4, the Central Government can add any industry to schedule I by notification in the official gazette. Under these powers, various industries have been added from time to time. The schedule at present covers almost all types of industry, including cement, cigarettes, iron and steel, textiles, chemicals, food products, aerated water, paper and paper products, electrical, mechanical and general engineering products, beedi, automobile repairing and servicing, medical and pharmaceutical preparations, brick making etc. Practically, all organized industries are covered under the Act.

Question 5

State whether the following statement is true or false and give reason therefor with reference to the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

"The chairman of the Executive Committee is appointed by the Central Board".

Answer

This statement is false because under section 5AA (2) clause (a) the Chairman of the Executive Committee is appointed by the Central Government from among the members of the Central Board.

Question 6

While an employee may increase his contribution to Provident Fund, is an employer also liable to proportionately increase his contribution to the above under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952? Explain.

Answer

Under section 6 of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 an employee may if he so desires, contribute an amount exceeding ten percent of his basic wages, dearness allowance and retaining allowance if any, subject to the condition that the employer shall not be under an obligation to pay any contribution over and above his contribution payable under this section.

Hence the employer is not required to match the increased contribution of an employee.

Question 7

Write a note on Employees Deposit-Linked Insurance Scheme.

Answer

Section 6C(1) empowers Central Government to frame by notification in official gazette, a scheme to be called the Employees' Deposit Linked Insurance Scheme, 1976 for the purpose of providing life insurance benefits to employees of any establishment or class of establishments to which PF Act is applicable.

Under the scheme a Deposit Linked Insurance Fund was set up. Under the scheme, an employer is required to pay into the Fund such amount, not exceeding 1% of the aggregate of the basic wages, dearness allowances and retainership allowance if any, as is notified by the Central Government. .[Section 6C(2)].

The employer is also required to pay into the fund an additional sum of money not exceeding 25% of the contribution he is required to make into the fund under section 6C (2). This sum paid into the Fund is made to meet all expenses for the administration of the Employees' Deposit Linked Insurance Scheme.

The Insurance Fund vests in the Central Board and will be administered by Central Board as specified in the Insurance Scheme [Section 6C(5)].

The Employees' Deposit Linked Insurance Scheme may provide for all or any of the matters specified in Schedule IV.

The said Scheme may provide for any of its provisions to take effect prospectively or retrospectively on such date as specified in the scheme. [Section 6C(7)].

The employee is not required to contribute any amount to the Scheme.

The salary limit for coverage of employees is same as that of Employees Provident Fund Scheme.

Question 8

The Employees' Deposit Linked Insurance Scheme, under Section 6C of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 has been amended by the Central Government. State these amendments.

Answer

Amendments have been made to the Employees' Deposit Linked Insurance Scheme from time to time, in order to ensure increasing support to millions of workmen covered under the EPF, Pension and Insurance Schemes.

The latest amendment has been introduced vide Notification dated 22nd August 2014 issued by the Ministry of Labour and Employment, Government of India. This amendment has made a huge change which incorporates the following benefits:

(a) The statutory wage ceiling under the EPF, EPS and EDLI has been increased from INR 6,500 to INR 15,000 per month.

(b) For the financial year 2014-15, the minimum pension is fixed at INR 1,000/ month for the members of the EPS or their nominee/ widow, etc

(c) Effective from 1st September 2014, all new EPF members shall not become a member of EPS, if their pay is more than INR 15,000/ month at the time of joining. In other words, no allocation towards pension fund will be made for such new members and the entire employee and employer contribution will go to the provident fund account;

(d) The insurance benefit under the EDLI scheme has been increased by 20% in addition to the existing admissible benefits.

Prior to this path breaking amendment the "The Central Government amended the Employees' Deposit Linked Insurance Scheme, 1976 was amended by the introduction of the Employees' Deposit Linked Insurance (Amendment) Scheme, 2010, according to which on the death of an employee, who is member of the Fund or of a provident fund exempted under section 17 of the Act, the person entitled to receive the provident fund accumulations of the deceased shall, in addition to such accumulations be paid an amount, equal to the average balance in the account of the deceased in the fund or a provident fund exempted under section 17 of the Act, as the case may be, during preceding twelve months or during the period of his membership, whichever is less, except where the average balance exceeds rupees fifty thousand, the amount payable shall be rupees fifty thousand plus 40% of the amount in excess of fifty thousand subject to a ceiling of Rupees one lakh."

This above provision says that the EDLI amount is equal to the average balance of incumbent's PF in the last 12 months or the overall balance, whichever is less. But if the balance exceeds ₹ 50,000, the incumbent's nominee will get ₹ 50,000 plus 40% of the excess balance up to a total of ₹ 1 lakh.

Employees' Deposit Linked Insurance (Amendment) Scheme, 2011 *made further amendments to the EDLI Scheme.*

As per the Notification No. G.S.R. 9(E),dated 8th January ,2011 , the Central Government revised the benefits provided to the employees under the Employees' Deposit Linked Insurance(Amendment) Scheme,2010. Under the revised scheme, the benefit provided in case of death of an employee who was member of the Fund or of a Provident fund exempted under Section 17 of the Act at the time of the death, their family will get 20 times of the average wages of the last 12 months of the member.

By this amendment, benefits provided to the employees under the Employees' Deposit Linked Insurance(Amendment) Scheme, 2010 has been enhanced. According to which maximum benefits under the scheme will now be ₹ 1,30,000/- , as the wage ceiling upto which contribution can be paid under the scheme is ₹ 6500.

This amendment has changed the methodology of computation by introducing a new and additional method for computation of benefit that has to be paid to the nominee of the deceased along with existing method of computation i.e., as per the EDLI(Amendment) Scheme, 2010, which ever is higher.

Employees' Deposit Linked Insurance (Amendment) Scheme, 2014

According to the Notification No. G.S.R. 610(E), dated 22nd August, 2014, as per the above amendment scheme, wage limit upto which contribution can be paid under the scheme has been revised from rupees six thousand five hundred to rupees fifteen thousand. And the benefit provided under the scheme shall be further increased by twenty 20% in additions to the benefits provided under paragraph 22 of the scheme, as the case may be.

[**Note**: The students are advised to study thoroughly the latest amendment made in 2014 and read the earlier ones only for reference].

Question 9

An employee of a limited company filed a claim for provident fund settlement with the Provident Fund Commissioner. However, he did not get any settlement from the authority even after six month's. Referring to the EPF & MP Act, 1952 what course of action an authority should have taken in this respect.

Answer

The Provident Fund "claims" complete in all respects submitted along with the requisite documents are required to be settled and the benefit amount paid to the beneficiaries within 30 days from the date of its receipt of the complete "claims" by the Commissioner.

If there is any deficiency in the claim, the same shall be recorded in writing and communicated to the applicant within 30 days from the date of receipt of such application.

In case the Commissioner fails without sufficient cause to settle a claim complete in all respects within 30 days, the Commissioner shall be liable for the delay beyond the said period and penal interest at the rate of 12% per annum may be charged on the benefit amount and the same may be deducted from the salary of the Commissioner.

Question 10

Describe the procedure for determination of moneys, due and escaped from employer under EPF & MP Act,1952?

Or

Explain the provisions of Employees' Provident Funds and Miscellaneous Provisions Act, 1952 with regard to determination of 'Escaped Amount' after an officer has passed an order concerning 'Determination of Amount' due from an Employer under the Act.

Answer

Determination of moneys due from employers (Section 7A) : (1) Power to authorities to determine the due amount- Section 7A (1) of the Act gives power to the authorities mentioned therein *i.e.,* Central PF Commissioner, Additional Central PF Commissioner, Deputy PF Commissioner or any Regional PF Commissioner Assistant PF Commissioner to determine by order, the amount due from an employer under the provisions of the Act and the Pension or the Insurance Schemes and also decide the following additional matters:

(*i*) amount due as contribution.

(*ii*) the date from which the same is due.

(*iii*) the administrative charges.

(*iv*) amount to be transferred under Sections 15 or 17 of the Act.

(*v*) any other charges payable by the employer under the Act.

(2) Power to conduct enquiry- The authorities have been given power to conduct such enquiry as may be deemed necessary and for this they have been granted the same powers as are vested in a Court.

(3) Opportunity to an employer represent his case- Further under sub section (3), an order must not be made unless the employer concerned is given a reasonable opportunity of representing his case.

(4) Failure of employer/ employee to attend enquiry, produce documents etc.- Under sub section (3A) where the employer, employee or any other person required to attend the inquiry under Subsection (1) fails to attend such inquiry without assigning any valid reason or fails to produce any document or to file any report or return when called upon to do so, the officer conducting the inquiry may decide the applicability of the Act or determine the amount due from any employer, as the case may be, on the basis of the evidence adduced during such inquiry and other documents available on record.

(5) Set-aside of an order passes against an employer ex-parte- Further under sub section (4) of section 7A where an order under Sub-section (1) is passed against an employer *ex parte*, he may, within three months from the date of communication of such order, apply to the officer for setting aside such order and if he satisfies the officer that the show cause notice was not duly served or that he was prevented by any sufficient cause from appearing when the inquiry was held, the officer shall make an order setting aside his earlier order and shall appoint a date for proceeding with the inquiry.

No such order shall be set aside merely on the ground that there has been an irregularity in the service of show cause notice if the officer is satisfied that the employer had notice of the date of hearing and had sufficient time to appear before the officer.

(6) Appeal to an order- It is also explained that where an appeal has been preferred under this Act against an order passed *ex parte* and such appeal has been disposed of otherwise than on the ground that appellant has withdrawn the appeal, no application shall lie under this Sub-section for setting aside the *ex parte* order.

Under sub section (5) no order passed under this section shall be set aside on any application under Sub-section (4), under notice thereof has been served on the opposite party.

(7) Quasi- judicial nature of proceedings -Thus, the scope of enquiry and manner of conducting the enquiry is at the discretion of the authority. As the proceedings shall be quasi-judicial and shall vitally affect the rights of the parties the principle of natural justice must be strictly followed in deciding the dispute in the proceeding. The employer is entitled to a reasonable opportunity of being heard. The order made under this section shall be final and will not be called in question in any Court of law.

Determination of escaped amount (Section 7C) : Where an order determining the amount due from an employer under Section 7A or Section 7B has been passed and if the officer who passed the order :

(a) has reason to believe that by reason of the omission or failure on the part of the employer to make any document or report available, or to disclose, fully and truly, all material facts necessary for determining the correct amount due from the employer, any amount so due from such employer for any period has escaped his notice;

(b) has, in consequence of information in his possession, reason to believe that any amount to be determined under Section 7A or Section 7B has escaped from his determination for any period notwithstanding that there has been no omission or failure as mentioned in clause (*a*) on the part of the employer.

He may, within a period of five years from the date of communication of the order passed under Section 7A or Section 7B, re-open the case and pass appropriate order re-determining the amount due from the employer in accordance with provisions of this Act.

However, no order re-determining the amount due from the employer shall be passed under this section unless the employer is given a reasonable opportunity of representing his case by other documents available on record.

Question 11

Examine the provisions in respect of review of orders passed under Section 7 A of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

Answer

Review of orders – According to section 7B of the EPF & Miscellenous Provisions Act, 1952**,** an order passed under section 7A can be reviewed as follows:

1. Any person aggrieved by an order made under sub-section (1) of section 7(A) but from which no appeal has been preferred under this Act, and who, from the discovery of new and important matter or evidence which, after the exercise of due diligence was not within his knowledge or could not be produced by him at the time when the order was made, or on account of some mistake or error apparent on the face of the record or for any other sufficient reason, desires to obtain a review of such order, may apply for a review of that order to the officer who passed the order.

2. Such officer may also on his own motion review his order if he is satisfied that it is necessary so to do on any such ground.

3. Every application for the aforesaid review shall be filed in such form and manner and within such time as may be specified in the Scheme; and

4. Where it appears to the officer receiving an application for review that there is no sufficient ground for a review, he shall reject the application.

5. Where the officer is of opinion that the application for review should be granted, he shall grant the same.

6. No appeal shall lie against the order of the officer rejecting an application for review but an appeal under this Act shall lie against an order passed under review as if the order passed under review were the original order passed by him under section 7A.

Question 12

Examine the rules relating to review of order regarding determination of applicability of the EPF & MP Act, 1952 and the money due.

Answer

Under section 7B (1) of the EPF & Misc Provisions Act, 1952 any person who is aggrieved by the order under Section 7A(1) can make an application to the officer who has passed the order, for review of the same in following cases:

(a) If new and important evidence is discovered which could not be produced earlier as it was not within his knowledge even after due diligence; or

(b) There is some mistake or error apparent on the records; or

(c) Any other sufficient reason

It may be noted further that no application for review can be made if an appeal has been filed under the Act.

Under section 7B (2), every application under sub section (1) above, is required to be filed in such form and manner and within such time as may be prescribed in the Scheme.

The officer can either reject the application for review if there are not sufficient grounds for review, or he can grant the review. [Section 7B (3) and (4)].

Appeal cannot be filed against order rejecting the application for review. However, if fresh order is passed after the review, appeal can be filed against such order [Section 7B(5)].

In *Balu Fire Clay Niwas v. U.O.I., 2003 LLR 578 (Jhar HC)*, it was held that when statute provides for review, it cannot be contended that petitioner should have filed appeal against the order. It was also held that review petition should be disposed of by a speaking order.

Question 13

Examine the constitution of appellate tribunal, its jurisdiction and the procedures relating thereto under the Employees' Provident Funds and Miscellaneous Provision Act, 1952.

Answer

(1) Appeal to appellate tribunal- Under section 7I (1) of the EPF & Misc Provisions Act, 1952 any person aggrieved by:

(a) a notification issued by the Central Government; or

(b) an order passed by the Central Government; or

(c) an order passed by any authority, under the various sections of the Act, as specified in this section;

may prefer an appeal to a Tribunal against such order. However, no appeal to the Tribunal can be made against an order passed by the officer, rejecting an application for review of his order under section 7B or section 14 B.

(2) Constitution of appellate tribunal- In terms of section 7D (1):

(a) The EPF Appellate Tribunal shall be constituted by the Central Government by notification in the Official Gazette;

(b) The Central Government shall constitute one or more such Tribunals;

(c) The Appellate Tribunals will be constituted on the basis of jurisdiction within specified location which shall be included in the notification;

(d) The Appellate Tribunal shall have the powers which are conferred on it by the EPF & Misc Provisions Act 1952;

(e) Such Tribunal shall have one person only, the Presiding Officer, who will be appointed by the Central Government who shall be the judge on the matters dealt with by it;

(f) No person shall be eligible to be appointed as the presiding officer of a Tribunal as above unless he is qualified to be appointed as a judge of a high court or a district judge.

The presiding officer holds office for five years or until he attains the age of 62 years, whichever is earlier [Section 7E].

Section 7F (1) provides that the Presiding Officer of the Employees' Provident Funds Appellate Tribunal may by notice in writing under his hand addressed to the Central Government, resign his office. However, the Presiding Officer shall continue in his office:

(a) unless he is permitted by the Central Government to relinquish his office sooner; or

(b) until the expiry of three months from the date of receipt of such notice or

(c) until a person duly appointed as his successor enters upon his office;

(d) or until the expiry of his term of office,

whichever is the earliest.

(3) Jurisdiction and Procedure of the appellate tribunal- The Tribunal, during proceedings, will give opportunity of hearing to parties. It will then pass order (a) confirming, modifying or annulling the order appealed against, or (b) remand the matter back to the authority for fresh directions, with such directions as the Tribunal may deem fit [Section 7L(1)].

The Tribunal has powers to rectify its order, if it is apparent from the records. Such rectification can be made within five years from date of the order. If such rectification has

effect of increasing the liability of the employer, notice has to be given to the employer and opportunity of hearing will be given before passing order [Section 7L(2)].

An order passed by the Tribunal is final and no appeal can be filed in any Court of law against the order [section 7L(4)].

Appeal can be entertained only after depositing 75% of amount demanded. However, the Tribunal can waive or reduce the deposit, for reasons to be recorded in writing [Section 7-O].

Question 14

State whether the following statement is true or false and give reason therefor with reference to the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

"Employee Provident Fund Appellate Tribunal shall consist of three judges".

Answer

This statement is false as the Employees' Provident Funds Appellate Tribunal shall consist of one judge in terms of section 7D (2).

Question 15

Briefly explain the formation of Employees' Provident funds Appellate Tribunal under the EPF & MP Act, 1952.

Answer

Under section 7D (1) of the EPF & Misc Provisions Act, 1952 the Central Government may, by notification in the Official Gazette, constitute one or more Appellate Tribunals to be known as the Employees' Provident Funds Appellate Tribunal to exercise the powers and discharge the functions conferred on such Tribunal by the EPF & MP Act,1952 and every such Tribunal shall have jurisdiction in respect of establishments situated in such area as may be specified in the notification constituting the Tribunal.

From the above provision the following points emerge:

(a) The EPF Appellate Tribunal shall be constituted by the Central Government by notification in the Official Gazette;

(b) The Central Government shall constitute one or more such Tribunals;

(c) The Appellate Tribunals will be constituted on the basis of jurisdiction within specified location which shall be included in the notification;

(d) The Appellate Tribunal shall have the powers which are conferred on it by the EPT & Misc Provisions Act 1952;

(e) Such Tribunal shall have one person only as appointed by the Central Government who shall be the judge on the matters dealt with by it;

(f) No person shall be eligible to be appointed as the presiding officer of a Tribunal as above unless he is qualified to be appointed as a judge of a high court or a district judge.

Question 16

R, a 57 years old district judge was appointed by the Central Government as Presiding Officer of the Employee's Provident Funds Appellate Tribunal for a period of five years. After three years, he (R) resigns from his office and ceases to work with immediate effect without handing over the charge to his successor, who was not appointed by the Government till that date. Examine the validity of R's action to cease work under the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

Answer

Section 7 F (1) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 provides that the Presiding Officer of a Employees' Provident Funds Appellate Tribunal may by notice in writing under his hand addressed to the Central Government, resign his office provided that the Presiding Officer 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 until the expiry of his term of office, whichever is the earliest.

Hence, R's action is invalid as per above provisions. He is supposed to continue for three months unless he is relieved earlier by the Central Government or his successor appointed by the Central Government has taken up the office, whichever is earlier.

Question 17

What are the orders that can be passed by Employees' Provident Funds Appellate Tribunal on appeals against the orders passed by the Central Government or authorized officers?

Answer

Under section 7L (1) the 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 annulling the orders appealed against or may refer the case back to the authority which passed such order with such directions as the Tribunal may think fit, for a fresh adjudication or order as the case may be, after taking additional evidence, if necessary.

Under sub section (2) a Tribunal may at any time within five years from the date of its order, with a view to rectifying any mistake apparent from the record amend any order passed by it under sub-section (1) and shall make such amendment in the order if the mistake is brought to the notice by the parties to the appeal.

However, an amendment which has the effect of enhancing the amount due from, or otherwise increasing the liability of, the employer shall not be made unless the Tribunal has given notice to him of its intention to do so and has allowed him reasonable opportunity of being heard.

Further, under sub section (3) a Tribunal shall send a copy of every order passed under this section to the parties to the appeal.

Section 7L (4) further provides that any order made by a Tribunal finally disposing of an appeal shall not be questioned in any court of law. In short, the order of the Tribunal shall be final and binding on all parties concerned.

Question 18

State whether the following statement is true or false and give reason therefor with reference to the Employees Provident Funds and Miscellaneous Provisions Act, 1952.

"An employer generally has to deposit 50% of the money due from him so as to go on appeal "

Answer

This statement is false as an employer under Section 7-O of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 has to deposit 75% of the money due from him so as to go on appeal.

Question 19

S retired from the services of PQR Limited, on 31st March, 2009. He had a sum of ₹ 5 lac in his Provident Fund Account. It has become due for payment to S on 30th April, 2009 but the company made the payment of the said amount after one year. S claimed for the payment of interest on due amount at the rate of 15 percent per-annum for one year. Decide, whether the claim of S is tenable under the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

Answer

According Section 7Q of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 the employer shall be liable to pay simple interest @ of 12% per annum or at such higher rate as may be specified in the Scheme on any amount due from him under this Act from the date on which the amount has become so due till the date of its actual payment:

Provided that higher rate of interest specified in the Scheme shall not exceed the lending rate of interest charged by any scheduled bank.

As per above provision, S can claim for the payment of interest on due amount @ 12 percent per annum or at the rate specified in the Scheme, whichever is higher, for one year. Here in the absence of specified rate he(S) can claim only 12 percent per annum interest on the due amount.

Hence claim of S for interest rate of 15% is not tenable.

Question 20

Explain briefly the mode of recovery that may be followed by the recovery officer under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 for recovering the amount due from an employer.

Answer

Under section 8B (1) of the EPF & Misc Provisions Act, 1952 where any amount is an arrear under section 8, of EPF & MP Act, 1952 the authorised officer may issue to the Recovery Officer a certificate under his signature specifying the amount of arrears. The Recovery Officer, on receipt of such certificate shall proceed to recover the amount specified therein from the establishment or as the case may be, the employer by one or more of the modes mentioned below:

(a) attachment and sale of the movable or immovable property of the establishment or, as the case may be, the employer;

(b) arrest of the employer and his detention in prison;

(c) appointing a receiver for the management of the movable or immovable properties of the establishment or, as the case may be, the employer;

The attachment and sale of any property under section 8B shall first be effected against the properties of the establishment. Where such attachment and sale is insufficient for recovery the whole of the amount of arrears specified in the certificate, the Recovery Officer may then take proceedings against the property of the employer for recovery of the whole or any part of such arrears.

Under section 8B(2) it is further provided that the authorised officer may issue a certificate under section 8B(1) notwithstanding the fact that proceedings for recovery of the arrears by any other mode have been taken [.

Notwithstanding that a certificate has been issued to the Recovery Officer for the recovery of the amount, the authorised officer may grant time for the payment of the amount, and thereupon the recovery officer shall stay the proceedings until the expiry of the time so granted [Section 8E].

Question 21

State the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 relating to the protection of the amount standing to the credit of an employee in the provident fund against attachment.

Or

X, an employee in ABC Ltd (covered by the EPF and MP Act, 1952) died in an accident. State to whom the amount standing in his account to be payable under the provisions of the Act.

Answer

As per Section 10 of the Employees' Provident Funds and Miscellaneous Provisions Act,1952, the amount standing to the credit of any member in the fund or of any exempted employee in a provident fund shall not in any way be capable of being assigned or charged and shall not be liable to attachment under any decree or order of any court in respect of any debt or liability incurred by the member or exempted employee, and neither the official assignee appointed

under the Presidency Town Insolvency Act,1909, nor any receiver appointed under the Provincial Insolvency Act,1920, shall be entitled to or have any claim on, any such amount. This protection also applies to provident fund, pension and insurance amount receivable by employee under the scheme.

The amount standing to the credit of the person at the time of his death is payable to his nominees under the scheme or the rules under this Act.

Further, the amount shall be free from any debt or other liability incurred by the deceased or the nominee before the death of the member or of the exempted employee and shall also not be liable to attachment under any decree or order of any Court. (Section 10, EPF & MP Act, 1952).

Question 22

A company which is covered by the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 was adjudged insolvent and an order for winding up was made. State, in this connection, whether the Provident Fund is attachable and whether the payment of Provident Fund contribution be considered as priority over other Debts of the Company.

Or

Discuss under the Employees' Provident Funds and Miscellaneous Act, 1952 as to whether the Provident fund contribution is a preferential payment in case of the employer being declared insolvent.

Answer

Protection against attachment: According to section 10 of the Employee's Provident Fund and Miscellaneous Provisions Act, 1952, the amount standing to the credit of any member or of any exempted employee in the Provident Fund shall not in anyway be capable of, being assigned or charged and shall not be liable to attachments under any decrees order of any court in respect of any debt or liability, incurred by the member or the exempted employee. Neither the official assignee appointed under the Presidency town Insolvency Act, 1909 nor any Receiver appointed under the Provincial Insolvency Act 1920 shall be entitled to have any claim on any such amount. Such amount shall also not be liable to attachment under any degree or order of any court.

Priority of Payment of Contribution over other debts(Section 11): If the employer is adjudged an insolvent or if the employer is a company and an order for winding thereof has been made, the amount due from the employer whether in respect of the employee's contribution or the employer's contribution must be included among the debts which are to be paid in priority to all other debts under Section 49 of the Presidency-Towns Insolvency Act, Section 61 of the Provincial Insolvency Act, Section 327 of the Companies Act, 2013(i.e., section 530 of the Companies Act, 1956), in the distribution of the property of the insolvent or the assets of the company. In other words, this payment will be a preferential payment

provided the liability therefor has accrued before this order of adjudication or winding up is made.

Question 23

An Inspector appointed under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 makes an inspection at 10 p.m. (five hours after factory timings) and seeks to take copies of the "Shareholders' Register". How far under the Act is his action reasonable?

Answer

Under Section 13(2) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, an Inspector can inspect and make copies of, or take extract from any book, register or other document maintained in relation to the establishment and, where he has reason to believe that any offence under this Act has been committed by an employer, seize with such assistance as he may think fit, such book, register or other document or portions thereof as he may consider relevant in respect of that offence.

Further, under section 13 (2) (b) the inspector can enter and search any establishment at any reasonable time which cannot be 5 hours after the factory timings.

In the present case the Inspector had sought to take copies of the "Shareholders' Register" which is irrelevant document for the purpose of EPF and MP Act, 1952. Moreover, he has visited the office after the working hours (10.00 pm) which is not reasonable.

Hence, the actions of the inspector are completely unreasonable under the EPF & Misc Provisions Act, 1952

Question 24

What are cognizable offences under the Act?

Answer

Cognizable offences mean the offences which are taken note of by the court for proceedings thereon. Under section 14 AC (1) no court shall take cognizance of any offence punishable under this Act, except:

(a) on a report in writing of the facts constituting such offence;

(b) The report must be made by an Inspector appointed under Section 13.

(c) The report is made with the previous sanction of the Central Provident Fund Commissioner or such other officer as may be authorised by the Central Government, by notification in the Official Gazette, in this behalf,;

Section 14 AC (2) further provides that no court inferior to that of a Presidency Magistrate or a first class Magistrate, shall try any offence under this Act or the Scheme or the Pension Scheme or the Insurance Scheme.

Question 25

State whether the following statement is true or false and give reason therefor with reference to the Employees Provident Funds and Miscellaneous Provisions Act, 1952.

"Default in payment of contribution by employer is a cognizable offence".

Answer

This statement is true because according to Section 14AB of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, offences relating to default in payment of contribution by the employer is a cognizable offence.

A cognizable offence is defined in section 2 of the Criminal Penal Code as one where the police can arrest a person without warrant under the law in force.

Question 26

An employee leaves the establishments in which he was employed and gets employment in another establishment wherein he has been employed. Explain the procedure laid down in the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 in this relation.

Or

Describe in brief the mode of transfer of balance to the credit of Provident Fund Account of an employee leaving one organisation and joining another organisation, to the new employer under the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

Or

An employee working in an establishment covered by the E.P.F. and M.P. Act, leaves his employment and takes up employment in another establishment. State in this connection:

(i) How shall the amount accumulated to his P.F. Account be transferred?

(ii) What steps shall be taken if the establishment in which he has joined is not covered by the Act?

(iii) What would be your answer if the establishment in which he was previously working is not covered by the Act?

Answer

Transfer of accumulated amount to the credit of Employees' Provident Funds on change of employment

Section 17 A (1) provides that where an employee employed in an establishment to which this Act applies leaves his employment and obtains re-employment in another establishment to which this Act does not apply, the amount of accumulations to the credit of such employee in the provident fund of the establishment left by him shall be transferred, within such time as may be specified by the Central Government in this behalf, to the credit of his account in the

provident fund of the establishment in which he is re-employed, if the employee so desires and the rules in relation to that provident fund permit such transfer.

Similarly under sub section (2) where an employee employed in an establishment to which this Act does not apply leaves his employment and obtains re- employment in another establishment to which this Act applies, the amount of accumulations to the credit of such employee in the provident fund of the establishment left by him may, if the employee so desires and the rules in relation to such provident fund permit, be transferred to the credit of his account in the Fund or as the case may be, in the provident fund of the establishment in which he is re-employed.

Question 27

Is the amount standing to the credit of a member of the Provident Fund attachable in the execution of decree or order of the Court? Examine the law, on this point, laid down in the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

Answer

Attachment of Provident Fund: According to Section 10 of E.P.F. & M.P. Act, 1952 the amount standing to the credit of any member in the fund or of any exempted employee in a provident fund shall not in any way be capable of being assigned or charged and shall not be liable to attachment under any decree or order of any court in respect of any debt or liability incurred by the member or the exempted employee, and neither the official assignee appointed under the Presidency Towns Insolvency Act nor any receiver appointed under the Provincial Insolvency Act shall be entitled to or have any claim on, any such amount.

The amounts standing to the credit of aforesaid categories of persons at the time of their death and payable to their nominees under the scheme or the rules, and the amount shall be free from any debt or other liability incurred by the deceased or the nominee before the death of the member or of the exempted employee and shall also not be liable to attachment under any decree or order of any court.

Question 28

Explain the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 authorising certain employers to maintain a Provident Fund Account.

Answer

Under section 16 A (1) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, the Central Government may, on an application made to it in this behalf by the employer and the majority of employees in relation to an establishment employing one hundred or more persons, authorize the employer by an order in writing, to maintain a provident fund account in relation to the establishment subject to such terms and conditions, as may be specified in the scheme.

No authorization shall, however, be made under this sub-section, if the employer of such establishment had committed any default in the payment of provident fund contribution or had committed any other offence under this Act during the three years immediately preceding the date of such authorization.

Further, section 16A (2) provides that where an establishment is authorised to maintain a provident fund account as aforesaid, the employer in relation to such establishment shall maintain such account, submit such return, deposit the contribution in such manner, provide for such facilities for inspection, pay such administrative charges, and abide by such other terms and conditions, as may be specified in the scheme.

Section 16A (3) provides that any authorization made under this Section may be cancelled by the Central Government by order in writing if the employer fails to comply with any of the terms and conditions of the authorization or where he commits any offence under any provisions of this Act.

However, before cancellation of the authorization, the Central Government shall give the employer a reasonable opportunity of being heard.

Question 29

State the establishments, which were exempted from the operation of EPF & MP Act, 1952?

Answer

Under section 16(1) the EPF & MP Act, 1952 does not apply to:

(a) Any establishment registered under the Co-operative Societies Act, 1912, employing less than 50 persons and working without the aid of power; or

(b) To any other establishment belonging to or under the control of the Central Government or a State Government and whose employees are entitled to the benefit of contributory provident fund or old age pension in accordance with any scheme or rule framed by the Central Government or the State Government governing such benefits; or

(c) To any other establishment set up under any Central, Provincial or State Act and whose employees are entitled to the benefits of contributory provident fund or old age pension in accordance with any scheme or rule framed under that Act governing such benefits; or

(d) Any other class of establishment, which the Central Government has by notification in the Official Gazette, that it is expedient to do so on the basis of the financial position, subject to such conditions and for such period as may be prescribed by the Central Government.

Question 30

Manorama Group of Industries sold its textile unit to Giant Group of Industries. Manorama Group contributed 25% of total contribution in Pension Scheme, which was due before sale under the provisions of Employees' Provident Funds and Miscellaneous Provisions Act, 1952. The transferee company (Giant Group of Industries) refused to pay the remaining 75% contribution in the Pension Scheme. Decide, in the light of the Employees' Provident Funds

and Miscellaneous Provisions Act, 1952, who will be liable to pay for the remaining contribution in case of transfer of establishment and upto what extent?

Answer

The problem as asked in the question is based on the provisions of section 17(B) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. Accordingly where an employer in relation to an establishment, transfers that establishment in whole or in part by sale, gift, lease or license or in any other manner whatsoever, the employer and the person to whom the establishment is so transferred shall be jointly or severally liable to pay the contribution and other sums due from the employer under the provisions of this Act of the Scheme or Pension Scheme, as the case may be, in respect of the period upto the date of such transfer. It is further provided in the Proviso to the said section that the liability of the transferee shall be limited to the value of the assets obtained by him on such transfer.

It would be thus evident from the aforesaid provisions that 17-B deals with the liability of transferor and transferee in regard to the money due from the transferor establishment under (a) the Act or (b) the Scheme (c) and Pension Scheme. The liability of the transferor and transferee is joint and several, but the liability of the transferee is limited to the value of the assets obtained by the transferee from such transfer. Therefore applying the above provisions in the given case the transferor Manorama Group of Industries, the transferor has paid only 25% of the total liability as contribution in Pension Scheme before sale of the establishment. With regards to remaining 75% liability both the transferor and transferee companies are jointly and severally liable to contribute. In case, the transferor refuses to contribute, the transferee will be liable, to pay. However, the liability of the transferee company shall be limited to the value of assets obtained by it from the transfer.

Question 31

Solar Industries Limited sold its unit to Mars Industries Limited and contributed 30% contribution in the Pension Scheme. The transferee company refused to bear the balance 70% contribution in the Pension Scheme. Decide, under the employees' provident Fund and Miscellaneous Provisions Act, 1952, the liability of remaining contribution.

Answer

The problem asked in the question is based on the provisions of section 17B of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. Accordingly, where an employer in relation to an establishment, transfers that establishment in whole or in part by sale, gift, lease or licence or in any other manner whatsoever, the employer and the person to whom the establishment is so transferred shall be jointly or severally liable to pay the contribution and other sums due from the employer under the provisions of this Act of the scheme or pension scheme, as the case may be, in respect of the period upto the date of such transfer. It is provided that the liability of the transferee shall be limited to the value of the assets obtained upto the date of transfer.

It would thus be evident from the aforesaid provisions that section 17B deals with the liability of transferor and transferee in regard to the money due under the Act, scheme or the Pension scheme. In the case of transfer of establishment brought in by sale, gift, lease etc., the liability of the transferor and the transferee is joint and several, but it is limited to the period upto the date of the transfer.

Therefore, applying the above provision of law, Solar Industries Ltd., has paid only 30% of the total liability as contribution in Pension Scheme before sale of the establishment. With regard to the remaining 70% liability both the transferor and the transferee companies are jointly and severally liable to contribute. In case, the transferor refuses to contribute, the transferee is liable but the liability of the transferee (Mars Industries Limited) is limited to the extent of assets obtained by it from the transfer of the establishment.

Question 32

Explain the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 regarding the following:

(i) rate of interest on amount due from the employer under the Act.

(ii) maximum limit of interest rate

(iii) the period for which the employer is liable to pay the said interest.

Answer

Rate, limit and period of payment of interest:

As per Section 7Q of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952

(i) the employer shall be liable to pay simple interest at the rate of 12 per cent per annum or at such higher rate as may be specified in the Scheme only if he has delayed in the payment of any amount due from him under this Act. The interest shall be payable from the due date till the date of payment.

(ii) although the upper limit of interest rate is not given in the Act, it is clearly mentioned that the higher rate of interest specified in the Scheme cannot exceed the lending rate of interest charged by any scheduled bank.

(iii) The period for which the employer is liable to pay the interest is from the date on which the amount has become so due till the date of its actual payment.

Question 33

An Inspector appointed under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 makes an inspection at 8 a.m. (an hour before factory timings) and seeks to take copies of the "Income Tax Returns". How far under the Act is his action reasonable?

Answer

Validity of Act of Inspector: According to Section 13(2)(b) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, the inspector can at any reasonable time, enter and search any establishment and require any one found in charge thereof to produce before him for examination any accounts, books, registers and other documents relating to employment of persons or the payment of wages in the establishment.

Further, under Section 13(2)(d) of the said Act, an inspector can inspect and make copies of, or take extract from any book, register or other document maintained in relation to the establishment and, when he has reason to believe that any offence under this Act has been committed by any employer, seize with such assistance as he may think fit, such book, register or other document or portions thereof as he may consider relevant in respect of that offence.

In the instant case, the inspector has sought to take copies of the "Income Tax Returns", which are not relevant documents for the purpose of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. Moreover, the inspector has visited the office of establishment before the normal working hours of the office, which is not reasonable.

Hence, the action of the inspector is NOT reasonable.

Question 34

State the provisions of Employees' Provident Funds and Miscellaneous Provisions Act, 1952 regulating the quantum of contribution to be made by the employer and employee to the Provident Fund. Is it possible for an employee to increase the amount of his contribution to the Provident Fund more than the minimum contribution as statutorily prescribed ?

Answer

Contribution to Provident Fund under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952: Section 6 of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 regulates contribution to Provident Fund Scheme established under the Act.

The employer's contribution shall be 10% of the basic wages, dearness allowance and retaining allowance, if any payable to each of the employees whether employed by him directly or by through a contractor.

The employee's contribution shall be equal to the contribution payable by the employer in respect of him.

In case the employee so desires, he may contribute an amount exceeding ten percent of his basic wages, dearness allowance and retaining allowance if any, subject to the

condition that the employer shall not be under an obligation to pay any contribution over and above his contribution payable under this section.

Dearness allowance includes cash value of any food concession allowed to the employees. Retaining allowance means the sum paid for retaining the service, when the factory is not working.

The Central Government may by notification make the employer's contribution equal to 12% for certain establishments class of establishments.

Exercise

1. *Kumar & Sons company sold its manufacturing unit to X & Co. Kumar & Sons contributed 30 % of total contribution in pension scheme which was due before the sale under the EPF& MP Act,1952. X & Co. refused to bear remaining 70% of the contribution in the pension scheme. Decide who will be liable to pay the remaining contribution?*

   [**Hint**: Both the parties are liable jointly and severally for the remaining contribution as per the Section 17 B of the EPF&MP Act,1952]

2. *State whether the following statement is correct/incorrect.*

   (i) The maximum contribution that an employee can make to his provident fund account is 10%.

   (ii) The amount of the provident fund of an employee is not attachable even after it is has been received by the employee.

   [**Hint:**(i) Incorrect as per the provision given under Section 6 of the EPF&MP Act,1952]

   (ii) Incorrect as per section 10 of the EPF&MP Act,1952]

3. *Generally the Employees' Provident funds and Miscellaneous Provisions Act, 1952 applies to entities employing more than*

   (a) 10 persons.

   (b) 20 persons.

   (c) 100 persons.

   (d) 1000 persons.

   [**Hint:** Option (b) as per section1(3)(a) of the Employees' Provident Funds and Miscellaneous Act,1952]

4. *The Central Government may apply the provisions of this act even if it employs less than required persons.*

   (a) True.

   (b) False.

[**Hint**: Option (a) as per section 1(3)(b) of the Employees' Provident Funds and Miscellaneous Act,1952]

5. *The liability for employer to contribute under the Employees' Provident Funds etc. Act, 1952 is 10% of the employees' emoluments.*

   (a) True.

   (b) False.

   [**Hint**: True, according to section 6 of the Employees' Provident Funds and Miscellaneous Act,1952]

   Note: This has now been revised to 12%

6. *The maximum contribution that an employee can make to his provident fund account is 10%.*

   (a) True.

   (b) False.

   [**Hint**: False, because according to section 6 of the Employees' Provident Funds and Miscellaneous Act,1952 the maximum contribution can be 12%]

   Note: There is no limit to the contribution that an employee can make to his PF. The only condition is that the Employer's contribution is limited to 12%.

5 The Payment of Gratuity Act, 1972

Question 1

State whether the following statements are true or false and give reasons therefor with reference to the Payment of Gratuity Act, 1972.

i. The Payment of Gratuity Act, 1972 is largely based on Kerala Industrial Employees Payment of Gratuity Act, 1972.

ii. A retrenched employee is also eligible for gratuity.

iii. Where an employee's resignation has not been accepted, then that employee is not eligible to claim gratuity.

iv. Where the negligence of employee causes loss to the employer, then the gratuity shall be wholly forfeited.

v. An appeal against the Controlling Authority's order must generally be made within 60 days.

Answer

i. This statement is false because the Payment of Gratuity Act, 1972 is largely based on West Bengal Employees' Payment of Compulsory Gratuity Act, 1971.

ii. This statement is true because in the case of *State of Punjab Vs. Labour Court* (1986), it was held that a retrenched employee is also eligible for gratuity. Under section 4 of the Payment of Gratuity Act, 1972 gratuity is payable to every employee on the termination of his employment if he has completed 5 years of continuous service. Hence, in the case of a retrenched employee, he shall be eligible for gratuity upto the date of retrenchment if he has completed 5 years of service. It is assumed that he is retrenched in compliance with the applicable labour laws in this regard and has been paid the required compensation.

iii. This statement is false as it was held in *Mettur Spinning Mills Vs. Deputy Commissioner of Labour*, (1983) II LLJ 188, that non acceptance of the resignation is no hurdle in the way of an employee to claim gratuity.

iv. This statement is false because when loss is caused by the negligence of employee, there gratuity shall be forfeited to the extent of the damage or loss so caused as laid down in section 4(6) clause (a) of the Payment of Gratuity Act, 1972.

v. This statement is true as an appeal against the Controlling Authority's order must be made within 60 days [Section 7 (7) of the Payment of Gratuity Act, 1972].

Question 2

K is an employee of RST Limited, a software company which works five days, in a week. K was not in continuous service during the financial year 2009-10. However, she worked only for 150 days because she was on maternity leave with full pay for 50 days. Referring to the provisions of the Payment of Gratuity Act, 1972 decide, whether K is entitled to gratuity payable under the Act?

Answer

As per sub section 1 of Section 2 A of the Payment of Gratuity Act, 1972 an employee shall be said to be in continuous service for a period if he has, for that period, been in uninterrupted service. This uninterrupted service will include the period during which the employee could not work on account of sickness, accident, leave, lay-off, strike or a lockout or cessation of work not due to any fault of an employee.

Further sub section 2 of section 2A states that where any employee (not being an employee employed in a seasonal establishment) is not in continuous service (as defined in sub section 1) for any period of one year he shall be deemed to be in continuous service under the employer for the said period of one year, if the employee during the period of twelve calendar months preceding the date with reference to which calculation is to be made, has actually worked under the employer for not less than (i) one hundred and ninety days, in the case of any employee employed below the ground in a mine or in an establishment which works for less than six days in a week, and (ii) two hundred and forty days, in any other case.

The explanation to section 2A (2) clarifies that for the purposes of calculating the number of days on which an employee has actually worked under an employer shall include the days on which in the case of a female, she has been on maternity leave, so, however, that the total period of such maternity leave does not exceed twelve weeks.

Thus, as per the above provisions-

K will be considered to be in continuous employment during the year for a period she worked + the period for which she was on maternity leave = 150 + 50 = 200 days. Since, she worked in an establishment which works for five days in a week for more than 190 days, so she will be entitled to gratuity.

Question 3

Mr. X was an employee of Mutual Developers Limited. He retired from the company after completing 30 years of continuous service. He applied to the company for the payment of gratuity within the prescribed time. The company refused to pay the gratuity and contended that due to stringent financial condition the company is unable to pay the gratuity. Mr. X applied to the Appropriate Authority for the recovery of the amount of gratuity.

Examine the validity of the contention of the company and also state the provisions of law to recover the gratuity under the Payment of Gratuity Act, 1972.

Answer

(i) Gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years on his superannuation or on his retirement or resignation or on his death or disablement due to accident or disease under Section 4(1) of the Payment of Gratuity Act,1972. Further, section 7(2) provides that as soon as gratuity becomes payable, the employer shall, whether the application for the payment of gratuity has been given or not by the employee, determine the amount of gratuity and give notice in writing to the person to whom the gratuity is payable and also to the controlling authority specifying the amount of gratuity so determined.

The employer shall arrange to pay the amount of gratuity within 30 days for the date of its becoming due/payable to the person to whom it is payable [Section 7(3)], along with simple interest (at rates specified) if it is not paid within the period specified except where the delay in the payment is due to the fault of the employee and the employer has obtained permission thereon from the Controlling Authority [Section 7(3A)].

(ii) If the gratuity payable under the Act is not paid by the employer within the prescribed time to the person entitled thereto, the Controlling Authority shall issue a certificate for the amount to the Collector to recover the same along with compound interest at such rate as prescribed by the Central Government from the date of expiry of the prescribed time as land revenue arrears, to enable the person entitled to get the amount, after receiving the application from the aggrieved person (Section 8).

Before issuing the certificate for such recovery the Controlling Authority shall give the employer a reasonable opportunity of showing cause against the issue of such certificate. The amount of interest payable under the Section shall not exceed the amount of gratuity payable under this Act in no case (Section 8).

In the given case the facts are commensurate with provisions of law as stated above under Sections 7 and 8 of the Payment of Gratuity Act, 1972. Therefore, Mr. X is entitled to recover gratuity as he has completed the service of 30 years. The company cannot take the plea of stringent financial conditions for not paying the gratuity to Mr. X. On the refusal by the company, Mr. X can apply to the appropriate authority and the company will be liable to pay the gratuity along with interest as decided by such authority.

Question 4

Explain as to when is the gratuity payable to an employee of an establishment, under the provisions of the Payment of Gratuity Act, 1972.

Answer

According to section 4 (1) of the Payment of Gratuity Act, 1972, gratuity shall be payable to an 'employee' on the termination of his employment after he has rendered continuous services for not less than 5 years:

a. On his superannuation, or

b. On his retirement or resignation, or

c. On his death or disablement due to accident or disease.

The condition of the completion of five years of continuous service is not essential in case of the termination of the employment of any employee due to death or disablement.

Generally, gratuity is payable to the employee himself. However, in case of death of the employee, it shall be paid to his nominee or if no nomination has been made, to his legal heirs.

The payability of gratuity to the employee is his right as well as the obligation of the employer. By the change of ownership, the relationship of employer and employees subsists and the new employer cannot escape from the liability of payment of gratuity to the employees. (Pattathurila K. Damodharan Vs M. Kassim Kanju, 1993).

An employee resigning from service is also entitled to gratuity (Texmaco Ltd. V/s Sri Ram Dhan, 1992) and non acceptance of the resignation is no hurdle in the way of an employee to claim gratuity (Mettur Spinning Mills V/s Deputy Commissioner of Labour, 1983).

Further under section 7(3) the employer shall arrange to pay the amount of gratuity within 30 days for the date of its becoming due/payable to the person to whom it is payable.

Question 5

Explain the manner in which the gratuity payable to employees in a seasonal as well as other establishments is calculated under the Payment of Gratuity Act, 1972. State also the maximum amount of gratuity payable under the Act.

Answer

Computation of gratuity amount: Section 4 of the Payment of Gratuity Act, 1972 stipulates the manner in which the amount of gratuity payable to an employee will be calculated.

Non Seasonal Establishments -In the case of establishments other than seasonal establishments, the employer shall pay the gratuity to an employee at the rate of 15 days wages based on the rate of wages last drawn by the employee concerned for every completed year of service or part thereof in excess of 6 months.

In the case of piece rated employees, daily wages, shall be computed on the average of the total wages received by him for a period of 3 months immediately preceding the termination of his employment and for this purpose the wages paid for any overtime work shall not be taken into account.

In the case of a monthly rated employee 15 days wages shall be calculated by dividing the monthly rate of wages last drawn, by 26 and by multiplying the quotient by 15.

Seasonal Establishments - In the case of seasonal establishment the employees can be classified into 2 groups.

(i) Those who work throughout the year and

(ii) Those who work only during the season.

The former are entitled to get the gratuity at the rate of 15 days wages for every completed year of service or part thereof in excess of 6 months. The latter are entitled to receive gratuity at the rate of 7 days for each season.

Under section 4(3) the amount of gratuity payable to an employee shall not exceed ₹ Ten lakhs as amended in 2010.

Question 6

Examining the provisions of the Payment of Gratuity Act, 1972, state whether gratuity is payable to an employee for the periods when he does not actually work in the organization. Explain the manner in which gratuity is calculated for regular employees.

Answer

Periods for which Gratuity Payable:

Yes, the periods for which gratuity is payable to an employee includes those periods during which he does not actually work in the organization which are the following:

1. Lay off under the Industrial Disputes Act, 1947.
2. Leave with full wages.
3. Maternity leave for female employees.
4. Absence due to temporary disablement caused during employment.

Manner in which gratuity is calculated: Quantum of gratuity payable is 15 days' wages on the last drawn wages for every completed year of service or part thereof in excess of six months subject to a maximum of ₹ 10 Lakhs.

Question 7

When an employee becomes disabled due to any accident or disease and is unable to do the same work and re-employed on the reduced wages, how the gratuity of such employee shall be, computed under the provisions of the Payment of Gratuity Act, 1972?

Answer

Computation of Gratuity of a disabled employee: According to Section 4 (4) of the Payment of Gratuity Act, 1972, when an employee becomes disabled due to any accident or

disease and is not in a position to do the same work and re-employed on reduced wages on some other job, the gratuity will be calculated in two parts :-

- For the period preceding the disablement: on the basis of wages last drawn by the employee at the time of his disablement.
- For the period subsequent to the disablement: On the basis of the reduced wages as drawn by him at the time of the termination of services.

In the case of *Bharat Commerce and Industries Vs. Ram Prasad*, it was decided that if for the purposes of computation of quantum of the amount of gratuity the terms of agreement or settlement are better than the Act, the employee is entitled for that benefit.

However, the maximum statutory ceiling limit as providing under Sub-Section 3 of Section 4 of the Act which is ₹ 10 Lakhs , cannot be reduced by mutual settlement or agreement.

Question 8

Explain the provisions of the Payment of Gratuity Act, 1972 relating to 'forfeiture of the amount of Gratuity' payable to an employee.

Answer

Forfeiture of gratuity: Section 4(6) of the Payment of Gratuity Act, 1972 deals with cases in which gratuity payable to an employee may be forfeited.

According to clause (a) of the said sub section, the gratuity of an employee whose services have been terminated for any act, willful omission or negligence causing any damage or loss to, or destruction of, property belonging to the employer, shall be forfeited to the extent of the damage or loss so caused.

Further, clause (b) provides that the gratuity payable to an employee may be wholly or partially forfeited if the services of such employee have been terminated for –

(i) his riotous or disorderly conduct or any other act of violence on his part, or

(ii) any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment.

Question 9

National Steels Limited decided to forfeit the amount of gratuity of its employees A, B and C on account of disorderly conduct and other acts which caused loss to the property belonging to the company. A, B and C committed the following acts:

(i) A refused to surrender the occupied land belonging to the company.

(ii) B committed theft under law involving offence of moral turpitude.

(iii) C after superannuation continued to occupy the quarter of the company for six months.

Against the decision of the company, A, B and C applied to the appropriate authorities for relief. The company contented that the right to gratuity is not a statutory right and the forfeiture of the amount of gratuity was within the law.

Examine the contention of the company and the decision taken by the company to forfeit the amount of gratuity in the light of the Payment of Gratuity Act, 1972.

Answer

Forfeiture of Gratuity: In accordance with the provisions of Section 4(6) of the Payment of Gratuity Act, 1972, if the services of any employee have been terminated for any act, willful omission, or negligence causing any damage or loss to or destruction of, property belonging to the employer, the gratuity shall be forfeited to the extent of the damage or loss so caused.

Further, if the services of such an employee have been terminated for any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment, the gratuity payable to the employee may be wholly or partially forfeited.

Under section 4(1) of the Payment of Gratuity Act, 1972 gratuity is payable to an employee on termination of employment provided he completes five years of continuous service with the employer. The condition of the completion of five years' continuous service is not essential in case of the termination of the employment of any employee due to death or disablement.

The gratuity payable is an obligation of the employer and any forfeiture in full of part of the gratuity payable to an employee can be made only in terms of section 4(6). In *K. C. Mathew vs. Plantation Corporation of Kerala Ltd. 2001 LLR (2) (Ker)*, it was held that withholding of gratuity is not permissible except under those circumstances enumerated in Section 4(6) and that the right to gratuity is a statutory right and none can be deprived of it except as provided by the law.

The correctness of the decision taken by National Steels Ltd. in the given case, regarding forfeiture of the gratuity to its employees A, B and C may be tested in the light of Section 4(6) of the Payment of Gratuity Act, 1972 as referred above.

(i) A, has it appears from the facts given, illegally occupied the land of the company and hence has deliberately caused loss to the company by wrongfully appropriating its property. Hence, his gratuity may be forfeited by the company under section 4(6). This may also be termed as disorderly conduct on the part of A.

(ii) The offence of theft committed by B, under law involves moral turpitude and his gratuity stands wholly forfeited in view of Section 4(6) of the Act [relevant case is *Bharat Gold Mines Ltd vs. Regional Labour Commissioner, 1987, 70 FJR 11 (Karnataka)]*. It is presumed that such theft is committed by B in the course of his employment.

(iii) C had wrongfully occupied the company's quarter after the termination of his employment for six months. C may have caused a deliberate loss to the company by his wrongful occupation for 6 months as the quarter could not be given to another employee and the

company may have incurred the cost of rent in such case. Hence, the company is entitled to charge the rent from him and after adjusting other dues the remaining amount of gratuity may be paid [relevant case is *Wazir Chand vs. Union of India 2001, LLR172 (SC)].*

Question 10

Wazir Chand happens to be a retired Railway servant who occupies the Government quarter, and even after superannuation continued to occupy the Government quarter. For such continuance, the Government, in accordance with Rules, has charged penal rent from the retired Wazir Chand and after adjusting the dues of the Government, the balance amount of the gratuity, which was payable, has been offered to be paid.

Examine the contention of the Government and the decision taken by Government to adjust the amount of gratuity in the lights of the provision of the Payment of Gratuity Act, 1972.

Answer

Payment of Gratuity- According to Section 4(6) of the Payment of Gratuity Act, 1972, if the services of an employee have been terminated for;

i. any act

ii. willful omission or

iii. negligence

causing any damage or loss to, destruction of property belonging to the employer, then the gratuity shall be forfeited to the extent of damage or loss so caused.

Wazir Chand even after superannuation continued to occupy the quarter and the Government in accordance with the rules, charged the penal rent from him and after adjusting other dues, the balance gratuity amount was offered to be paid to him.

In the case of *Wazir Chand Vs Union of India,* the Court has decided that Wazir Chand having un-authorisedly occupied the Government quarter, was liable to pay the penal rent in accordance with rules and therefore, there is no illegality in those dues being adjusted against the death-cum-retirement dues of the ex-employee.

Question 11

An employee who is governed by the Payment of Gratuity Act, 1972 committed a theft in the course of his employment. And consequently his services was terminated. State in this connection, whether the gratuity payable to him shall be wholly or partly forfeited.

Answer

Reduction and forfeiture of Gratuity: Under Section 4 (6)(a) of the Payment of Gratuity Act, 1972, in the case of damage, loss or destruction of property of employer, due to the willful omission or negligence of the employee, the amount of gratuity to the extent of loss or damage shall be forfeited by the employer.

Further, under section 4(6)(b)the gratuity payable to an employee may be wholly or partially forfeited, where the services of an employee are terminated on the ground of:

(i) riotous or disorderly conduct or act of violence; or

(ii) committing an offence involving moral turpitude in the course of his employment.

Theft is an offence involving moral turpitude and consequently, if the services of an employee had been terminated for committing theft in the course of his employment, the gratuity payable to him under the provisions of the Act shall be wholly forfeited in view of Section 4(6)(b)(ii). *[Bharat Gold Mines Ltd. Vs Regional Labour Commissioner (Central), (1987) 70 FJR 11 (Kern.)]*]

Question 12

What are the procedures for nominations under the Payment of Gratuity Act, 1972 in establishments for which the Central Government is the appropriate government.

Answer

Under section 6(1), each employee who has completed one year of service, shall make, within such time, in such form and in such manner, as may be prescribed, nomination for the purpose of the second proviso to sub-section (1) of Section 4. The time, form and manner in case of employees in establishment where Central Government is 'Appropriate Government, are as under:

a. nomination shall be made in form 'F' in duplicate;

b. Nomination shall be given to employer or sent by registered post. The employee should get proper receipt or acknowledgement from employer who shall fill details in the form and return one copy to the employee.

c. Nomination shall be submitted within 30 days after completion of service of one year.

d. An employee who did not have family but acquired family later should submit nomination form in duplicate in form G within 90 days after acquiring family.

e. Notice of change in nomination shall be filed in form H.

Question 13

Examine how disputes are resolved under the Payment of Gratuity Act, 1972.

Answer

Under section 7(4)(a) if there is any dispute regarding the amount of gratuity payable to an employee or admissibility of any claim of or in relation to, an employee for payment of gratuity or the person entitled to receive the gratuity, the employer shall deposit, such amount as he admits to be payable by him as gratuity, to the controlling authority.

Section 7(4)(b) further provide that where there is a dispute with regard to any matter or matters specified in Clause (a), the employer or employee or any other person raising the dispute may make an application to the Controlling Authority for deciding the dispute.

The controlling authority shall, after due inquiry and after giving the reasonable opportunity of being heard to the parties to the dispute, determine the matter or matters in dispute. After such inquiry if any amount is found to be payable to the employee, the controlling authority shall direct the employer to deposit with it such amount or the difference of amount so determined and the amount already deposited by the employer to the controlling authority.

The controlling authority shall pay the amount deposited by the employer including the excess amount, if any, to the person entitled thereto.

As soon as the employer made the said deposit, the controlling authority shall pay the amount to the applicant where he is the employee or where the applicant is not the employee, to the nominee or as the case may be, the guardian of such nominee or legal heir of the employee, if he is satisfied that there is no dispute as to the right of the applicant to receive the amount of gratuity.

For the purpose of conducting inquiry, the controlling authority shall have the same powers as are vested in a court, while trying a suit, under the Code of Civil Procedure, 1908. The proceeding made by him will be the 'judicial proceedings' within the meaning of Sections 93 & 228 for the purposes of Section 196, Indian Penal Code the controlling authority will avail all the powers like enforcing the attendance, production of documents, receiving evidences on affidavits and issuing commission for the examination of witnesses. [Section 7(4)]

Question 14

What is the law relating to recovery of amount of gratuity under the payment of Gratuity Act, 1972 in case the said amount is not paid by the employer?

Answer

Law relating to recovery of gratuity under the Payment of Gratuity Act, 1972:

As per the provision given under section 8 of the Payment of Gratuity Act 1972, if the gratuity payable under the Act is not paid by the employer within the prescribed time, to the person entitled thereto, there the Controlling Authority shall, on an application received from the aggrieved person, issue a certificate for that amount to the Collector to recover the same along with the compound interest at such rate as prescribed by the Central Government, as land revenue arrears and pay to the persons entitled thereto.

Before issuing the certificate for such recovery the Controlling Authority shall give the employer a reasonable opportunity of showing cause against the issue of such certificate.

The amount of interest payable under this section shall not exceed the amount of gratuity payable under this Act in no case.

Question 15

Aswani who was an employee of Sun Televisions Limited, retired on 1st January 2013 after 30 years of continuous service. The company did not pay the amount of gratuity to Aswani till the end of December 2013. Now, Aswani claims the amount of gratuity along with interest. Decide, under the Payment of Gratuity Act, 1972, whether Aswani will succeed in his claim?

Answer

As per the provisions of section 4(1) of the Payment of Gratuity Act, 1972, gratuity shall be payable to an "employee" (defined in section 2(e) of the Act) on the termination of his employment after he has rendered continuous service for not less than five years –

- On his superannuation or
- On his retirement or resignation or
- On his death or disablement due to accident or disease;

Further, as per the provisions of section 7(3), the employer shall arrange to pay the amount of gratuity within thirty days from the date it becomes payable to the person as gratuity, whether the application for the payment of gratuity has been given or not by the employee.

Section 8 of the Act deals with Recovery of gratuity – If the amount of gratuity payable under this Act is not paid by the employer, within the prescribed time, to the person entitled thereto, the controlling authority shall, on an application made to it in this behalf by the aggrieved person, issue a certificate for that amount to the Collector, who shall recover the same, together with compound interest thereon at such rate as the Central Government may, by notification, specify, from the date of expiry of the prescribed time, as arrears of land revenue and pay the same to the person entitled thereto provided that the controlling authority shall, before issuing a certificate under this section, give the employer a reasonable opportunity of showing cause against the issue of such certificate provided further that the amount of interest payable under this section shall, in no case exceed the amount of gratuity payable under this Act.

Applying the above provisions of law to the question, Mr. Aswani will succeed and the company M/s. Sun Television Ltd., is required to pay gratuity along with interest as per the application of section 8 of the Act.

Question 16

Discuss the provisions relating to penalties under the Payment of Gratuity Act, 1972.

Answer

The provisions relating to penalties under the Payment of Gratuity Act are contained in section 9 which are as follows:

Making false statement or false representation – Under section 9(1) of the Payment of Gratuity Act, 1972 any person who knowingly makes or causes to be made, any false

statement or false representation for the purpose of avoiding payment to be made under the Payment of Gratuity Act or for enabling another person to avoid such payment, shall be punishable with imprisonment upto six months or with a fine upto ₹ 10,000 or with both.

Contravening provisions of Gratuity Act or rules – Section 9(2) of The Payment of Gratuity Act, 1972 lays down the punishment for an employer who contravenes the provisions of the Act. Under the said section an employer who contravenes or makes a default in complying with the provisions of the Payment of Gratuity Act, 1972 or Rules made thereunder shall be punishable for a term which shall not be less than three months but which can extend upto one year or with a minimum fine of ₹ 10,000 (but which may extend upto ₹ 20,000).

Offence relating to non-payment of gratuity – The proviso to section 9(2) further states that if the contravention relates to non-payment of any gratuity payable under the Payment of Gratuity Act, the term of imprisonment for the employer shall be minimum six months and maximum two years. However, the Court can impose a lesser term of imprisonment, if the Court for reasons to be recorded by it in writing, is of the opinion that a lesser term of imprisonment would meet the ends of justice.

Employer can charge another person as the actual offender – Under section 10 of the Payment of Gratuity Act:

a. where an employer is charged with an offence punishable under this Act,

b. he shall be entitled, to have any other person charged as the actual offender and brought before the Court at the time appointed for hearing the charge; AND IF

c. the employer proves to the satisfaction of the Court that he has used due diligence to enforce the execution of this Act; and

d. that the said other person committed the offence in question without his knowledge, consent or connivance, then

e. that other person shall be convicted of the offence; and

f. shall be liable to the same degree of punishment as if he were the employer and

g. the employer shall be discharged from any liability under this Act in respect of such offence

According to the proviso to section 10, if the person charged as the actual offender by the employer cannot be brought before the Court at the time appointed for hearing the charge, the Court shall adjourn the hearing from time to time for a period not exceeding three months and if by the end of that period the person charged as the actual offender cannot still be brought before the Court, the Court shall proceed to hear the charge against the employer and shall, if the offence be proved, convict the employer.

Cognizance of offence – Under section 11 (1) the cognizance of any offence punishable under this Act, can be taken only on the complaint made by or under the authority of the 'Appropriate Government'.

Complaint can also be filed by the 'controlling authority' under the authority of the appropriate government, if the employer has not paid gratuity within six months from the expiry of the prescribed time.

Question 17

'N' is employed in ABC Limited, a seasonal establishment. The factory was in operation from 1st March to 30th June during the financial year 2014-15. Though, 'N' was not in continuous service during this period, he had worked for 95 days. Referring to the provisions of the Payment of Gratuity Act, 1972, decide whether 'N' is entitled to gratuity.

Answer

Payment of Gratuity to Seasonal Employee: Sub-section 3 of Section 2A of the Payment of Gratuity Act, 1972 provides that where an employee, employed in a seasonal establishment, is not in continuous service within the meaning of clause (1), for any period of one year or six months, he shall be deemed to be in continuous service under the employer for such period if he has actually worked for not less than seventy-five percent of the number of days on which the establishment was in operation during such period.

In the given problem, "N" has worked for 95 days in ABC Limited, and as per the above provision, "N" has worked for more than 75 % of number of days on which the establishment was in operation i.e. 75 % of 120 days (1st of March to 30th June) = 90 days. Therefore, "N" shall be entitled for gratuity.

Question 18

Mr. X was an employee of Green Sugars, Ltd. The whole of undertaking of Green Sugars Ltd. was taken-over by a new company named Modern Sugars Ltd. The services of Mr. X remained continuous in the new company. After serving for one year Mr. X met with an accident and became permanently disabled. Mr. X applied to the new company for the payment of gratuity. The new company refused to pay gratuity on the ground that Mr. X has served only for a year in the new company.

Examine the validity of the refusal of the company in the light of the provisions of the Payment of Gratuity Act, 1972.

Answer

Entitlement to Gratuity: According to Section 4 (1) of the Payment of Gratuity Act, 1972, gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years on his superannuation, or, on his retirement or resignation or on his death or disablement due to accident or disease.

The proviso to the said section states that the condition of the completion of five years of continuous service is not essential in case of the termination of the employment of any employee due to death or disablement for the purpose of this section.

Disablement has been explained as such disablement which incapacitates an employee for the work which he was capable of performing before the accident or disease resulting in such disablement.

Further, by the change of ownership, the relationship of employer and employees subsists and the new employer cannot escape from the liability of payment of gratuity to the employees; it was held in the case of Pattathurila K. Damodaran Vs M. Kassim Kanju (1993) I LLJ 1211 (Ker).

The given problem fulfils all the above requirements as stated. Therefore, Mr. X is entitled to recover gratuity after becoming permanently disabled and continuous service of five years is not required in this case. Hence, the company cannot refuse to pay gratuity on the ground that he has served only for a year.

Exercise

1. *Mark the correct answer*

   For calculation of gratuity under the Payment of Gratuity Act, 1972 the number of days in a month is to be taken as

   (a) Actual number of days on employment

   (b) 26 days

   (c) 15 days

   (d) 30 days

   [**Hint:** Option (b) is the correct answer as per Section 4(2) of the Payment of Gratuity Act, 1972]

2. *Mr. X was the owner of a factory to which the Payment of Gratuity Act, 1972 was applicable. Mr. X had appointed Ms. D as the Labour Officer for the Factory and given his specific instructions for deducting the employees' contribution as provided by the law. But Ms. D had manipulated the records and cheated the employees by making excessive deductions and pocketing the excess. The Inspector identified the irregularities and sent notice to Mr. X. Does he have a defense?*

   [**Hint:** Yes, as per Section 7(B) of the Payment of Gratuity Act,1972]

3. *Forfeiture of Gratuity is possible under certain circumstances.*

   (a) True.

   (b) False.

   [**Hint**: True as per Section 4(6) of the Payment of Gratuity Act, 1972]

4. *The ceiling on the Gratuity amount is rupees----------*

   [**Hint:** 10 Lakhs as per the amendment in Section 4(3) under the Payment of Gratuity (Amendment) Act, 2010]

5. *Gratuity can be attached in execution of any degree or order of any civil, revenue or criminal court*

   (a) True.

   (b) False.

   [**Hint:** False, as per Section 13 of the Payment of Gratuity Act, 1972]

6 The Companies Act, 2013

UNIT 1: PRELIMINARY

Question 1

What is a company?

Answer

Section 2 (20) of the Companies Act, 2013 defines a 'company' as a company incorporated under this Act or under any previous company law.

The most striking feature of the company form of organisation is that it comes into existence by a legal process called "incorporation", whereby it acquires the unique characteristic of being a separate legal entity. In other words when a company is registered, it is clothed with a legal personality with the following features:

a. Perpetual succession: A company is distinct and separate from its members who may die or change without affecting its continued existence until it is wound up on the grounds and in the manner as specified by the Act.

b. Separate Entity: A company can own property, have banking account, raise loans, incur liabilities and enter into contracts. Even members can contract with company, acquire right against it or incur liability to it.

c. Limited Liability: For the debts of the company, its creditors can sue it and not its members whose liability is limited to the unpaid amount on shares held by them or the guarantees provided by them to contribute on the winding up of the company, depending on the type of company.

d. As the company is an artificial person, it can act only through some human agency, viz., members and directors. The directors are responsible for the management and the administration of the affairs of the company on all matters except those which can be authorized by the members at general meetings in accordance with the various provisions of the Companies Act 2013. However, they are not the agents of the members of the company.

e. [1]Common Seal: Every company has a common seal which is affixed on documents and contracts in order to authenticate its formal acts.

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[1]*(The Ministry of Corporate Affairs through the Companies (Amendment) Act, 2015 has made the provisions related to common seal as optional w.e.f. 29th May, 2015.)

Question 2

Who shall be considered as promoter according to the definition given in the Companies Act, 2013? Explain.

Answer

Promoter- According to section 2 (69) of the Companies Act, 2013, Promoter means a person –

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

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

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

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

Question 3

'A company is a person separate from its members'. Explain.

Examine the circumstances under which the Courts may disregard the Company's Corporate Personality.

Or

What do you understand by "separate legal entity of the company?" State the circumstances where under the separate legal entity of the company can be ignored and liability can be imposed on the persons regulating the affairs of the company?

Or

Under what circumstances the law disregards the principle that a company is a separate legal entity distinct from its members?

Or

Briefly state the circumstances to lift the status of corporate legal entity of company under the Companies Act, 2013?

Or

Explain clearly the meaning of Lifting the Corporate Veil, as applicable in case of companies incorporated under the Companies Act, 2013. Under what circumstances the veil of a company can be lifted by the court?

Answer

A company in the eyes of law is regarded as an entity separate and distinct from its members. Any of its members can enter into contracts with the company in the same manner as with any

other individual. Further, a shareholder or member of a company cannot be held liable for the acts of the company even if he holds virtually the entire share capital. The company's money and property belong to the company, and not to the shareholders. *(Salomon v. Salomon & Co. Ltd.)*.

This principle of differentiating the legal entity of the company from that of its shareholders may be referred to as 'the veil of incorporation'. The Courts in general consider themselves bound by this principle. The effect of this principle is that the members or shareholders of a company cannot be held liable in respect of any liability accruing on the company. A company is expected by law to meet its liabilities and obligations from its own resources and its members cannot be called upon to discharge the same.

However, under certain exceptional circumstances the courts may disregard or pierce the corporate veil of a company and hold persons controlling the affairs of the company liable for the acts of the company. Where the legal entity of a corporate body is misused for fraudulent and dishonest purposes, the individuals concerned will not be allowed to take shelter behind the corporate entity of the company.

The human ingenuity, however, started using this veil of corporate personality blatantly as a cloak for fraud or improper conduct. Thus, it became necessary for the Courts to break through or lift the corporate veil or crack the shell of corporate personality or disregard the corporate personality of the company. Thus while by fiction of law a corporation is a distinct entity, yet, in reality it is an association of persons who are in fact the beneficial owners of all the corporate property *(Gallaghar v. Germania Brewing Co.)*.

The circumstances or the cases in which the Courts have disregarded the corporate personality of the company are:

1. *Protection of revenue:* (To prevent evasion of taxation) The Courts may ignore the corporate entity of a company where it is used for tax evasion. *(Juggilal v. Commissioner of Income Tax, B.F. Guzdar v. Commissioner of Income Tax Bombay)*.
2. *Prevention of fraud or improper conduct:* The legal personality of a company may also be disregarded in the interest of justice where the machinery of incorporation has been used for some fraudulent purpose like defrauding creditors or defeating or circumventing law. Professor Gower has rightly observed in this regard that the veil of a corporate body will be lifted where the 'corporate personality is being blatantly used as a cloak for fraud or improper conduct'. Thus where a company was incorporated as a device to conceal the identity of the perpetrator of the fraud, the Court disregarded the corporate personality *(Jones v. Lipman) (Gilford Motor Co. v. Home)*.
3. *Determination of character of a company whether it is enemy:*A company may assume an enemy character when persons in *de facto* control of its affairs are residents in an enemy country. In such a case, the Court may examine the character of persons in real control of the company and declare the company to be an enemy company. (*Daimler Co. Ltd. v. Continental Tyre& Rubber Co. Ltd)*.

4. *Where the company is a sham:* The Courts also lift the veil or disregard the corporate personality of a company where a company is a mere cloak or sham (hoax). *(Gilford Motor Co. Ltd. v. Home).*
5. *Company avoiding legal obligation:* Where the use of an incorporated company is being made to avoid legal obligations, the Court may disregard the legal personality of the company and proceed on the assumption as if no company existed.
6. *Company acting as agent or trustee of the shareholders:* Where a company is acting as agent for its shareholders, the shareholders will be liable for the acts of the company *(F.G. Films Ltd., In re.)*
7. *Avoidance of welfare legislation*: Where the courts find that there is avoidance of welfare legislation, it will be free to lift the corporate veil. (*Workmen of Associated Rubber Industry Ltd. v. Associated Rubber Industry Ltd.*).
8. *Protecting public policy:* The Courts invariably lift the corporate veil or a disregard the corporate personality of a company to protect the public policy and prevent transactions contrary to public policy. *(Connors v. Connors Ltd.).*
9. *In quasi-criminal cases:* The courts pierce the corporate veil in quasi-criminal cases in order to look behind the legal person and punish the real persons who have violated the law.

Question 4

Some of the creditors of Get Rich Quick Ltd. have complained that the company was formed by the promoters only to defraud the creditors and circumvent the compliance of legal provisions of the Companies Act, 2013. In this context they seek your advice as to the meaning of corporate veil and when the promoters can be made personally liable for the debts of the company.

Answer

Corporate Veil: After incorporation, the company in the eyes of law becomes a different person from the shareholders who have formed the company. The company has its own existence and as a result the shareholders cannot be held liable for the acts of the company even though they hold the entire share capital of the company. This recognition of the company as a separate legal entity and being liable for its own acts and liabilities is known as the "Corporate Veil". However, under certain exceptional circumstances the courts lift or pierce the corporate veil by ignoring the separate entity of the company and the promoters and other persons who have managed and controlled the affairs of the company. Thus, when the corporate veil is lifted by the courts, the promoters and persons exercising control over the affairs of the company are held personally liable for the acts and debts of the company. In the following circumstances, corporate veil can be lifted by the courts and promoters can be held personally liable for the debts of the company.

(i) Trading with enemy country.

(ii) Evasion of taxes.

(iii) Forming a subsidiary company to act as its agent.

(iv) The benefit of limited liability is destroyed by reducing the number of members below 7 in the case of public company and 2 in the case of private company for more than six months.

(v) Under law relating to exchange control.

(vi) Device of incorporation is adopted to defraud creditors or to avoid legal obligations.

Question 5

ABC Pvt. Ltd., is a Private Company having five members only. All the members of the company were going by car to Mumbai in relation to some business. An accident took place and all of them died. Answer with reasons, under the Companies Act, 2013 whether existence of the company has also come to the end?

Answer

Death of all members of a Private Limited Company, Under the Companies Act, 2013: The most distinguishing feature of a company is its being a separate entity from the shareholders and promoters who form it. This lends stability and perpetuity to the company form of business organization. In short, a company is brought into existence by a process of law and can be terminated or wound up or brought to an end only by a process of law. Its life is not impacted by the death, insolvency or retirement of any or all shareholder(s) or director(s).

The provision for transferability or transmission of the shares helps to preserve the perpetual existence of a company by allowing the constitution and identity of shareholders to change.

In the present case, ABC Pvt. Ltd. does not cease to exist even by the death of all its shareholders. The legal process will be for the successors of the deceased shareholders to get the shares registered in their names by way of the process which is called "transmission of shares". The company will cease to exist only when it is wound up by a due process of law.

Therefore, even with the death of all members (i.e. 5), ABC (Pvt.) Ltd. does not cease to exist.

Question 6

F, an assessee, was a wealthy man earning huge income by way of dividend and interest. He formed three Private Companies and agreed with each to hold a bloc of investment as an agent for them. The dividend and interest income received by the companies was handed back to F as a pretended loan. This way, F divided his income into three parts in a bid to reduce his tax liability.

Decide, for what purpose the three companies were established? Whether the legal personality of all the three companies may be disregarded.

Answer

The House of Lords in *Salomon Vs Salomon & Co. Ltd.* laid down that a company is a person distinct and separate from its members, and therefore, has an independent separate legal existence from its members who have constituted the company. But under certain circumstances the separate entity of the company may be ignored by the courts. When that happens, the courts ignore the corporate entity of the company and look behind the corporate façade and hold the persons in control of the management of its affairs liable for the acts of the company. Where a company is incorporated and formed by certain persons only for the purpose of evading taxes, the courts have discretion to disregard the corporate entity and tax the income in the hands of the appropriate assessee.

(1) The problem asked in the question is based upon the aforesaid facts. The three companies were formed by the assessee purely and simply as a means of avoiding tax and the companies were nothing more than the façade of the assessee himself. Therefore, the whole idea of Mr. F was simply to split his income into three parts with a view to evade tax. No other business was done by the company.

(2) The legal personality of the three private companies may be disregarded because the companies were formed only to avoid tax liability. It carried on no other business, but was created simply as a legal entity to ostensibly receive the dividend and interest and to hand them over to the assessee as pretended loans. The same was upheld in *Re Sir DinshawManeckji Petit* AIR 1927 Bom.371 and *Juggilal vs. Commissioner of Income Tax* AIR (1969) SC (932).

Question 7

Explain clearly the concept of "perpetual-succession" in relation to a company incorporated under the Companies Act, 2013.

Answer

Perpetual Succession: Perpetual succession means the continued existence of any entity until the time that it is wound up by following a due process of law. A company is an artificial legal person with a perpetual existence. It never dies nor does its existence depend upon the life of its members. It is not in any manner affected by insolvency, mental disorder or retirement of any or all of its members. It is created by a process of law and can be put to an end only by the process of law. Members may come and go but the company will go on forever (until dissolved). It continues to exist even if all its members are dead.

Question 8

State whether the following statement is correct or incorrect:

A company is a legal person but not a citizen.

Answer

Correct

Question 9

What is meant by a Guarantee Company? State the similarities and dissimilarities between a Guarantee Company and a Company having Share Capital.

Answer

Meaning of Guarantee Company*:* Where it is proposed to register a company with limited liability, the choice before its promoters is either to limit their liability by the value of shares purchased by them or by limiting their liability by the amount of guarantees given by them. Section 2 (21) of the Companies Act, 2013 defines a Company Limited by Guarantee as a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.

Thus, the liability of the members of a guarantee company is limited to a stipulated amount in terms of individual guarantees given by members and mentioned in the memorandum. The members cannot be called upon to contribute more than such stipulated amount for which each member has given a guarantee in the memorandum of association. The articles of association of such company shall state the number of members with which the company isto be registered.

Similarities and dis-similarities between the Guarantee Company and the Company having share capital: The common features between a "guarantee company" and the "company having share capital" are legal entity and limited liability. In case of a company limited by shares, the liability of its members is limited to the amount remaining unpaid on the shares held by them. Both these type of companies have to state this fact in their memorandum that the members' liability is limited.

However, the dissimilarities between a 'guarantee company' and 'company limited by shares' is that in the former case the members will be called upon to discharge their liability only after commencement of the winding up of the company and only to the extent of amounts guaranteed by them respectively; whereas in the case of a company limited by shares, the members may be called upon to discharge their liability at any time, either during the life of the company or during the course of its winding up and the amount payable by the members will be limited to the unpaid amount on shares held by them respectively.

Further to note, the Supreme Court in *Narendra Kumar Agarwal vs. SarojMaloo (1995) 6* SC C 114 has laid down that the right of a guarantee company to refuse to accept the transfer by a member of his interest in the company is on a different footing than that of a company limited by shares. The membership of a guarantee company may carry privileges much different from those of ordinary shareholders in companies limited by shares.

It is also clear from the definition of the guarantee company that it does not raise its initial working funds from its members. Therefore, such a company may be useful only where no working funds are needed or where these funds can be had from other sources like endowment, fees, charges, donations etc.

Question 10

Can a non-profit organization be registered as a company under the Companies Act? If so, what procedure does it have to adopt?

Answer

Registration of a non-profit organisation as a company: According to section 8 (1) of the Companies Act 2013, the Registrar of Companies may allow person or an association of persons to be registered as a Company under the Companies Act if it has been set up for promoting commerce, arts, science, sports, education, research, social welfare religion, charity, protection of environment or any such other useful object and intends to apply its profits or other income in promotion of its objects. However, such company has to prohibit payment of any dividend to its members.

Procedure: An association of persons intending to carry any or all or some of the activities mentioned in section 8 (1) as mentioned above, has to apply to the Registrar of Companies seeking its permission for being set up as a company under the Act. The central government if satisfied on the above may by the issue of a licence in such manner as may be prescribed and on such conditions as it may deem fit, allow such association to be registered as a limited company under section 8 (1) without the addition of word "Limited" or words "Private Limited" as the case may be, to its name.

After the issue of the licence by the Central Government, an application must be made to the Registrar in the prescribe form after which the Registrar will register the association of persons as a company under section 8(1). Under section 8 (2) a company registered under section 8 (1) as above, shall enjoy all the privileges and be subject to all the obligations of a limited company.

This licence issued by the Central Government is revocable, and on revocation the Registrar shall put the words 'Limited' or 'Private Limited' against the company's name in the Register. But before such revocation, the Central Government must give the company a written notice of its intention to revoke the licence and provide an opportunity to it to be represented and heard in the matter.

Question 11

Mr. V, alongwith six other persons desires to float a company for charitable purposes, as permissible under Section 8 of the Companies Act, 2013. He seeks your advise about the procedure to be followed to give effect to the above proposal. Advise him.

Answer

Company for charitable purposes (Section 8 of the Companies Act, 2013): According to Section 8 of the Companies Act, 2013 the procedure to be followed to give effect to the said proposal is as follows:

1. Mr. V, and the six other persons with him should first prepare and sign the MOA and AOA (which may either be drafted in its own format or may be in the formats available in the Companies Act.)
2. The company may either be limited by shares or by guarantee and the choice made must be mentioned in the Memorandum of Association (MOA).
3. The object of the proposed company must be for promoting commerce, arts, science, sports, education, research, social welfare religion, charity, protection of environment or any such other useful object.
4. The Articles of Association (AOA) will include a clause prohibiting the distribution of dividend.
5. All the profits of the company should be applied on the promotion of its objects as mentioned above and incorporated in the MOA and the AOA.
6. The association of persons (Mr. V and his friends) should apply to the Registrar of Companies seeking a license for the formation of the proposed company.
7. The Central Government will on being satisfied of the facts of the case, issue a license to the Association of Persons(AOP) and may impose any conditions which it deems fit.
8. On receipt of the license from the Central Government, the Association of Persons (AOP) shall apply to the Registrar in the prescribed form with the required documents for registration of the company.
9. The registration process of the company with the Registrar of companies will start with the approval of the name of the proposed company for which three options will be submitted to the Registrar in the prescribed format with the prescribe fee.
10. The Registrar will provide the names available and one will be finally chosen by the promoters for use.
11. After getting the name from the ROC, the draft MOA and AOA must be got approved by Regional Director who has been delegated the powers by the Central Government.
12. Three copies of a approved MOA and AOA along with the registration and filing fee, documents like form 1, 18, 32 and consent etc. must be submitted.
13. A power of attorney in favour of Practicing CA/CS/CMA oran advocate for presentation before ROC to make corrections and collect incorporation certificate must also be filed on non judicial stamp paper.
14. The company becomes operative on receipt of the certificateof incorporation.

Question 12

State whether the following statement is correct or incorrect:

'A private limited company must have a minimum of two directors, while a public limited company must have at least three directors.'

Answer

Correct

Question 13

Under what circumstances a company becomes subsidiary of another company under the provisions of the Companies Act, 2013?

Answer

Holding and Subsidiary Companies are relative terms. A company is a holding company of another only if the other is its subsidiary. Section 2 (87) of the Companies Act 2013 lays down the circumstances under which a company becomes a subsidiary company of another company which becomes its holding company. These circumstances are as under:

(a) When the holding company controls the composition of Board of Directors of the subsidiary company or companies, or

(b) When the holding company exercises or controls more than one half of the total share capital either on its own or together with one or more of its subsidiary companies, or

(c) Where a company is the holding company of the company which fulfils any of the above conditions, e.g., if A Ltd. is the holding company of B Ltd., but C Ltd. is the holding company of A Ltd., then B Ltd. will automatically become a subsidiary of C Ltd.

Question 14

With reference to the provisions of the Companies Act, 2013 explain the circumstances under which a subsidiary company can become a member of its holding company. Examine the position of the following with regard to membership in a company:

(i) An Insolvent

(ii) Partnership Firm.

Answer

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

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

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

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

Position of the following with regard to membership in a company:

(i) Partnership Firm: Section 2 (55) of the Companies Act 2013 defines a member as a subscriber to the memorandum of association whose name is entered in the Register of Members following the incorporation of the company, every other person who agrees in writing to become a member of the company and whose name is entered in the register of members of the company and any person holding shares in a company and whose name is entered as the beneficial owner in the records of the depository.

A partnership firm may therefore hold shares in a company provided its name appears in the register of members of the company. However, as a firm is not a legal entity it will be able to hold shares in the individual names of partners as joint shareholders. However, this will not apply to a "Limited Liability Partnership". *(Ganesh Das Ram Gopal v. R.G. Cotton Mills Ltd.)*

Under section 8 (3) of the Companies Act 2013, a firm may be a member of a company incorporated under section 8 i.e. a company formed as a charitable or social venture.

(ii) An Insolvent: An insolvent may be a member of a company. So long as his name appears in the register of members, he is a member and is entitled to vote even though his shares vest in the Official Assignee or Receiver. *(Morgan v. Gray)* allotment or transfer of shares is by way of security for the purpose of a transaction.

Question 15

The paid-up Share Capital of AVS Private Limited is ₹1 crore, consisting of 8 lacs Equity Shares of ₹10 each, fully paid-up and 2 lacs Cumulative Preference Shares of ₹10 each, fully paid-up. XYZ Private Limited and BCL Private Limited are holding 3 lacs Equity Shares and 1,50,000 Equity Shares respectively in AVS Private Limited.

XYZ Private Limited and BCL Private Limited are the subsidiaries of TSR Private Limited.

With reference to the provisions of the Companies Act, 2013, examine whether AVS Private Limited is a subsidiary of TSR Private Limited?

Answer

Holding, subsidiary relationship: In terms of section 2 (87) of the Companies Act 2013, a company will be the subsidiary of a company which holds a majority of shares in it through its subsidiary company or companies. In this case XYZ Pvt Ltd. and BCL Pvt Ltd. together hold a majority of equity shares in AVS Pvt Ltd. and both these companies are subsidiaries of TSR Pvt Ltd it will have a majority stake in the composition of the Board of Directors of AVS Pvt Ltd. Hence, TSR Pvt, Ltd will be treated as the holding company of AVS Pvt Ltd.

Question 16

Which of the institutions are regarded as "Public Financial Institutions" under the Companies Act, 2013?

Answer

Public Financial Institutions: By virtue of Section 2 (72) of the Companies Act, 2013 the following institutions are defined as public financial institutions:

(i) The Life Insurance Corporation of India established under the Life Insurance Act 1956;

(ii) The Infrastructure Development Finance Co Ltd;

(iii) Specified company referred to in Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002;

(iv) Institutions notified by the Central Government in consultation with the Reserve Bank of India;

(v) institutions notified by the Central Government under section 4A(2) of the Companies Act, 1956 so repealed under section 465 of this Act.

Section 2 (72) further provides that no institution shall be notified by the Central Government as above unless:

a. It is established or constituted byor under any Central or State Government Act; or

b. Not less than fifty one percent of the paid up share capital is held or controlled by the Central Government or any State Government or partly by the Central Government and partly by one or more State Governments.

[**Note** :- The Ministry of Corporate Affairs (MCA) vide General Circular No. 34/2011 dated 2nd June, 2011 has framed the following criteria for declaring any Financial Institution as PFI:

(a) A Company or Corporation should be established under a Special Act or the Companies Act being Central Act

(b) Main business of the Company should be Industrial / Infrastructural Financing

(c) The company must be in existence for at least 3 years and their financial statement should show that their income from Industrial / Infrastructural financing exceeds 50% of their income

(d) The net worth of the company should be ₹ One thousand crore

(e) The company is registered as Infrastructure Finance Company (IFC) with RBI or as an Housing Finance Company (HFC) with National Housing Bank

(f) In the case of CPSUs/SPSUs, no restriction shall apply with respect to financing specific sector(s) and net worth

Any financial institution applying for declaration as PFI shall fulfill the aforesaid criteria.]

Question 17

Define a Private Company. Explain the procedure for conversion of a Public Company into a Private Company.

Answer

Definition of a Private Company: According to Section 2 (68) of the Companies Act, 2013 a 'private company' means a company which has a minimum paid-up capital[2] as may be prescribed and which by its Articles:

(a) restricts the right to transfer its shares if any.

(b) limits the number of its members to 200 not including its employee members (present or past) [Joint holders of shares are treated as a single member].

(c) prohibits any invitation to the public to subscribe for any securities of the company.

Procedure for conversion of a Public Company into a Private Company:

Section 14 (1) states that subject to the provisions of the Companies Act 2013 and the conditions contained in the Memorandum, a company may, by special resolution, alter its Articles including alterations which may have the effect of converting a public company into a private company (or vice versa).

Further any alteration which has the effect of converting a public company into a private company will not have any effect except with the approval of the Tribunal which may pass such order as it deems fit.

Hence, the broad procedure for conversion of a public company into a private company would comprise of the following steps:

1. Check that the Memorandum of Association does not contain any restrictive clause. If yes, alteration of the Memorandum will be necessary through a special resolution;
2. Alteration of the Articles to incorporate the restrictions required u/s 2 (68) by a special resolution
3. Application to the Tribunal for approval of the change
4. After the approval of the Tribunal, every alteration of the articles and a copy of the order of the Tribunal approving the alteration shall be filed with the Registrar, within a period of fifteen days, who shall register the same.
5. Any alteration of the articles registered as above shall be valid as if it were originally in the articles.

Question 18

Sparkle Infotech Ltd. was registered as a Public Company. There are 76 members in the Company as stated below:

(i) Directors and their relatives *36*

[2] Words "of one lakh rupees or such higher paid up share capital" omitted by the Companies (Amendment) Act, 2015 w.e.f. 29/5/2015.

(ii)	*Employees*	*12*
(iii)	*Ex-employes (shares were allotted when they were employees)*	*8*
(iv)	*7 couples holding shares jointly in the names of husband and wife (7X2)*	*14*
(v)	*Others*	*6*
Total number of members		*76*

The Board of Directors of the Company proposes to convert it into a Private Company. Advise the Board of Directors about the steps to be taken for conversion into a Private Company including reduction in the number of members, if necessary, as per the Companies Act, 2013.

Answer

A private company as per Section 2(68) cannot have more than 200 members, hence the current shareholding will not be an issue.

The procedure for converting a public company will require:

(i) Passing of a Special Resolution authorizing the conversion and altering the articles so as to include therein the restrictions specified in Section 2(68)

(ii) Changing the name clause of the Memorandum of the company by omitting the word "Private".

(iii) Obtaining the approval of the Tribunal as required by Section 14(1).

(iv) Filing of the documents along with a printed copy of the articles as altered with the Registrar within 15 days. [Section 14 (2)]

(Note: Section 14(2) is not yet notified.)

Question 19

Define Private Company. Briefly explain the privileges and exemptions for a private company as provided under the Companies Act, 2013.

Answer

A private company means a company which has a minimum paid-up capital as may be prescribed, and by its articles –

(a) restricts the right to transfer its shares, if any;

(b) limits the number of its members to 200;

(c) prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company;

(d) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

It enjoys some privileges and exemptions, which a public company is deprived of. These are as follows:

1. Two or more persons may form a private company [Section 3(1)(b)].
2. A private company is not required to have independent directors [Section 149 (4)].
3. A private company is exempt from the provisions of having an audit committee constituted by the Board of Directors [Section 177(1)]
4. The directorship of a private company which is either a holding or a subsidiary company of a public company will not be included in determining the maximum number of directorships that a person may hold in public companies which is restricted to ten[Section 165 (1)].
5. A private company is exempt from the constitution of a Nomination & Remuneration Committee [section 178(1)], as well as Stakeholders Relationship Committee [section 178 (5)].

It should be noted that as the number of members of a private company has been raised from 50 to 200, some exemptions have been withdrawn due to higher number of members.

Question 20

Explain in brief the mode of incorporation of a company.

Answer

[3]**Mode of registration/incorporation of company:** In terms of section 3(1)(a) a public company may be formed for any lawful purpose with 7 or more persons by subscribing their names to a memorandum and complying with the requirements of the Companies Act for the registration of companies.

In exactly the same way, under section 3 (1)(b), 2 or more persons can form a private company.

Under section 3 (1)(c) a one person company may be formed by one person in which case the company will be a private company.

Persons who conceive the idea of forming the company and form the same under the provisions of the Act are known as promoters. They take all necessary steps for its registration.

(a) **Lawful purpose:** The essence of validly incorporated company is that it must consist of a particular number of persons and must be set up for a lawful purpose. Unless the

[3]Vide Notification G.S.R. 349(E), dated 1st May 2015, the Central Government through the enforcement of **the Companies (Incorporation) Amendment Rules, 2015**, inserted Rule 36 to the Companies (Incorporation) Rules, 2014 in exercise of the power conferred by sections 3, 4, 5 and 7, read with section 469 sub-section (1) & (2) of the Companies Act, 2013. For the purpose of simplifying the filing of forms for incorporation of a company, the integrated process shall apply with effect from 1st May, 2015. For details, refer the Supplementary Study Paper.

purpose appears to be unlawful *ex facie* or is transparently illegal or prohibited by way of statute, it cannot be regarded as an unlawful purpose.

(b) **Applying for the name:** The promoters of the company should decide upon at least three suitable names in order of preference in order to afford flexibility to the Registrar in deciding on the availability of the best possible available name.

(c) **Documents to be filed:** After getting the name approved, certain documents along with the application and prescribed fees, should be filed with the Registrar.

(d) **Subscribing their names:** Subscribing the names means signing the names in the Memorandum signifying their intention to jointly form a company and take up the number of shares mentioned against each.

(e) **Certificate of incorporation:** Upon the registration of the documents mentioned earlier under the head "Documents to be filed for registration of the company" and the payment of the necessary fees, the Registrar of Companies issues a certificate that the company is incorporated, and in the case of a limited company that it is limited.

Question 21

[4]Which documents are required to be filed with the Registrar of Companies at the time of registration of a company under the provisions of the Companies Act, 2013?

Answer

Filing of document with the Registrar of Companies:

After getting the name approved, the following documents along with the application and prescribed fee, are to be filed with the Registrar:-

(1) Memorandum of Association

(2) Articles of Association

(3) The agreement, if any, which the company proposed to enter into with any individual for appointment as its Managing or Whole Time Director or Manager.

(4) A declaration that the requirements of the Act and the rules framed there under have been complied with. This declaration is required to be signed by an advocate of the Supreme Court or High Court or an attorney or a pleader having the right to appear before High Court or a Company Secretary or a Chartered Accountant in whole time

[4]Vide Notification G.S.R. 349(E), dated 1st May 2015, the Central Government through the enforcement of **the Companies (Incorporation) Amendment Rules, 2015**, inserted Rule 36 to the Companies (Incorporation) Rules, 2014 in exercise of the power conferred by sections 3, 4, 5 and 7, read with section 469 sub-section (1) & (2) of the Companies Act, 2013. For the purpose of simplifying the filing of forms for incorporation of a company, the integrated process shall apply with effect from 1st May, 2015. For details, refer the Supplementary Study Paper.

practice in India who is engaged in the formation of a company, or by person named in the Articles as a Director, Manager or Secretary of the company.

(5) In the case of a public company having share capital, where the Articles name a person as director/directors, the list of the directors and their written consent in prescribed form to act as directors and take up qualification shares.

(6) A company shall, on and from the fifteenth day of incorporation and all times thereafter, have a registered office capable of receiving and acknowledging all communications and notices as may be addressed to it.

(7) Apart from the above, the company shall furnish to the Registrar a verification of its registered office under Section 12 (2) within 30 days of incorporation in such manner as prescribed.

Question 22

What is the meaning of "Certificate of Incorporation" under the provisions of the Companies Act, 2013?

Answer

Certificate of Incorporation: Under section 7 (2) the Registrar shall on the basis of documents and information filed for the formation of a company, shall register the aforesaid documents and information and issue a certificate that the company is incorporated in the prescribed form to the effect that the proposed company is incorporated under this Act.

Section 7 (3) further provides that on and from the date of incorporation mentioned in the certificate of incorporation the Registrar shall allot to the company a Corporate Identification Number(CIN) which shall be the distinct identity of the company and which shall also be included in the certificate of incorporation. The company becomes a legal entity from the date mentioned in the certificate of incorporation and continues to be so till it is wound up.

Question 23

What are the effects of registration of a company?

Answer

Section 9 of the Companies Act, 2013 provides that, from the date of incorporation mentioned in the certificate of incorporation, such of the subscribers to the Memorandum and all other persons, as may from time to time become members of the company, shall be a body corporate by the name contained in the memorandum, capable forthwith of exercising all the functions of an incorporated company under this Act and having perpetual succession with power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued by the said name.

Accordingly, when a company is registered and a certificate of incorporation is issued by the Registrar, three important consequences follow:

(i) The company becomes a **distinct legal entity**. Its life commences from the date mentioned in the certificate of incorporation capable of entering into contracts in its own name, acquiring, holding and disposing of property of any nature whatsoever and capable of suing and being sued in its own name.

(ii) It acquires a life of **perpetual existence** by the doctrine of succession. The members may come and go, but it goes on forever, unless it is wound up.

(iii) Its **property is not the property of the shareholders**. The shareholders have a right to share in the profits of the company as and when declared either as divided or as bonus shares. Likewise any liability of the company is not the liability of the individual shareholders.

Question 24

Though six out of seven signatures to the Memorandum of Association of a company were forged, the company was registered and the Certificate of Incorporation was issued. Can the registration of the company be challenged subsequently on the ground of forged signatures?

Or

The Memorandum of Association of a company was signed by two adult members and by a guardian of the other five minor members, the guardian signing separately for each minor member. The Registrar registered the company and issued under his hand a Certificate of Incorporation. The plaintiff contended that (a) conditions of registration were not duly complied with, and (b) that there were no seven subscribers to the Memorandum. Will the Court uphold his contention?

Answer

Yes, (being a fundamental right under the Constitution of India to go for legal proceedings) the registration of the company can be challenged but it will not in any way affect or cancel the registration of the company and the Memorandum and Articles.

Section 10 (1) of the Companies Act, 2013 states that subject to the provisions of the Act, the Memorandum and Articles shall, when registered, bind the company and the members thereof, to the same extent as if they respectively had been signed by the company and by each member, and contained covenants on its and his part to observe all the provisions of the Memorandum and of the Articles.

Question 25

The Articles of a Public Company clearly stated that Mr. A will be the solicitor of the company. The company in its general meeting of the shareholders resolved unanimously to appoint B in place of A as the solicitor of the company by altering the articles of association. Examine, whether the company can do so? State the reasons clearly.

Answer

According to Section 10(1) of the Companies Act,2013, the memorandum and articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member and contained covenants on its and his part to observe all the provisions of the memorandum and articles.

Further, under Section 14 (1) subject to the provisions of this Act and to the conditions contained in the Memorandum, a company may, by a special resolution, alter its Articles.

Moreover, under section [5]14 (2) the company will be required to file within fifteen days the altered Articles with the Registrar along with necessary documents, such as the copy of the special resolution etc, and in such manner as may be prescribed. On receipt of all documents the Registrar shall register the same.

Section 14 (3) further provides that any alterations in the Articles on registered will be valid as if they were in the original Articles.

In the present case, the company has altered the Articles by a unanimous resolution of the members passed at a general meeting. Hence, the alteration is valid and after registration of the altered Articles, the appointment of B will stand and A will be terminated.

Question 26

Explain fully the doctrine of Ultravires and state its implications.

Or

Briefly explain the doctrine of "ultravires" under the Companies Act, 2013. What are the consequences of ultravires acts of the company?

Answer

The objects for which a company is formed are laid down in the Object Clause of the Memorandum of Association. These objects define the limits of activities of the company and as a legal entity a company cannot operate outside the ambit defined in its objects clause in the Memorandum. The objects clauses are classified into Main objectives and other objectives. A company therefore, is empowered to do only such acts which are:

(a) within the framework of the Memorandum *i.e.* stated in clear terms in the objects clause in the Memorandum of Association of the company, or

(b) reasonably and fairly incidental to the attainment of its main objects, or

(c) which are otherwise authorised by the Companies Act.

If the company does any act which is not covered under the above three categories, such acts shall be beyond the power of the company and shall be declared *ultravires* the Memorandum of the Company. The term *ultravires* means "*beyond the powers".*

[5] Section 14(2) of the Companies Act, 2013 is not yet enforced.

A company being an artificial legal person cannot operate outside the powers given to it in its objects clause and any contract which is ultra vires shall be *void ab initio*.

The decisions given in the following leading cases, have proved the point in question, that ultra vires acts of the company are void and inoperative wholly. The cases are:

(1) Ashbury Railway Carriage and Iron Co. Ltd. V. Riche (I875)

(2) Re German Date Coffee Co. (1882)

(3) Egyptian Salt Co. v. Port said Salt Association (1931)

Implications of ultra vires Acts:

The implications of ultra vires contracts are as under:

(1) Neither party can enforce the contract

(2) It is an established legal requirement that persons entering into contracts with the company must satisfy themselves that the terms of the same are within the powers of the company and not ultra vires.

(3) There is no claim on the part of any party to enforce an ultra vires contract nor can he claim any compensation.

(4) There is no personal liability on the part of the directors of the company unless they have represented an ultra vires contract fraudulently as a permissible one.

Question 27

X, a chemical manufacturing company distributed 20 lacs (₹ Twenty Lacs) to scientific institutions for furtherance of scientific education and research. Referring to the provisions of the Companies Act, 2013 decide whether the said distribution of money was "Ultra vires" the company?

Answer

Distribution of Rupees Twenty Lacs by a company engaged in Chemical manufacturing is not 'Ultravires' since it was conducive to the continued growth of the company as chemical manufacturers *(Evans vs Brunner, Mood & Co. Ltd.1921)*. In order for a contract to be ultra vires, it would be essential to refer to its objects clause. Restrictions of the type mentioned in the question are not an item of the Objectives Clause. Hence, the issue of ultra vires does not arise to such a donation.

Question 28

The Directors of a company registered and incorporated in the name "Mars Textile India Ltd." desire to change the name of the company entitled "National Textiles and Industries Ltd." Advise as to what procedure is required to be followed under the Companies Act, 2013?

Answer

Change in the name of company: In the first instance, Mars Textile India Ltd., should ascertain from the Registrar of Companies whether the proposed name viz. National Textiles and Industries Ltd. is available or not. For this purpose, the company should file the

prescribed Form No.INC.24 with the Registrar along with the necessary fees. The Registrar after examination will inform whether the new name is available or not for registration.

In case the name is available, the company has to pass a special resolution approving the change of name to National Textiles and Industries Ltd.

Thereafter the approval of the Central Government should be obtained as provided in Section 13(2)of the Companies Act, 2013. The power of Central Government in this regard has been delegated to the Registrar of Companies. Thus, the company has to file an application along with the prescribed filing fee for change of name. The change of name shall be complete and effective only on the issue of a fresh certificate of incorporation by the Registrar. The Registrar shall enter the new name in the Register in place of the former name13(3). The change of name shall not affect any rights or obligations of the company and it shall not render defective any legal proceedings by or against it.

Question 29

Explain the procedure for change of name of a company, as provided in the Companies Act, 2013.

Answer

Procedure for the Change of name under the Companies Act, 2013:

According to Section 13 (1) of the Companies Act, 2013, a company may, by special resolution, and after complying with the procedure specified in this section alter the provisions of its Memorandum.

The Name Clause in the Memorandum states the name of the company. It can be changed in the following manner:

a. Passing of the Special Resolution of members at a duly convened general meeting;

b. Hence, in order to convene the general meeting it will be preceded by a Board Meeting

c. The change in name must be in accordance with the provisions of Section 4 (2) and (3). These sub sections prohibit a company from registering with a name similar to an existing company's name or with names listed as undesirable by the Act.

d. After the approval of members the approval of the Central Government, must also be obtained.The power of Central Government in this regard has been delegated to the Registrar of Companies.

e. The approval of the Central Government shall not be necessary when the name change is merely to delete or add the word "Private" before the word "Limited" in the name consequent upon conversion of the company from a public to a private company or vice versa;

f. The documents are required to be filed with the Registrar, who will then register the new name in place of the old name of the company and issue a fresh certificate of incorporation in the new name;

g. The new name will be effective only on and from the date of issue of the new certificate of incorporation by the Registrar as above.

Question 30

Explain the steps to be taken by a company for transfer of its registered office from one State to another?

Answer

Procedure for shifting registered office from one state to another:

The Memorandum of a company includes a clause "Registered Office" which states the state in which the registered office of the company is situated.

Section 13 (1) of the Companies Act 2013, allows a company to change any of the clauses of its Memorandum by a special resolution of its members. In some cases the additional approval of the Central Government is necessary.

In order to the change its registered office from one State to another the Companies Act, 2013 lays down the following steps and procedure:

1. *Resolution of the Board of Directors:* The first step in changing registered office is that the board of directors must adopt a resolution to that effect and convene a general meeting of members in which the change is approved.
2. *Special resolution*: A special resolution must be passed by the company in the general body meeting of shareholders/members. [Section 13 (1)].
3. *Approval of the Central Government:* Under section 13 (4) the alteration of the Memorandum relating to the change of the registered office from one state to another shall not have any effect, unless it is approved by the Central Government on an application in such form and in such manner as may be prescribed. Here, the powers of Central Government are delegated to Regional Directors at Mumbai, Kolkata, Chennai, Noida, Ahmedabad, Hyderabad and Shillong. Hence, the company will have to make the required application after the name is approved by the members by special resolution;
4. *Disposal of application :*Under section 13 (5) the Central Government/Regional Director shall dispose of the application within 60 days and before passing its order, it may satisfy itself that the alteration has the consent of creditors, debenture holders and other persons concerned with the company, or that adequate provisions have been made by the company either for the due discharge of their liabilities or adequate security has been provided for such discharge.
5. *Registration with Registrar:* Under section 13 (7) the company shall file a certified copy of the Central Government order approving the alteration with the Registrar of each of the States within such time and in such manner as may be prescribed, who shall register the same. The Registrar of the State where the registered office is being shifted toshall issue a fresh certificate of incorporation indicating the alteration.

Question 31

M/s ABC Ltd. a company registered in the State of West Bengal desires to shift its registered office to the State of Maharashtra. Explain briefly the steps to be taken to achieve the purpose.

Would it make a difference, if the Registered Office is transferred from the Jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies within the same State?

Or

VD Company Ltd. is registered in Tamil Nadu within the jurisdiction of the Registrar of Companies, Chennai. The company proposes to shift its registered office to a place within the jurisdiction of Registrar of Companies, Coimbatore. State the steps to be taken by the company to give effect to the proposed shifting of its registered office.

Answer

Transfer of Registered Office of a Company: The change in the address of the registered address of a company requires an alteration to its Memorandum which is covered under section 13 of the Companies Act, 2013.

In order to shift the registered office from the State of West Bengal/Tamil Nadu to the State of Maharashtra/ Coimbatore, M/s ABC Ltd./ VD Company Ltd. has to take the following steps:

(i) To hold a Board Meeting for the purpose of calling a general meeting of the members of the company in which the shifting of the registered office from West Bengal/Tamil Nadu to Maharashtra / Coimbatore will have to be approved;

(ii) The general meeting of the members will have to pass a special resolution approving the change of address of the registered office from West Bengal/Tamil Nadu to Maharashtra/ Coimbatore as required by section 13 (1) of the Companies Act 2013.

(iii) Make an application to the Central Government/Regional Directors in such form and manner as may be prescribed, for getting its approval under section 13 (4) of the Companies Act 2013.

(iv) Under section 13 (7) of the Companies Act 2013, where an alteration of the Memorandum results in the transfer of the registered office of the company from one state to another, a certified copy of the order of the Central Government approving the alteration shall be filed by the company with the registrar of each of the states, within such time and in such manner as may be prescribed, and the registrars shall register the same. The registrar of the state where the registered office is being shifted to, shall issue a fresh certificate of incorporation indicating the alteration. In the present case, it will be the registrars of both West Bengal/Tamil Nadu to Maharashtra/ Coimbatore.

(v) The change in name will be effective only after the issue of the fresh certificate of incorporation by the Registrar of the state where the registered office is being shifted to, Maharashtra in this case.

Change of registered office from the jurisdiction of one Registrar to the other Registrar within the same State*:* A change of registered office from the jurisdiction of one registrar to another does not involve an alteration to the Memorandum of a company as the location clause in the Memorandum merely states the name of the state, which is not changed by such relocation. Hence, the provisions of section 13 which deals with the alteration of the Memorandum do not apply.

However, according to section 12 (5) of the Companies Act, 2013 except on the authority of a special resolution passed by a company, the registered office of the company shall not be changed from one city or town to another within the same state. In case of change of the registered office from the jurisdiction of one registrar to another such change must be confirmed by the Regional Director also, on an application made in this behalf by the company. He shall certify the registration within a period of thirty days from the date of filing of such confirmation. The certificate shall be conclusive evidence that all the requirements of this Act with respect to change of registered office have been complied with and the change shall take effect from the date of the certificate. [Section 12(6) &(7)].

Question 32

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

Answer

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

However, under section 12 (5) of the Act which deals with the registered office of company, the change in registered office from one town or city to another in the same state, must be approved by a special resolution of the company. Further, presuming that the Registrar will remain the same for the whole state of Maharashtra, there will be no need for the company to seek the confirmation to such change from the Regional Director.

Question 33

State with reason, whether the following statement is correct or incorrect, according to the Companies Act, 2013.

Change of Registered Office of Company from one place to another within a State requires confirmation by the Central Government.

Answer

Incorrect. A change in the location of its registered office by a company from one place to another within the same state does not result in the alteration of its Memorandum and hence the provisions and requirements under section 13 of the Companies Act, 2013 will not apply.

However, under section 12 (5) of the Act, the change in registered office from one town to another within the same state must be approved by a special resolution of the company.

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

Further, presuming that where the Registrar remains the same in the two towns, there it will be not required for the company to additionally seek the confirmation to such change from the Regional Director.

Question 34

The object clause of the Memorandum of Association of LSR Private Ltd, Lucknow authorized it to do trading in fruits and vegetables. The company, however, entered into a Partnership with Mr. J and traded in steel and incurred liabilities to Mr. J. The Company, subsequently, refused to admit the liability to J on the ground that the deal was 'Ultra Vires' the company. Examine the validity of the company's refusal to admit the liability to J. Give reasons in support of your answer.

Answer

In terms of section 4(1)(c) of the Companies Act, 2013, the powers of the company are limited to:

(i) Powers expressly given in the "Objects Clause" of the Memorandum (which is popularly known as 'express' power), or conferred by the Companies Act, or by any other statute and

(ii) powers reasonably incidental or necessary to the company's main objects (termed as "Implied' powers).

The Act further provides that the acts beyond the powers of a company are ultra vires and void and cannot be ratified even though every member of the company may give his consent *[Ashbury Railway Carriage Company Vs Richee]*

The objects clause enables the shareholders, creditors or others to know what its powers are and what is the range of its activities. The objects clause therefore is of fundamental importance to the shareholders, creditors and every other person who deals with the company in any manner what so ever. A company being an artificial legal person can act only within the ambit of the powers conferred upon it by the Memorandum through the "Objects Clause".

Every person who enters into a contractual relationship with a company on any matter is presumed to be aware of its objects and is supposed to have examined the Memorandum of Articles of the company to ensure proper contractual agreement. If a person fails to do so, it is entirely at his own peril.

It is also pertinent to note that the objects of a company may be changed by following the provisions for the change of Memorandum as laid out in section 13 of the said Act.

M/s LSR Pvt. Ltd is authorised to trade directly on fruits and vegetables. It has no power to enter into a partnership for Iron and steel with Mr. J. Such act cannot be treated as being within either the 'express' or 'implied' powers of the company. Mr J who entered into partnership is deemed to be aware of the lack of powers of M/s LSR (Pvt) Ltd. In the light of the above, Mr, J cannot enforce the agreement or liability against M/s LSR Pvt. Ltd under the Companies Act. Mr. J should be advised accordingly. This conclusion is supported by the decision reported in the case of the *'Ganga Mata Refinery Company (Pvt) Ltd CIT'*.

However, under the Indian Contract Act, 1872 where a person derives any benefit either in the absence of a contract or under a void agreement, will be liable to make a reasonable payment for the value of such benefit. (Please refer to Quasi Contracts and Void Agreements)

Question 35

The Memorandum of Association of a company was presented to the Registrar of Companies for registration and the Registrar issued the certificate of incorporation. After complying with all the legal formalities a company started a business according to the object clause, which was clearly an illegal business. The company contends that the nature of the business cannot be gone into as the certificate of incorporation is conclusive. Answer the question whether company's contention is correct or not.

Answer

Section 3 of the Companies Act, 2013 states that a company may be formed for any lawful purpose by 7 or more persons in case of public company, 2 or more persons in case of private company and 1 person in case of a one person company. Hence, a company cannot be formed for an unlawful purpose or for carrying on illegal business.

Section 9 of the Act further provides that from the date of incorporation mentioned in the certificate of incorporation, such subscribers to the memorandum and all other persons, as may from time to time, become members of the company, shall be a body corporate capable of exercising all the functions of an incorporated company under this Act. Under this Act a company can be formed for a lawful purpose. Hence, a company cannot be formed in the first place for an illegal business activity.

In the present case the Registrar was at fault in issuing the certificate of incorporation but the issue of the certificate of incorporation does not give the company the right to do illegal business.

On applying the above provisions in the present problem, the company's contention is wrong. Though a certificate of incorporation is a conclusive evidence of its formation and existence,, it does not render its illegal objectives as legal. In *Bowman v. Secular Society Ltd*., the court held that the statute does not provide that all or any of the objects specified in the memorandum, if otherwise illegal, would be rendered legal by the certificate. Therefore, the contention of the company that the nature of business cannot be gone into after the certificate of incorporation has been obtained is not tenable. Moreover, the illegality of its objects is adequate grounds for the Registrar to rectify his gross mistake and suo motto take necessary steps to cancel the certificate of incorporation.

Question 36

What are the purposes for which "objects" can be altered by a company under the Companies Act, 2013? Briefly explain the procedure to be applied to such matters.

Or

State the purposes for which the object clause of the Memorandum of Association of a public limited company, registered under the Companies Act, 2013, can be altered.

Or

Explain the provisions of law and procedure relating to alteration of object clause stated in the Memorandum of Association of a company under the Companies Act, 2013.

Or

The management of Ambitious Properties Ltd., has decided to take up the business of food processing activity because of the downward trend in real estate business. There is no provision in the object clauses of the Memorandum of Association to enable the company to carry on such business. State with reasons whether its object clause can be amended. State briefly the procedure to be adopted for change in the object clause.

Answer

Alteration of Objects

The Companies Act, 2013 has made alteration of the memorandum simpler and more flexible. Under section 13 (1) of the Act a company may, by a special resolution any after complying with the provisions of section 13, alter the provisions of its Memorandum. In the case of alteration to the objects clause, the sub section (6) of Section 13 requires the filing of the Special Resolution by the company with the Registrar. Section 13 (9) states that the Registrar shall register any alteration to the Memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution by the company. Section 13 (10) further stipulates that no alteration in the Memorandum shall take effect unless it has been registered with the Registrar as above.

Hence, the Companies Act now permits any alteration to the objects clause with ease.

Procedure

Companies are now under liberty to alter the object clause of the memorandum of association with just the approval of its members by a special resolution without obtaining further approval from Central Government or any other authority. The procedure may be elaborated as under:

a) Holding a Board Meeting for the purpose of convening the meeting of members for approving the alteration in objects clause by a special resolution;

b) Approving the alteration to the objects clause by passing a special resolution in general meeting of members.

c) Filing of the special resolution with the Registrar of Companies

d) Registration of the alteration to be done by the Registrar within one month from the date of filing of the special resolution along with a printed copy of the memorandum as altered

Question 37

A company was started with the object of building 'A mall with shops'. The building was destroyed by fire and the company wanted to alter the objects clause in the memorandum by substituting the words 'A mall with shops' with the words "Shops, Residential buildings and Warehouses for letting purposes.' Will this alteration of the memorandum for the purpose be permissible? Decide referring to the provisions of the Companies Act, 2013.

Answer

Alteration of objects: Under section 13 (1) of the Companies Act, 2013 the alteration to the Memorandum is permissible now without restriction and only with the approval of members through a special resolution duly registered with the Registrar. Hence, the proposed alteration is permissible.

Question 38

Explain the steps to be taken by a company for starting a business for which there is no provision in the objects clause of the Memorandum of Association.

Answer

Section 4 (1) (c) of the Companies Act 2013 clearly provides for the Memorandum to include the objects for which the company is formed. A company is therefore, formed to carryon activities only in line with its objects as defined in the Memorandum. Any act outside the objects clause is termed "ultra vires" and is considered void.

Hence, if a company wishes to start a business which is not provided for in its Memorandum, it must first alter its Memorandum to include that business in its objects clause. This is a simple process defined in section 13 of the Act. It can be done with the approval of the members by a special resolution and the registration of the same with the Registrar.

Question 39

RSP Limited, with a limited liability of its members by guarantee of ₹10 lac to each member. The company increases the liability of the members from ₹ 10 to 15 lac by an alteration made in the liability clause of the Memorandum of Association. Referring to the provisions of the Companies Act, 2013 decide, whether the members of the company are liable for the increased liability.

Answer

The limitation of liability is an essential clause in the Memorandum and on registration of the company becomes binding on all present and future members.

The present question states that the liability of the members has been increased by the company without clarifying the mode. The company can act only through its Board of Directors or through its members. The Board of Directors do not have the authority to alter the clause; hence it means that the alteration was approved by the members at a general meeting. However, section 13 of the Act which deals with the alteration of the Memorandum does not provide for the alteration of its liability clause. Hence, the liability of members cannot be altered once the company is formed.

The alteration in the given question is therefore invalid.

Question 40

The Articles of Association of a Limited Company provided that 'X' shall be the Law Officer of the company and he shall not be removed except on the ground of proved misconduct. The company removed him even though he was not guilty of misconduct. Decide, whether company's action is valid?

Answer

Section 5 (1) of the Companies Act, 2013 states that the Articles of a company contain the regulations for the management of a company. Further section 5 (2) provides that the Articles of a company shall contain all matters that are prescribed under the Act and also such additional matters as may be considered necessary for the management of the company.

Removal of Law Officer: The Memorandum and Articles of Association of a company are binding upon company and its members and they are bound to observe all the provisions of memorandum and articles as if they have signed the same [Section 10(1)].

However, the company and members are not bound to outsiders in respect of anything contained in memorandum/articles by which such outsiders have been given any rights. This is based on the general rule of law that a stranger to a contract cannot acquire any right under the contract.

In this case, Articles conferred a right on 'X', the law officer that he shall not be removed except on the ground of proved misconduct. In view of the legal position explained above, 'X' cannot enforce the right conferred on him by the articles against the company. Hence the

action taken by the company (i.e. removal of 'X' even though he was not guilty of misconduct) is valid. *(Eley V Positive Govt. Security Life Assurance Co., Major General ShantaShamsherjung V Kamani Bros. P. Ltd.)*

However, by altering the Articles by a special resolution under section 14 of the Act and Mr. X can be removed.

Question 41

Explain the limitations relating to alternation of Articles of Association of a company.

Answer

Limits on the Alteration of Articles: Every company has a right to alter its articles by following a simple process laid down in section 14 of the Companies Act, 2013.

Generally speaking the right of a company to alter its Articles is without and restriction. However, section 14 of the Act limits the right of the company to alter its Articles by imposing the following restrictions:

(i) The alteration cannot override its Memorandum or in any way conflict with the provisions thereof.

(ii) It cannot not be in violation of any provision of the Companies Act or any other statute.

(iii) It cannot allow an activity which is illegal (as a company can be formed only for a lawful object).

(iv) An alteration to the Articles cannot increase the liability of its member which has been already defined in the Memorandum.

Question 42

"The Doctrine of Indoor Management always protects the persons (outsiders) dealing with a company." Explain the above statement. Also, state the exceptions to the above rule.

Answer

Doctrine of Indoor Management (the Companies Act, 2013): According to the "doctrine of indoor management" the outsiders, dealing with the company though are supposed to have satisfied themselves regarding the competence of the company to enter into the proposed contracts are also entitled to assume that as far as the internal compliance to procedures and regulations by the company is concerned, everything has been done properly. They are bound to examine the registered documents of the company and ensure that the proposed dealing is not inconsistent therewith, but they are not bound to do more. They are fully entitled to presume regularity and compliance by the company with the internal procedures as required by the Memorandum and the Articles. This doctrine is a limitation of the doctrine of "constructive notice" and popularly known as the rule laid down in the celebrated case of *Royal British Bank v. Turquand*. Thus, the doctrine of indoor management aims to protect outsiders against the company.

Exceptions: In the following circumstances an outsider dealing with the company can not claim any relief on the ground of "indoor management":

1. **Knowledge of irregularity**: Where a person dealing with a company has actual or constructive notice of the irregularity as regards internal management, he can not claim the benefit under the rule of indoor management. (T*.R. PRATT (Bombay) Ltd. v. E.D. Sasson& Co. Ltd.)*
2. **Negligence:** Where a person dealing with a company could discover the irregularity if he had made proper inquiries, he can not claim the benefit of the rule of indoor management. The protection of this rule is also not available where the circumstances surrounding the contract are so suspicious as to invite inquiry, and the outsider dealing with the company does not make proper inquiry (*Anand Bihari Lel v. Dinshaw& Co.), (Under-Wood v. Bank of Liver Pool).*
3. **Act void ab initio and forgery**: Where the acts done in the name of a company are void ab initio, the doctrine of indoor management does not apply. The doctrine applies only to irregularities that otherwise might affect a genuine transaction.
4. **Acts outside the scope of apparent authority**: If an officer of a company enters into a contract with a third party and if the act of the officer is apparently beyond the scope of his authority, the company is not bound (*Kreditbank Cassel v. Schenkers Ltd*.).

Question 43

Briefly explain the doctrine of "Constructive Notice" under the Companies Act, 2013. Are there any exceptions to the said doctrine?

Answer

Doctrine of Constructive Notice: In consequences of the registration of the memorandum and articles of association of the company with the Registrar of Companies, a person dealing with the company is deemed to have constructive notice of their contents *(T.R. Pratt (Bombay) Ltd. v. E.D. Sassoon & Co. Ltd.)*. This is because these documents are construed as 'public documents'. Accordingly if a person deals with a company in a manner incompatible with the provisions of the aforesaid documents or enters into transaction which is ultra vires these documents, he must do so at his peril.

The doctrine of constructive notice is not a positive one but a negative one like that of estoppels of which it forms parts. It operates only against the person who has been dealing with the company but not against the company itself; consequently he is prevented from alleging that he did not know that the constitution of the company rendered a particular act or a particular delegation of authority ultra vires.

There is one limitation to the doctrine of constructive notice of the Memorandum and the Articles of a company. The outsiders dealing with the company are on their part entitled to assume that as far as the internal proceedings of the company are concerned, everything has been done properly in accordance with the Memorandum and Articles and the Act. They are

only bound to read the registered documents and satisfy themselves that the proposed dealing is not inconsistent therewith, but are not bound to do more; they need not inquire into the regularity of the internal proceedings as required by the Memorandum and the Articles. This limitation of the doctrine of constructive notice is known as the 'doctrine of indoor management' or the rule laid down in the celebrated case of *Royal British Bank v. Turquand*. Thus, whereas the doctrine of constructive notice protects the company against outsiders, the doctrine of indoor management seeks to protect outsiders against the company.

Question 44

Explain the doctrine of 'Indoor management' in brief.

The Secretary of a Company issued a share certificate to 'A' under the Company's seal with his own signature and the signature of a Director forged by him. 'A' borrowed money from 'B' on the strength of this certificate. 'B' wanted to realise the security and requested the company to register him as a holder of the shares. Explain whether 'B' will succeed in getting the share registered in his name.

Answer

The doctrine of Indoor Management is laid down in the *Royal British Bank vs. Turquand (1956) 6E&B 327 case* in which the directors of RBB (Royal British Bank) gave a bond to one T (Turquand) without the required resolution being passed. The Articles empowered the directors to issue such bonds under the authority of a proper resolution. In fact no such resolution was passed. It was decided in the case that notwithstanding the non passing of the required resolution, T could sue on the bonds on the ground that he was entitled to assume that the resolution had been duly passed. Thus, the persons dealing with the company are entitled to assume that the acts of the directors or the officers of the company are validly performed, if they are within the scope of their apparent authority.

However, this doctrine is not applicable where the person dealing with the company has notice of irregularity or when an instrument purporting to be enacted on behalf of the company is a forgery.

In the instant problem the doctrine of indoor management will not apply as the certificate is a forgery which does not give a good title to A and thereby to B. The title of the buyer cannot be better than that of the seller (Sale of Goods Act, 1930). Hence, 'B' will not succeed in getting the share registered in his name.

Question 45

A Managing Director of a company borrowed a sum of money by executing a document in which he forged the signature of two other directors who are required to sign as per requirements of articles. Can the company deny liability to creditors?

Answer

In Ruben v. Great Fingall Consolidated, it was held that Doctrine of Indoor Management could not be extended to cases of forgery. Transaction effected by forgery is void ab initio. However, in *Sri Krishan v. Mondal Bros. & Co.* it was held that a company may be held liable for any fraudulent Acts of its officers acting under ostensible authority. Therefore, in the instant case, company will not be allowed to deny liability in order to defeat bona fide claims of the creditor.

Question 46

Who shall be considered as promoter according to the definition given in the Companies Act, 2013? Explain.

Answer

Promoter- According to section 2 (69) of the Companies Act, 2013, Promoter means a person –

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

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

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

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

Question 47

Define the term 'Small Company' as contained in the Companies Act, 2013.

Answer

Small Company: Under Section 2 (85) of the Companies Act, 2013, "small company" means a company, other than a public company:-

(i) having paid-up share capital not exceeding fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; and

(ii) having turnover as per its last profit and loss account not exceeding two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees.

Exceptions: This section shall not apply to:

(A) a holding company or a subsidiary company;

(B) a company registered under section 8, or

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

Question 48

What is the importance of registered office of a company? State the procedure for shifting of a registered office of the company from one state to another state under the provisions of the Companies Act, 2013.

Answer

Importance of registered office:

- ***Section 12 (1) states that a company shall, on and from the fifteenth day of its incorporation and at every time thereafter, have a registered office capable of receiving and acknowledging all communications and notices addressed to it.***
- ***Section 12 (3) further requires every company to:***
  - ***Paint or affix its name and address of its registered office, and keep the same painted and affixed, on the outside of every office or place in which its business is carried on. Such display must be in a conspicuous position, in legible letters in characters and letters of the local language in addition to any other language (if chosen by the company);***
  - ***Get its name, address of its registered office and the corporate identity number and other details, on all its business letters, bill heads, notices and other official publications;***
- ***From the above provisions of the Companies Act, 2013, the extremely high importance of the registered office of a company can be well understood as it serves as the location where : (a) necessary documents may be served upon, or deposited; (b) notices, letters, etc., may be issued ; (c) inspection may be done, and (d) communication may be made. The domicile and the nationality of a company is determined by the place of its registered office. This is also important for determining the jurisdiction of the Court governing it.***
- ***Notice of the situation of the registered office and of every change therein must be sent to the Registrar (otherwise than through a statement as to the address of the registered office in the annual report) within 30 days of the date of incorporation and the date of change. This provision is designed to locate the spot where the records of the company could be inspected and where the letters should be addressed and notices served upon the company.***

Procedure for shifting the registered office from one state to another state (Section 13, of the Companies Act, 2013):

In order to shift the registered office from one state to another the following procedure will have to be followed:

(i) Hold a Board Meeting for the purpose of calling a general meeting of the members of the company in which the shifting of the registered office from one state to another will have to be approved;

(ii) The general meeting of the members will have to pass a special resolution approving the change of address of the registered office from one state to another as required by section 13 (1) of the Companies Act 2013.

(iii) Make an application to the Central Government/Regional Directors in such form and manner as may be prescribed, for getting its approval under section 13 (4) of the Companies Act 2013.

(iv) Under section 13 (7) of the Companies Act 2013, where an alteration of the Memorandum results in the transfer of the registered office of the company from one state to another, a certified copy of the order of the Central Government approving the alteration shall be filed by the company with the registrar of each of the states, within such time and in such manner as may be prescribed, and the registrars shall register the same. The registrar of the state where the registered office is being shifted to, shall issue a fresh certificate of incorporation indicating the alteration.

(v) The change in name will be effective only after the issue of the fresh certificate of incorporation by the Registrar of the state where the registered office is being shifted to.

Exercise

1. *XYZ (P) Ltd. was incorporated on January 20, 2009. A similar company with identical name and similar objects was inadvertently incorporated on September 20, 2009. On account of similarity in name and objects, XYZ (P) Ltd filed a petition on January 25, 2010 that the Central Government should direct the company incorporated at a latter date to change its name so that its business interest are protected. State in this connection whether the company incorporated at a later date can be directed by the Central Government to change its name.*

   [**Hints**: Yes, Read Section 4(2) and Section 16 of the Companies Act, 2013]

2. *The existing number of members in a public limited company is below the requirement as per the Companies Act, 2013. However, the company is continuing its business operations. State the legal consequences arising out of such continuance business.*

   [**Hints:** Members who are aware of the fact are personally and severally liable for the whole of the debts contracted]

3. *XYZ Ltd., intends to start a new additional business which has no relation to the existing business. State whether it can do so under the provision of the Companies Act, 2013.*

   [**Hints:** Yes, as per the provision laid down in Section 13 (8) and (9) of the Companies Act, 2013]

4. *M/s ABC Ltd. a company registered in the State of West Bengal desires to shift its registered office to some other place in the same State.*

   Would it make a difference, if the Registered Office is transferred from the Jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies within the same State?

   [**Hints**: Yes, as per the Sections 13 of the Companies Act, 2013]

5. *The Directors of a Company borrowed ₹ 50,000/- from A on a transaction which is ultra vires the Company. Discuss the rights of A against the Company and its Directors.*

   [**Hints**: A does not have any right against the company]

6. *Under the Articles, the Directors of a Company had power to borrow upto ₹ 1,00,000 without the consent of the General Meeting. The Directors themselves lent ₹ 2,00,000 to the Company without such consent and took Debentures. Is the Company liable for ₹ 2,00,000.*

   [**Hints**: Company is not liable]

7. *The management of Kamna Real Estate Ltd. has decided to take up the business of food processing activity because of the downward trend in real estate business. There is no provision in the object clauses of the memorandum of association to enable the company to carry on such business. State whether its object clause can be amended.*

   [**Hints**: No, as per Section 13 of the Companies Act, 2013]

8. *A Managing Director of a Company borrowed a sum of money by executing a document in which he forged the signature of two other directors who are required to sign as per requirements of the articles. Can the Company deny liability to creditors?*

   [**Hints**: No, as per the decision given in *Sri Kishan v. Mondal Bros. & Co*. where it was held that a Company may be held liable for any fraudulent acts of its officers acting under ostensible authority.]

UNIT – 2: PROSPECTUS

Question 1

Explain the meaning and role of the Prospectus.

Answer

Meaning of Prospectus: Section 2(70) of the Companies Act, 2013 defines the term Prospectus as any document described or issued as a prospectus, and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate. In this context, it should be noted that prospectus is not an offer in itself but an invitation to make an offer, signifying thereby that on acceptance of such an invitation by any member of the public, no binding contract between him and the company comes into being. Application for purchase of shares or debentures or for making a deposit constitutes an offer by the subscriber to the company and it is only on its acceptance by the company that a binding contract comes into existence.

Role: The prospectus is the main document on the basis of which the prospective investors decide whether or not they should subscribe to the securities offered by the company. The information in the prospectus is vital in every material aspect and any misstatements or concealment of material facts may result in huge losses to the investing public. Therefore, the Companies Act vide section 34 and 35 of the Companies Act, 2013 imposes both criminal liability and civil liability for untrue and misleading statements in the prospectus.

When Prospectus is not required to be issued?

Question 2

State the conditions where under the issuing of prospectus is not necessary under the provisions of the Companies Act, 2013.

Answer

Non-issuing of Prospectus:

Under section 23 (1) of the Companies Act, 2013 no company can issue securities of any nature to the public except through a prospectus. Further under section 25 of the Act any document, by which the offer for sale of securities of the company is made to the public such document, shall be deemed to be a prospectus issued by the company. Hence, in case of public issue of securities there is no situation under which a company can dispense with the issue of a prospectus as any document offering the sale will be deemed to be a prospectus.

However, the issue of prospectus is not necessary in the following exceptional cases-

(1) Where a company makes a private placement through issue of a private placement letter in terms of section 42 of the Companies Act, 2013.

(2) Where securities are offered to existing holders of such securities under a rights issue or a bonus issue in accordance with the provisions of this Act.

Question 3

What are the requirements as to the issue of the Prospectus?

Answer

Comprehensive rules and regulations have been incorporated into the Companies Act, 2013 in respect of this basic document which is the only source of vital information for the investors to ascertain the soundness or otherwise of the company. Since the prospectus is intended to save the investing public from victimisation, the Legislature has aimed at securing the fullest disclosure of all material and essential particulars and laying the same before all the prospective buyers of shares and imposing stringent liabilities for violations.

Briefly the rules and regulations are as follows:

(**i**) **Matters to be stated in a Prospectus** – In order to provide a thorough and comprehensive information on all aspects of the company and the proposed issue, section 26 (1) of the Companies Act, 2013 lists down a large list of items that must be stated in the Prospectus.

(ii) Registration of prospectus – Section 26 (4) provides that no prospectus shall be issued by or on behalf of a company or in relation to an intended company, unless on or before the date of its publication, there has been delivered to the Registrar for registration, a copy thereof signed by every person or his duly authorized representative, who is named therein as a director or proposed director of the company.

Under sub section (7) it is provided that the Registrar shall not register the prospectus unless the requirements for registration under section 26 are complied with and the prospectus is accompanied by the consent of all the persons named in the prospectus.

(iii) Approval of prospectus by various agencies: The draft prospectus has to be approved by various agencies before it is filed with the ROC of the concerned State.

(iv) The lead financial institution underwriting the issue, if applicable: The draft prospectus is vetted by SEBI to ensure adequacy of disclosures. However, vetting by SEBI does not amount to approval of prospectus. SEBI does not take any responsibility for the correctness of the statements made or opinions expressed in the prospectus.

Question 4

What is meant by "Abridged Prospectus"? Is it necessary to furnish abridged form of prospectus along with the application form for shares? Under what circumstances an abridged prospectus need not accompany the detailed information regarding prospectus along with the application form?

Answer

(1) **Meaning of Abridged Prospectus: -** According to Section 2(1) of the Companies Act, 2013, an abridged prospectus means a memorandum containing such salient features of a prospectus as may be specified by the SEBI by making regulations in this behalf.

(2) **Abridged prospectus to be issued along with application form**:- Section 33 (1) of the Companies Act, 2013 states that no application form for the purchase of any of the securities of a company can be issued unless such form is accompanied by an abridged prospectus. The abridged prospectus and application form should bear the same printed number. The investor may detach the share application form along the perforated line, after he has had an opportunity to study the contents of this abridged prospectus.

The objective of the abridged prospectus is to reduce the cost of issue as the detailed prospectus is a very bulky document whereas the contents of abridged prospectus are limited. However, under sub section (2) a copy of the prospectus shall, on a request by any person before the closing date of the subscription list and the offer, be furnished to him.

Penalty for failure to comply with sub section (3) can be a fine of up to ₹ 50, 000 for each fault.

(3) **Circumstances under which the abridged prospectus need not accompany the application forms:** In terms of the Proviso to section 33 (1) an abridged prospectus need not accompany the application form if it is shown that the form of application was issued:

(i) In connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to such securities; or

(ii) Where the securities are not offered to the public.

Question 5

What is the extent of liability of an expert, in relation to publication of prospectus, for any mis-statement in the report given by him?

Answer

An expert in terms of section 2 (38) of the Companies Act, 2013 has the professional qualification and the requisite expertise, power and authority to issue a certificate or a statement in a prospectus. Since, a prospectus is the key document based on which the prospective investors make their investment in the issue of securities of the company, it is very critical that statements made are authentic and correct.

The liability of an expert for mis statements made by him in the prospectus is covered in sections 34 and 35 of the Act. While section 34 lays down the criminal liability, section 35 provides for a civil liability. The liabilities apply to both the company and other persons.

Section 34 of the Companies Act 2013 states that where a prospectus, issued, circulated or distributed under this Chapter, includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead the reader, then every person who authorises the issue of such prospectus shall be liable under section 447. Section 447says that any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months (in case of public interest, the term of imprisonment shall not be less than three years) but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

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

Under section 35 where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, then the company and every person defined in this section including an expert, shall, without prejudice to any punishment to which he may be liable under section 36, be further liable to pay compensation to every person who has sustained such loss or damage.

Question 6

Explain the concept of "Shelf Prospectus" in the light of Companies Act, 2013. What is the law relating to issuing and filing of such prospectus?

Or

When is a company required to issue a 'shelf prospectus' under the provisions of the Companies Act, 2013? Explain the provisions of the Act relating to the issue of 'shelf prospectus' and filing it with the Registrar of Companies.

Answer

Shelf Prospectus: Section 2 (70) of the Companies Act, 2013 defines a "Prospectus" and includes a red herring prospectus and a shelf prospectus within the definition of "Prospectus". Further the explanation to section 31 of the Companies Act,2013 defines a shelf prospectus as a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus.

Section 31 of the Act states that any class or classes of companies, as the Securities and Exchange Board may provide by regulations in this behalf, may file a shelf prospectus with the Registrar at the stage of the first offer of securities included therein which shall indicate a period not exceeding one year as the period of validity of such prospectus which shall

commence from the date of opening of the first offer of securities under that prospectus, and in respect of a second or subsequent offer of such securities issued during the period of validity of that prospectus, no further prospectus is required.

From the above, the key features of a shelf prospectus are as under:

a. A shelf prospectus is a prospectus; hence it must comply with all the provisions of Section 26 of the Act which lays down the matters to be included in a prospectus and filing of the same with the Registrar. It must also comply with the other relevant and applicable sections of the Act to a prospectus.

b. A shelf prospectus may be issued by a class of companies only if and subject to the regulations of SEBI;

c. A shelf prospectus can have a validity of a maximum period of one year during which time the company may bring out a number of issue of securities, all covered by the same prospectus.

d. The validity of a shelf prospectus of a maximum period of one year shall commence from the date on opening of the first offer.

A company filing a shelf prospectus with the Registrar shall not be required to file prospectus afresh at every stage of offer of securities by it within a period of validity of such shelf prospectus.

However, under section 31 (2), a company shall be required to file an information memorandum on all material facts relating to new charges created, changes in the financial position of the company as have occurred between the first offer of securities or any previous offer of securities and the succeeding offer of securities and such other changes as may be prescribe, with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

Section 31 (3) states that where an information memorandum is filed every time an offer of securities is made, such memorandum together with the shelf prospectus shall be deemed to be the prospectus.

Question 7

What is meant by 'Red-herring prospectus? State the circumstances under which such prospectus is required to be filed with the Registrar of Companies. What is the requirement relating to filing of final prospectus in such cases?

Answer

Red-herring Prospectus (Section 32 of the Companies Act, 2013): Ared-herring prospectus means a prospectus which does not include complete particulars of the price or the quantum of securities offered therein [Explanation to Section 32]. Section 2 (70) of the Companies Act, 2013 defines a prospectus includes a red herring prospectus within its

meaning. Hence, a red herring prospectus is a prospectus within the meaning of section 2 (70).

Under section 32 (1) a public company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus. Therefore, the issue of a red herring prospectus does not absolve a company from issuing a regular prospectus in accordance with the relevant provisions of the Companies Act 2013.

According to section 32 (1) a company proposing to issue a red herring prospectus under sub-section (1) shall file it with the Registrar at least three days prior to the opening of the subscription list and the offer.

Section 32 (3) states that a red herring prospectus shall carry the same obligations as are applicable to a prospectus and any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus.

Section 32 (4) states that upon the closing of the offer of securities, the prospectus stating therein the total capital raised, whether by way of debt or share capital, and the closing price of the securities and any other details as are not included in the red herring prospectus shall be filed with the Registrar and the Securities and Exchange Board.

On the basis of offers received, company will finalise the issue price and issue size and then close the offer. After closure of offer of securities, a final prospectus will be prepared stating the total capital raised whether by way of debts, or share capital and the closing price of securities and any other details as were not complete in red-herring prospectus. The prospectus will be filled with ROC and also with SEBI in case of listed company.

Question 8

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

Answer

The Companies Act, 2013 vide sections 34 and 35 lay down the criminal and civil liabilities of the guilty parties in case of mis statements and misleading inclusions and omissions in a prospectus. Further, section 36 lays down the punishment for fraudulently inducing persons to invest moneys.

However, the present case before us is not in respect of liability for a possible mis statement but on the right of the allottee to avoid the contract of purchasing the shares from the company. In order to decide this, key factor is to determine if any material mis representation or concealment of a material fact has taken place and if such misrepresentation is fraudulent.

The non disclosure of the fact that dividends were paid out of capital profits is a concealment of material fact as a company is normally required to distribute dividend only from trading or

revenue profits and under exceptional circumstances can do so out of capital profits. Hence, a material misrepresentation has been made.

The question here is a direct issue arising from the consequence of misrepresentation on the contract and is governed by the Indian Contract Act, 1872.

Section 19 of the Indian Contract Act, 1872 states that when consent to an agreement is caused by coercion, fraud or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused.

Hence, in the given case the allottee can avoid the contract of allotment of shares. (*Rex V. Lord Kylsant*).

Question 9

When director is not liable for a misstatement in a prospectus?

Answer

When a director is not liable for criminal liability [Proviso to section 34]:

No criminal liability for any mis statement in a prospectus under this section shall apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

When a director is not liable for civil liability [Section 35 (2)]:

No civil liability for any mis statement under this section shall apply to a person if he proves that:

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

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

Question 10

An allottee of shares in a Company brought action against a Director in respect of false statements in prospectus. The director contended that the statements were prepared by the promoters and he has relied on them. Is the Director liable under the circumstances? Decide referring to the provisions of the Companies Act, 2013.

Answer

Yes, the Director shall be held liable for the false statements in the prospectus under sections 34 and 35 of the Companies Act, 2013. Whereas section 34 imposes a criminal punishment on every person who authorises the issue of such prospectus, section 35 more particularly includes a director of the company in the imposition of liability for such mis statements.

The only situations when a director will not incur any liability for mis statements in a prospectus are as under:

(a) No criminal liability under section 34 shall apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

(b) No civil liability for any mis statement under section 35 shall apply to a person if he proves that:

   a. Having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or

   b. The prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

Therefore, in the present case the director cannot hide behind the excuse that he had relied on the promoters for making correct statements in the prospectus. He will be liable for mis statements in the prospectus.

Question 11

State the remedies available against a company to a subscriber for allotment of shares on the faith of a misleading prospectus. What conditions must be satisfied by such a subscriber before opting for theremedies?

Answer

The remedies available to a subscriber arise more from the Indian Contract Act, 1872 than from the Companies Act, 2013. A misstatement in a prospectus will cover both an information included and an information omitted from the prospectus and may result from either a mistake, or a misrepresentation or a fraudulent statement.

The Companies Act, 2013 lays down the punishment for the company and the responsible parties which will include directors, promoters, experts etc. but does not mention the legal remedies available to an aggrieved investor apart from making the guilty persons liable to pay compensation to every person who has sustained loss or damage from purchase of securities on the strength of a prospectus containing mis statements.

Hence, we have to turn to the Indian Contract Act, 1872 which vide section 19 states that when consent to an agreement is caused by coercion, fraud or misrepresentation, the agreement is voidable at the option of the party whose consent was so caused. On the other hand, a party to contract, whose consent was caused by fraud or misrepresentation, may, if he thinks fit, insist that the contract shall be performed, and that he shall be put on the position in which he would have been if the representations made had been true.

Therefore, to summarize, the remedies available to a subscriber for mis-statements in prospectus are as under:

(a) He may claim compensation from directors, promoters or experts for any loss or damage sustained by such purchase;

(b) He may avoid the contract under section 19 of the Indian Contract Act, 1872 ; or

(c) He may enforce the contract and be placed in the position in which he would have been if the representation made has been true. This is an unlikely situation and may not be practically possible.

Hence, for all practical purposes he will have the remedies under (a) and (b) above.

Question 12

With a view to issue shares to the general public a prospectus containing some false information was issued by a company. Mr. X received copy of the prospectus from the company, but did not apply for allotment of any shares. The allotment of shares to the general public was completed by the company within the stipulated period. A few months later, Mr. X bought 2000 shares through the stock exchange at a higher price which later on fell sharply. X sold these shares at a heavy loss. Mr. X claims damages from the company for the loss suffered on the ground the prospectus issued by the company contained a false statement. Referring to the provisions of the Companies Act, 2013 examine whether X's claim for damages is justified.

Answer

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

A prospectus is a document inviting offers from the public. The prospectus and any statement therein has no legal binding either on the company or its directors, promoters or experts to a person who has not purchased securities in response to it.

Since X purchased shares through the stock exchange open market which cannot be said to have bought shares on the basis of prospectus. X cannot bring action for deceit against the directors. X will not succeed. It was held in the case of Peek Vs. Gurney that the above-mentioned remedy by way of damage will not be available to a person if he has not purchased the shares on the basis of prospectus.

Question 13

Peek Ltd. Co. issued and published its prospectus to invite the investors to purchase its shares. The said prospectus contained false statement. Mr. X purchased some partly paid

shares of the company in good faith on the Stock Exchange. Subsequently, the company was wound up and the name of Mr. X was in the list of contributors. Decide:

(i) Whether Mr. X is liable to pay the unpaid amount?

(ii) Can Mr. X sue the directors of the company to recover damages?

Answer

False statement in Prospectus under the Companies Act,2013

(i) Yes, X is liable to pay the unpaid amount on the shares. As X has purchased partly paid shares, so he is liable for the remaining value of the shares. At the time of winding up he is liable to contribute as a contributory. The related case law in this subject matter is *Peak vs. Gurney.*

(ii) No, X cannot sue the directors to recover damages for the misstatement in the prospectus. The shareholder must have relied on the statement in the prospectus in applying for shares offered by it to hold the responsible persons liable. If a person purchases shares in the open market, the prospectus is non operative as far as he is concerned. In the present case, Mr. X purchased shares on the stock exchange even if he did so on good faith he had not relied on the statement in prospectus.

Therefore, he cannot sue the directors of the company to recover damages.

Question 14

M applies for share on the basis of a prospectus which contains mis–statement. The shares are allotted to him, who afterwards transfers them to N. Can N bring an action for a rescission on the ground of mis-statement? Decide under the provisions of the Companies Act, 2013.

Answer

Mis-statement in prospectus: No, N cannot bring an action for rescission of the contract to buy shares from M on the ground of mis-statement as under section 37 of the Companies Act, 2013. A suit may be filed or any other action may be taken under section 34 or section 35 or section 36 only by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.

Question 15

Modern Furnitures Limited was willing to purchase teakwood estate in Chhattisgarh State. Its prospectus contained some important extracts from an expert report giving the number of teakwood trees and other relevant information in the estate in ChhattisgarhState. The report was found inaccurate. Mr. 'X' purchased the shares of Modern Furnitures Limited on the basis of the above statement in the prospectus. Will Mr. 'X' have any remedy against the company? When will an expert not be liable? State the provisions of the Companies Act, 2013 in this respect.

Answer

Under section 35 (1) of the Companies Act 2013, where a person has subscribed for securities of a company acting on any statement included in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who is a director, promoter or an expert shall, without prejudice to any punishment to which any person may be liable under section 36, be liable to pay compensation to every person who has sustained such loss or damage.

The Companies Act, 2013 lays down the punishment for the company and the responsible persons which includes directors, promoters, experts etc. but does not mention the legal remedies available to an aggrieved investor apart from the above mentioned compensation.

The remedy to an investor who has invested on the strength of the statements in the prospectus and such statements have turned out to be false or misleading, should also be assessed from the Indian Contract Act, 1872 which provides for various remedies for contracts induced by coercion, undue influence, misrepresentation, frauds or mistake. In the present case, Mr X has already purchased the shares which means the transaction has been completed, hence the option of rescinding it at his option does not arise. On the other hand Mr X can claim compensation for any loss or damage that he might have sustained from the purchase of shares. But this is possible only if he has sustained any loss or damage which has not been mentioned in the case given above.

Hence, Mr X will have no remedy either against the company or the expert based on the facts of the case given.

An expert will not be liable for any mis statements in the prospectus under the following situations:

(i) Section 26 (5): that having given his consent, he withdrew it in writing before delivery of the copy of prospectus for registration or

(ii) Section 35 (2): that the prospectus was issued without his knowledge or consent and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent; An expert will not be liable in respect of any statement not made him in the capacity of an expert and included in the prospectus as such;

Question 16

What is the law relating to criminal liability for mis-statement in the prospectus under the Section 34 of the Companies Act, 2013?

Answer

Under section 34 where a prospectus, issued, circulated or distributed, includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorizes the issue of such prospectus shall be liable under section 447.

Section 447 states that any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months (in case of public interest, the term of imprisonment shall not be less than three years) 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.

Hence, the criminal liability of the responsible persons shall arise only in case of fraudulent mis statements. In the absence of fraudulent intention, criminal liability shall not arise for any mis statements in the prospectus.

It is further provided in section 34 that no liability under the section shall apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

Question 17

State the liability of an 'Expert' in case of misrepresentation in the prospectus. When an expert will not be liable for his untrue statements made in the prospectus?

Answer

Punishment for mis-statements in a prospectus is contained in sections 34 and 35 of the Companies Act, 2013. While section 34 deals with criminal liability of the guilty persons, section 35 deals with the civil liability of the company and the specified persons.

Section 34 holds all those persons who authorize the issue of such prospectus which contains mis statements, it would not apply to an expert as he only gives an expert view on specific matters but does not authorize the issue of the prospectus. Authorization of the issue of a prospectus is done by directors and promoters and hence they will be criminally liable under this section.

Section 35 on the other hand imposes a liability on the company and every director, promoter, expert and any person who has authorized the issue of the prospectus, to pay compensation to every person who has sustained any loss or damage by subscribing for securities of the company by relying on any statement in the prospectus which has turned out to be mis leading.

Thus, the liability of an expert in case of misrepresentation in the prospectus will arise in terms of section 35 and will be specific to any mis statements made by him as an expert.

An expert will not be liable for any mis statements in the prospectus under the following situations:

(i) Section 26 (5): that having given his consent, he withdrew it in writing before delivery of the copy of prospectus for registration or

(ii) Section 35 (2): that the prospectus was issued without his knowledge or consent and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent;

(i) An expert will only be liable for any mis statements made by him in the capacity of an expert and not for any other statement in the prospectus.

Question 18

Explain the concept of "Deemed Prospectus" under the Companies Act, 2013. Point out the circumstances where under issuing the prospectus is not mandatory.

Answer

Deemed Prospectus: Under section 25 (1) of the Companies Act, 2013 any document by which an offer for sale of any securities is made to the public and the company allots or agrees to allot securities in terms thereof, then such document shall for all purposes, be deemed to be a prospectus and all enactments and rules of law as to the contents in a prospectus and as to liability in respect of mis-statements and omissions therein shall apply and shall have effect as they apply to a prospectus.

From the above provision it is quite clear that the deemed prospectus is not intended to be a document with any exceptions or concessions vis a vis a prospectus. It only broadens the scope of a prospectus to include not only the formal document issued as a prospectus but also all nature of communication made by the company with the intention of selling an issue. It is designed to prevent companies from making mis leading statements through various documents, notices or circulars while keeping the formal prospectus document clean.

When Prospectus need not be issued: The issue of prospectus under Section 23 of the Companies Act, 2013 is not necessary in the following circumstances:

(i) Where a person is a bona fide invitee to enter into an underwriting agreement with regard to any securities.

(ii) Where securities are offered through private placement by complying with the provisions related thereto in the Companies Act, 2013.

(iii) Where securities are issued through a rights issue or a bonus issue in accordance with the applicable provisions of the Act and in case of listed companies also in accordance with the provisions of the rules and regulations made by SEBI in this behalf.

Question 19

What do you mean by Allotment of shares?

Answer

Allotment of shares is the acceptance by the company of the offer to buy shares in response to an issue of shares. When shares are issued, applications are invited by the company from either the public or institutions in case of a public issue and from the private persons /

institutions in case of private placements to apply for the shares offered. When such applications are accepted and approved by the company, the shares are said to be allotted to the respective applicants.

Allotment of shares can only take place when shares are offered for sale by a company. Hence, allotment cannot be made in respect of bonus shares.

Question 20

Define Minimum Subscription. When it is liable to be refunded? Can share application money be deposited in any bank?

Answer

Minimum subscription is the minimum amount out of the total amount of securities issued by a company which is stated in the prospectus as such. A company under section 39 (1) of the Companies Act, 2013 cannot proceed with the allotment of securities to the public unless the amount stated in the prospectus as the minimum amount has been subscribed and the amounts payable on the application for the minimum amount so stated has been received by the company by cheque or by other instrument.

Further section 39 (2) states that the amount payable on application on every security must not be less than 5% of the nominal value (face value) of the security or such other percentage or amount as may be specified by SEBI by making regulations in this behalf.

However, it must be noted that the minimum amount stated in the prospectus as such may not necessarily be the same as the amount payable on application in respect of securities offered. On the other hand the moneys payable on application cannot be lower than the minimum amount as stated in the prospectus.

Under section 39 (3) if the stated minimum amount has not been subscribed and the sum payable on application, is not received within a period of 30 days from the date of issue of the prospectus, or such other period as may be specified by the Securities and Exchange Board, the amount received under sub-section (1) shall be returned within such time and manner as may be prescribed.

Section 40 (3) provides for the deposit of the application moneys received from the public for subscription to the securities offered, in a separate bank account in a scheduled bank and shall not be utilized for any purpose other than adjusting the same against the allotment of securities or refunding the same in case allotment is not made for any reason.

Question 21

What is 'Minimum Subscription' and "Opening of Subscription List" in Public Issue of Shares?

Answer

Minimum subscription is the minimum amount out of the total amount of securities issued by a company which is stated in the prospectus as such. A company under section 39 (1) of the

Companies Act, 2013 cannot proceed with the allotment of securities to the public unless the amount stated in the prospectus as the minimum amount has been subscribed and the amounts payable on the application for the minimum amount so stated has been received by the company by cheque or by other instrument.

The purpose behind the provision of minimum subscription is to prevent a company from starting its business without adequate financial resources. This is also an investor protection measure as the company has to refund the amounts collected on applications in case the minimum subscription as stated in the prospectus is not received.

There is a time gap between the date when an issue is opened and when the issue closes. The opening of the issue marks the date when the members of the public can begin to make applications for purchasing the securities offered and the closing date is the date after which the company will not accept any further applications. Both these dates are required to be mentioned in the prospectus under section 26 of the Companies Act, 2013.

The date on which the offer for securities open is called the opening of the subscription list in a public issue of shares.

Question 22

State with reason, whether the following statement is correct or incorrect, according to the Companies Act, 2013.

In the case of Public issue of shares, the subscription list is to be kept open for a minimum period of 3 working days.

Answer

Correct. The subscription list for public issues should be kept open for at least 3 working days and a disclosure to this effect should be made in the prospectus.

Question 23

In what way does the Companies Act, 2013 regulate and restrict the following in respect of a company going for public issue of shares:

(i) Minimum Subscription, and

(ii) Application Money payable on shares being issued? Explain.

OR

If a company does not receive the minimum subscription, it should refund money received from applicants within such time as may be prescribed.

Answer

The Companies Act, 2013 by virtue of provisions as contained in Section 39 (1) and (2) regulates and restricts the minimum subscription and the application money payable in a public issue of shares as under:

Minimum subscription [Section 39 (1)]

No Allotment shall be made of any securities of a company offered to the public for subscription; unless; -

(i) the amount stated in the prospectus as the minimum amount hasbeen subscribed; and

(ii) the sums payable on application for such amount has been paid to and received by the company-

Position as Per SEBI Regulations: As per SEBI Regulations, the minimum subscription in respect of public and rights issue shall be 90% of the issue amount. The requirement of 90% minimum subscription shall not be mandatory in case of offer for sale of securities. In case of non-receipt by the company of 90% of the issued amount from public subscription plus accepted development from underwriters or from other sources in case of under-subscribed issues, within 60 days from the date of closure of the issue, the company shall refund forthwith the subscription amount in full without interest and with interest @15% p.a. if not paid within 10 days after expiry of the said 60 days.

Application money: Section 39 (2) provides that the amount payable on application on each security shall not be less than 5% of the nominal amount of such security or such amount as SEBI may prescribe by making any regulations in this behalf.

Further section 39 (3) provides that if the stated minimum amount is not received by the company within 30 days of the date of issue of the prospectus or such time as prescribed by SEBI, the company will be required to refund the application money received within such time and manner as may be prescribed.

Section 40 (3) provides that all moneys received on application from the public for subscription to the securities shall be kept in a separate bank account maintained with a scheduled bank.

Question 24

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

Answer

Under section 40 (1) of the Companies Act, 2013 every company making a public offer shall, before making such offer, make an application to one or more recognised stock exchange or exchanges and obtain permission for the securities to be dealt with in such stock exchange or exchanges.

Section 40 (2) further states that where a prospectus states that an application under sub-section (1) has been made, such prospectus shall also state the name or names of the stock exchange in which the securities shall be dealt with.

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

Hence, under the Companies Act, 2013 by making the offer of shares before getting the approval from the stock exchanges, it has violated the provisions of section 40 and under section 40 (5) will be punishable with a fine which shall not be less than ₹ 5 Lakhs but may extend to ₹ 50 Lakhs and every officer in default shall be punishable with imprisonment for a term which may extend upto one year or with a fine of not less than ₹ 50,000/- but which may extend upto₹ 3 Lakhs, or with both.

[**Note:** The company seems to have defaulted because the question talks about proceeding with allotment which means that the offer has been made and applications received].

Question 25

When is an Allotment of Shares treated as an irregular allotment? State the effects of an irregular allotment.

Answer

Irregular allotment: The Companies Act, 2013 does not separately provide for the term "Irregular Allotment" of securities. Hence, one will have to examine the requirements of a proper issue of securities and consider the consequences of non fulfilment of those requirements.

In broad terms an allotment of shares is deemed to be irregular when it has been made by a company in violation of Sections 23, 26, 39 and 40. Irregular allotment therefore arises in the following instances:

1. Where a company does not issue a prospectus in a public issue as required by section 23; or
2. Where the prospectus issued by the company does not include any of the matters required to be included therein under section 26 (1), or the information given is misleading, faulty and incorrect; or
3. Where the prospectus has not been filed with the Registrar for registration under section 26 (4);
4. The minimum subscription as specified in the prospectus has not been received in terms of section 39; or
5. The minimum amount receivable on application is less than 5% of the nominal value of the securities offered or lower than the amount prescribed by SEBI in this behalf; or
6. In case of a public issue, approval for listing has not been obtained from one or more of the recognized stock exchanges under section 40 of the Companies Act, 2013.

Effects of irregular allotment: The consequences of an irregular allotment depend on the nature of irregularity. However, the Companies Act, 2013 does not mention (unlike the previous Companies Act) that in case of an irregular allotment the contract is voidable at the option of the allottee.

Under section 26 (9) of the Companies Act, 2013 if a prospectus is issued in contravention of the provisions of section 26, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

Similarly in case the company has not received the minimum subscription amount within 30 days of the date of issue of the prospectus, it must refund the application money received by it within the stipulated time. Any allotment made in violation of this will be void and the defaulting company and officers will be liable to further punishment as provided in section 39 (5).

Under section 40 (5) any default made in respect of getting the approval to listing of securities in one or more recognized stock exchange in case of a public issue, will render the company punishable with a fine which shall not be less than five lakh rupees but which may extend to fifty lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

Hence, under various provisions of the Companies Act, 2013 stringent punishment has been provided for against irregular allotment of securities but the option of going ahead with such allotment even if desired by the allottee is not specifically permitted.

Question 26

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

Answer

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

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

Question 27

The Board of Directors of M/s Reckless Investments Ltd. have allotted shares to the investors of the company without issuing a prospectus with the Registrar of Companies, Mumbai. Explain the remedies available to the investors in this regard.

Answer

According to Section 23 of the Companies Act, 2013, a public company can issue securities to the public only by issuing a prospectus. Section 26 (1) lays down the matters required to be disclosed and included in a prospectus and requires the registration of the prospectus with the Registrar before its issue.

In the given case, the company has violated with the above provisions of the Act and hence the allotment made is void. The company will have to refund the entire moneys received and will also be punishable under section 26 (9) of the Act.

Question 28

Mars India Ltd. owed to Sunil ₹1,000. On becoming this debt payable, the company offered Sunil 10 shares of ₹100 each in full settlement of the debt. The said shares were fully paid and were allotted to Sunil.

Examine the validity of these allotments in the light of the provisions of the Companies Act, 2013

Answer

Under section 62 (1) (c) of the Companies Act, 2013 where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, either for cash or for a consideration other than cash, such shares may be offered to any persons, if it is authorised by a special resolution and if the price of such shares is determined by thevaluation report of a registered valuer subject to such conditions as may be prescribed.

In the present case, Mars India Ltd is empowered to allot the shares to Sunil in settlement of its debt to him. The issue will be classified as issue for consideration other than cash must be approved by the members by a special resolution. Further, the valuation of the shares must be done by a registered valuer.

Question 29

Explain the provisions and main contents of "Return of Allotment" under the Companies Act, 2013.

Answer

Under section 39 (4) of the Companies Act, 2013 whenever a company having a share capital makes an allotment of securities, it shall file with the Registrar a return of allotment in such manner as may be prescribed.

Rule 12 of the *Companies (Prospectus and Allotment of Securities) Rules 2014* prescribes the manner for filing of the return of allotment. Whenever a company having a share capital makes any allotment of its securities, the company shall, within thirty days thereafter, file with the Registrar a return of allotment in *Form PAS – 3*, along with the fee as specified in the *Companies (Registration Offices and Fees) Rules, 2014*.

Attachments and inclusions in Form PAS 3:

a. A list of allottees states their names, address, occupation, if any, and number of securities allotted to each duly certified by the signatory of the Form PAS – 3 as being complete and correct as per the records of the company.

b. In the case of securities (not being bonus shares) allotted as fully or partly paid up for consideration other than cash, there shall be attached to the Form PAS – 3 a copy of the contract, duly stamped, pursuant to which the securities have been allotted together with copy of any contract of sale if relating to a property or an asset, or a contract for services or other consideration.

c. In the case of issue of bonus shares, a copy of the resolution passed in the general meeting authorizing the issue of such shares shall be attached to the Form PAS –3.

Question 30

Explain the conditions and the manner in which a company may issue depository receipts in a foreign country under the Companies (Issue of Global Depository Receipts) Rules, 2014.

Answer

Issue of Depository Receipts in Foreign Country: Section 41 of the Companies Act, 2013 is a newly added provision according to which a company may issue Global Depository Receipts to transact business with a depository mode in any foreign country. As per the law contained in the said Section, a company may, after passing a special resolution in its general meeting, issue depository receipts in any foreign country.

The *Companies (Issue of Global Depository Receipts) Rules, 2014*, provide the conditions and the manner in which a company may issue depository receipts in a foreign country.

Conditions for Issue of Depository Receipts:

(1) *Passing of Resolution*: The Board of Directors of the company intending to issue depository receipts shall pass a resolution authorizing the company to do so.

(2) *Approval of Shareholders*: The company shall take prior approval of its shareholders by a special resolution to be passed at a general meeting.

(3) *Depository Receipts shall be Issued by an Overseas Depository Bank*: The depository receipts shall be issued by an overseas depository bank appointed by the company and the underlying shares shall be kept in the custody of a domestic custodian bank.

(4) *Compliance with all the Provisions, Schemes, Regulations etc.*: The company shall ensure that all the applicable provisions of the scheme and the rules or regulations or

guidelines issued by the Reserve Bank of India are complied with before and after issue of depository receipts.

(5) *Compliance Report to be placed at the meeting*: The company shall appoint a merchant banker or a practicing chartered accountant or a practicing cost accountant or a practicing company secretary to ensure all the compliances relating to issue of depository receipts and the compliance report taken from such merchant banker or practicing chartered accountant or practicing cost accountant or practicing company secretary, as the case may be, shall be placed at the meeting of the Board of Directors of the company or of the committee of the Board of Directors authorised by the Board in this regard to be held immediately after closure of all formalities of the issue of depository receipts.

Manner for Issue of Depository Receipts:

(1) The depository receipts can be issued by way of public offering or private placement or in any other manner prevalent abroad and may be listed or traded in an overseas listing or trading platform.

(2) The depository receipts may be issued against issue of new shares or may be sponsored against shares held by shareholders of the company in accordance with such conditions as the Central Government or the Reserve Bank of India may prescribe or specify from time to time.

(3) The underlying shares shall be allotted in the name of the overseas depository bank and against such shares, the depository receipts shall be issued by the overseas depository bank abroad.

Question 31

Explain clearly the meaning of the term 'Underwriting' and 'Underwriting Commission'. In what way, does the Companies Act, 2013 regulate payment of such Commission? Explain.

Or

In what way does the Companies Act, 2013 regulate the payment of 'underwriting commission'? Explain the provisions of the Act, state the conditions to be complied with before payment of such commission can be made to underwriters of the company.

Answer

'Underwriting' is a contract entered into between the company and certain parties (called underwriters) whereby the underwriters guarantee to purchase or get investors to purchase the whole or an agreed portion of the securities that are not applied for by the public for subscription. In consideration of this guarantee the company pays a commission to the underwriters as a percentage of the value of the shares offered to the public.

The consideration payable to the underwriters for underwriting the issue of shares or debentures of a company is called underwriting commission. Such a commission is paid at a

specified rate on the issue price of the whole of the shares or debentures underwritten whether or not the underwriters are called upon to take up any shares or debentures. Thus, the underwriters are paid for the risk they bear in the placing of shares before the public. Underwriting commission may be in addition to brokerage.

Under Section 40 (6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, subject to the following conditions which are prescribed under the *Companies (Prospectus and Allotment of Securities) Rules, 2014*:

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

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

(c) the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent (5%) of the price at which the shares are issued or a rate authorised by the articles, whichever is less, and in case of debentures, shall not exceed two and a half per cent (2.5 %) of the price at which the debentures are issued, or as specified in the company's articles, whichever is less;

(d) the prospectus of the company shall disclose -

  i. the name of the underwriters;

  ii. the rate and amount of the commission payable to the underwriter; and

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

(e) there shall not be paid commission to any underwriter on securities which are not offered to the public for subscription;

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

Thus, the Underwriting commission is limited to 5% of issue price in case of shares and 2.5% in case of debentures. The rates of commission given above are maximum rates. Thecompany is free to negotiate lower rates with underwriters.

Question 32

The Board of Directors of a company decide to pay 5% of issue price as underwriting commission to the underwriters. On the other hand the Articles of Association of the company permit only 3% commission. The Board of Directors further decide to pay the commission out of the proceeds of the share capital. Are the decisions taken by the Board of Directors valid under the Companies Act, 2013?

Answer

Underwriting Commission

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

The same rules allow the commission to be paid out of proceeds of the issue or the profit of the company or both.

Therefore, the decision of the Board of Directors to pay 5% commission to the underwriters is invalid while the decision to pay out of the proceeds of the share issue is valid.

Question 33

Unique Builders Limited decides to pay 2.5 percent of the value of debentures as underwriting commission to the underwriters but the Articles of the company authorize only 2.0 percent underwriting commission on debentures. The company further decides to pay the underwriting commission in the form of flats. Examine the validity of the above arrangements under the provisions of the Companies Act,2013.

Answer

Section 40 (6) of the Companies Act 2013, provides that a company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to the a number of conditions which are prescribed under *Companies (Prospectus and Allotment of Securities) Rules, 2014*. In relation to the case given, the conditions applicable under the above Rules are as under:

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

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

(c) The rate of commission paid or agreed to bepaid shall not exceed, in case of shares, five percent (5%) of the price at which the shares are issued or a rate authorised by the articles, whichever is less, and in case of debentures, shall not exceed two and a half per cent (2.5 %) of the price at which the debentures are issued, or as specified in the company's articles, whichever is less;

Thus, the Underwriting commission is limited to 5% of issue price in case of shares and 2.5% in case of debentures. The rates of commission given above are maximum rates.

In view of the above, the decision of Unique Builders Ltd. to pay underwriting commission exceeding 2% as prescribed in the Articles is invalid.

The company may pay the underwriting commission in the form of flats as both the Companies Act and the Rules do not impose any restriction on the mode of payment though the source has been restricted to either the proceeds of the issue or profits of the company.

Question 34

Apex Metals Limited wants to provide financial assistance to its employees, to enable them to subscribe for certain number of fully paid shares. Considering the provision of the Companies Act, 2013, what advice would you give to the company in this regard?

Answer

Under section 67 (2)[6] of the Companies Act, 2013 no public company is allowed to give, directly or indirectly or by means of a loan, guarantee, or security, any financial assistance for the purpose of, or in connection with, a purchase or subscription, by any person of any shares in it or in its holding company.

However, section 67 (3) makes an exception by allowing companies to give loans to their employees other than its directors or key managerial personnel, for an amount not exceeding their salary or wages for a period of six months with a view to enabling them to purchase or subscribe for fully paid-up shares in the company or its holding company to be held by them by way of beneficial ownership.

Provided that disclosures in respect of voting rights not exercised directly by the employees in respect of shares to which the scheme relates shall be made in the Board's report in such manner as may be prescribed.

Hence, Apex Metals Ltd can provide financial assistance upto the specified limit to its employees to enable them to subscribe for the shares in the company provided the shares are purchased by the employees to be held for beneficial ownership by them. However, the key managerial personnel will not be eligible for such assistance.

Question 35

A Company wants to provide financial assistance to its employees to enable them to subscribe for fully paid shares of the company. Does it amount to purchase of its own shares. If, in the instant case, the company itself purchasing to redeem its preference shares, does it amount to acquisition of its own shares?

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[6]Ministry Vide **Notification G.S.R. 464 (E) dated 5th June 2015**, directed that section 67 shall not apply to private companies-

(i) in whose share capital no other body corporate has invested and money;

(ii) if the borrowings of such company from banks/financial institutions. Anybody corporate is less than twice its paid up share capital/ 50 crore rupees, whichever is lower; and

(iii) Such a company is not in default in repayment of such borrowings subsisting at the time of making transactions under this section.

Answer

Yes, the financial assistance to its employees by the company to enable them to subscribe for the shares of the company will amount to the company purchasing its own shares. However, section 67 (3)[7] permits a company to the give loans to its employees other than its directors or key managerial personnel, for an amount not exceeding their salary or wages for a period of six months with a view to enabling them to purchase or subscribe for fully paid-up shares in the company or its holding company to be held by them by way of beneficial ownership.

Section 68 of the Companies Act, 2013 however, allows a company to buy back its own shares under certain circumstances and subject to fulfilment of prescribed conditions.

Purchasing in order to redemption its preference shares, does amount to acquisition or purchase of its own shares. But this is allowed in terms of section 68 of the Companies Act, 2013 subject to the fulfilment of prescribed conditions, and upto specified limits and only after following the prescribed procedure.

Question 36

A public company proposes to purchase its own shares. State the source of funds that can be utilised by the company for purchasing its own shares and the requirements to be complied with by the company under the Companies Act before and after the shares are so purchased.

Or

ADJ Company Limited decides to buy-back its own shares. Advise the company's Board of Directors about the sources out of which the company can buy-back its own shares. What conditions are attached to the buy-back scheme of the company in accordance with the provisions of the Companies Act, 2013? Explain.

Or

Choose the correct answer from the following and give reasons:

Sources of funds for buy back of shares are:

(a) Free reserves or securities premium account

(b) The proceeds of any shares or other specified securities

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[7]Ministry Vide **Notification G.S.R. 464 (E) dated 5th June 2015**, directed that section 67 shall not apply to private companies-

(i) in whose share capital no other body corporate has invested and money;

(ii) if the borrowings of such company from banks/financial institutions. Anybody corporate is less than twice its paid up share capital/ 50 crore rupees, whichever is lower; and

(iii) Such a company is not in default in repayment of such borrowings subsisting at the time of making transactions under this section.

(c) (a) and (b) both

(d) None of the above.

Answer

Sources of funds for buy-back of shares: Under section 68 (1) of the Companies Act, 2013 a company can purchase its own shares or other specified securities. The purchase should be out of:

(i) its free reserves; or

(ii) the securities premium account; or

(iii) the proceeds of the issue of any shares or other specified securities.

However, buy-back of any kind of shares or other specified securities cannot be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

'Specified securities' includes employees' stock option or other securities as may be notified by the Central Government from time to time. [Explanation (1) under Section 68],

Requirements to be complied with before buy-back: Under section 68 (2) of the Companies Act, 2013 a company shall not purchase its own shares or other specified securities unless:

(a) the buy-back is authorised by its articles;

(b) a special resolution (also Declaration of Solvency to be filed with ROC & SEBI in case shares are listed on any recognised stock exchange), authorising the buy-back is passed at a general meeting of the company;

(c) the buy-back is 25% or less than of the aggregate of the paid-up capital and free reserves of the company;

Provided that the buy-back of equity shares in any financial year shall not exceed 25% of its total paid up equity capital in that financial year.

(d) the ratio of the aggregate of the secured and unsecured debt owed by the company is not more than twice the capital and free reserves after such buy-back;

Provided that the Central Government may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies.The second explanation to section 68 clarifies that the expression "free reserves" shall include the securities premium account .

(e) all the shares or other specified securities for buy-back are fully paid-up;

(f) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by SEBI in this behalf;

(g) the buy-back in respect of shares or other specified securities other than those specified in Clause (f) above is in accordance with such guidelines as may be prescribed.

Under section 68 (3) of the Companies Act, 2013 the notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement stating;

(a) a full and complete disclosure of all material facts;

(b) the necessity for the buy-back;

(c) the class of shares or securities intended to be purchased under the buy- back;

(d) the amount to be involved under the buy-back; and

(e) the time limit for completion of buy-back.

Under section 68 (4) of the Companies Act, 2013 every buy back must be completed within a period of one year from the date of the passing of the special resolution, or the Board Resolution where the buy back is upto 10% of the aggregate of the paid up capital and free reserves of the company.

Under section 68 (5) a company proposing to buy back its own shares must file with the Registrar and with SEBI a declaration of solvency signed by at least two directors out of which one must be the Managing Director. This must be filed before proceeding with the buy back.

Requirements to be complied with after buy-back:

(1) The securities bought back should be extinguished and physically destroyed within 7 days after completion of buy-back [Section 68 (7)].

(2) After completion of buy-back, a company cannot issue same kind of shares or security (which was bought back) for a period of 6 months. Allotment of rights issue renounced by members is also not permissible in this period. However, following are permitted:

   (i) issue of security of a different class that is other than one which was bought back,

   (ii) bonus issue,

   (iii) subsisting obligations such as conversion of warrants,

   (iv) stock option to employees

   (v) sweat equity

   (vi) conversion of preference shares or debentures into equity shares [Section 68(8)].

(3) The company should maintain a register showing securities bought back and consideration paid for the buy-back, date of cancellation of securities, date of extinguishment and physical destruction of securities other prescribed particulars [Section 68(9)].

(4) After completion of buy-back, a return has to be filed with the Registrar of Companies and Securities and Exchange Board of India if the company is listed within 30 days giving details as prescribed [Section 68(10)].

(5) If the buy-back is from free reserves, a sum equal to the nominal value of sharespurchased will be transferred to capital redemption reserve account. Details of such transfer will be disclosed in the balance sheet of the company [(Section 69 (1)].

Question 38

ABC Company Limited at a general meeting of members of the company pass an ordinary resolution to buy-back 30% of its Equity Share Capital. The articles of the Company empower the company for buy-back of shares. The company further decide that the payment for buy-back be made out of the proceed of the company's' earlier issue of equity shares. Explaining the provisions of the Companies Act, 2013, and stating the sources through which the buy-back of companies own shares be executed. Examine.

(i) Whether company's proposal is in order?

(ii) Would your answer be still the same in case the company instead of 30% decide to buy-back only 20% of its Equity Share Capital?

Answer

Buy Back of own Shares: Sources of Funds etc. Under section 68 of the Companies Act, 2013 a company can purchase its own shares or other specified securities subject to fulfilment of prescribed conditions and subject to defined limits and procedures.

Under the various sub sections of section 68 of the Companies Act, 2013 (please see previous answer) in the present case the following facts are note worthy:

a. The Articles permit buy back – This is in order;

b. The approval of the members is by way of an ordinary resolution – This is invalid as the resolution required is a special resolution;

c. The buy back approved is 30% of the Equity Share Capital – The maximum limit allowed for buy back is 25% of the aggregate of the paid up capital and free reserves. Since the value of free reserves is not mentioned this cannot be commented upon.

d. The company plans to pay for the buy back from the proceeds of an earlier equity issue - This is in violation of section 68 (1) of the Act.

Taking into account the above factors, the questions as asked in the problem can be answered as under:

(i) The company's proposal for buy-back is not in order as it has passed only an ordinary resolution and the out of the proceeds of an earlier equity issue in violation of section 68 (1).

(ii) The answer to the second question shall also be the same as the irregularity and contravention will not be affected by the buy back being 20%.

Question 39

ADJ Company Limited decides to buy-back its own shares. Advise the company's Board of Directors about the sources out of which the company can buy-back its own shares. What conditions are attached to the buy-back scheme of the company in accordance with the provisions of the Companies Act, 2013? Whether there is any time limit for the completion of buy–back of its shares? Explain.

Or

What are the conditions for the company for the buy–back of its own shares? Whether there is any time limit for the completion of buy–back of its shares?

Answer

Buy-back of shares sources and conditions (Section 68 (1) of the Companies Act, 2013): In accordance with section 68 of the Companies Act, 2013, a company may buy back of its own shares or other specified securities, out of the following sources:

1. Company's free reserves; or
2. Company's securities premium account; or
3. Out of the proceeds of any shared or other specified securities.

However, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

Conditions that must be complied with are as laid down in section 68 (2):

(1) Buy-back is authorised by the Company's Articles.

(2) A special resolution has been passed in general meeting of the company authorising buy-back.

(3) The buy-back is less than 25% of the aggregate of the total paid-up capital and free reserves of the company. Moreover, the buy-back of equity shares, cannot exceed 25% of company's paid up equity share capital in a financial year. However, section 68 (2) has authorised the Board of Directors through a Board Resolution, provided the buy back does not exceed 10% of the total paid up equity share capital and free reserves. However, there cannot be more than one such buy-back in any period of 365 days.

(4) The ratio of the aggregate of secured and unsecured debt owed by the company is not more than twice the equity capital and free reserve after such buy back. However, the Central Government may prescribe a higher ratio of the debt for a class or classes of companies.

(5) All shares or other specified securities are fully-paid-up,

(6) The buy back with respect to listed securities is in accordance with the regulations made by the SEBI in this behalf.

Time limit for completion of buy–back: Under section 68 (4), every buy–back shall be completed within 12 months from the date of passing the special resolution or a resolution passed by the Board where the buy back is upto 10% of the aggregate of paid up capital and free reserves.

Question 40

DJA Company Ltd., desirous of buying back of all its equity shares from the existing shareholders of the company, seeks your advice. Examining the provisions of the Companies Act, 2013 advise whether the above buy back of equity shares by the company is possible. Also state the sources out of which buy-back of shares can be financed.

Answer

Buy-back of Shares by Company (Section 68 (2) (c) of the Companies Act, 2013): In terms of section 68 (2) (c) of the Companies Act, 2013 a company is allowed to buy back a maximum of 25% of the aggregate of its paid up capital and free reserves. Hence, the company in the given case is not allowed to buy back its entire equity shares.

Section 68 (1) of the Companies Act, 2013 specifies the sources of funding buy back of its shares and other specified securities as under:

(a) Free reserves or

(b) Security Premium account or

(c) Proceeds of the issue of any shares or other specified securities

However, under the proviso to section 68 (1) no buy back of shares or any specified securities can be made out of the proceeds of an earlier issue of the same kind of shares or same kind of specified securities.

Question 41

Elucidate the circumstances in which a company cannot buy back its own shares as per the provisions of the Companies Act, 2013. M/s Growmore Pharma Limited is planning to buyback of its shares during the current year but the company has defaulted in the payment of term loan & interest thereon to its bankers. The company seeks your advice as to how and when the company can buy back its shares under these circumstances as per the provisions of the Companies Act, 2013.

Answer

Circumstances in which a company cannot buy back its own shares-As per section 70 of the Companies Act, 2013, a company cannot buy back shares or other specified securities directly or indirectly:

(a) Through any subsidiary company including its own subsidiaries; or

(b) Through investment or group of investment companies; or

(c) When the company has defaulted in the repayment of deposit or interest thereon, redemption of debentures or preference shares or payment of dividend or repayment of any term loan or interest thereon to any financial institution or bank. The prohibition does not apply if the default has been remedied and a period of three years has elapsed after such default ceased to subsist.

(d) Company has defaulted in filing of Annual Return (section 92), declaration of dividend (section 123) or punishment for failure to distribute dividend (section 127) and financial statement (section 129).

Under the Companies Act, 2013, now the company can buy-back even if it has defaulted in the repayment of deposit or interest thereon, redemption of debentures or preference shares or payment of dividend or repayment of any term loan or interest thereon to any financial institution or bank, provided the default has been remedied and period of 3 years has elapsed after such default ceased to subsist. Therefore, M/s. Growmore Pharma Limited needs to follow the procedure as highlighted above for buy-back of shares.

Question 42

Describe the ways to become a member of a company.

A company issued 20 partly paid equity shares and registered them in the name of the minor describing him as minor. The father of the minor signed the application on the minor's behalf. After some time company went into liquidation. The company filed a suit against father of the minor to recover the remaining amount on the shares. Whether the company will succeed? Advise.

OR

State the manner in which a person may acquire membership of a public company.

Answer

Under section 2 (55) of the Companies Act, 2013 a "member", in relation to a company, means -

(i) he subscriber to the memorandum of the company who shall be deemed to have agreed to become member of the company, and on its registration, shall be entered as member in its register of members;

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

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

From the above it is clear that a person can become a member only after his name is entered as a beneficial owner in the register of members of the company and in the records of a depository. However, in order to have his name entered in these documents the avenues available to a person to become a member are as under:

a. By subscribing to the Memorandum (for forming a company);

b. By agreeing in writing to become a member of the company – this is done in any one of the following ways:

   1. Applying for shares or securities in the company in response to a public issue;

   2. Purchasing the shares or securities of the company from the stock exchange in which such shares and securities are listed for trading;

   3. Purchasing shares or securities in terms of a private placement made by the company.

c. By registration as a member in the register of members and the records of the depository consequent upon transmission of such shares on the death of the registered member.

Member as a minor: Since becoming a member of a company requires a contractual relationship to exist between the person and the company, it is essential that a person who is not competent to enter into a contract cannot become a member in a company.

Under section 11 of the Indian Contract Act, 1872 every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is sound mind and is not disqualified from contracting by any law to which he is subject.

Therefore, a minor cannot become a member of a company. However, in case a minor has been admitted to a partnership it has been held that he enjoys the benefits of a partner without incurring any liability as long as he is a minor. This has been upheld in other cases as well.

In the present case therefore, as the shares are registered in the name of the minor, he shall enjoy all the benefits of a member without incurring any liability. The question of his father becoming liable does not arise as he is not a member of the company.

Therefore, the company will not succeed in making the father of the minor member liable.

Question 43

How far can a minor become a member of a company under the Companies Act, 2013?

OR

Explain the position of a minor in relation to obtaining membership in a company under the provisions of the Companies Act, 2013.

Answer

Position of a minor as a member in a company: In terms of section 11 of the Indian Contract Act, 1872 a minor is not competent to enter into contracts and hence, cannot become a member of a company as membership involves a contractual relationship between the member and the company.

A company is not allowed to register a minor as a member except under guardianship of a person competent to enter into a contract.

Hence, to take an example if X a minor wants to be registered as a member in a company, he must enter into the contract with the company through a guardian who will execute all the documents. The company in turn will register the minor as a member clearly mentioning the fact of his minority and mentioning the guardianship of the person under whom the minor has purchased the securities.

Irrespective of the mode of becoming a member, the minor can be registered as a member only under the guardianship of a person capable of entering into a contract.

Question 44

M/s Honest Cycles Ltd. has received an application for transfer of 1,000 equity shares of ₹10 each fully paid up in favour of Mr. Balak. On scrutiny of the application form it was found that the applicant is minor. Advise the company regarding the contractual liability of a minor and whether shares can be allotted to the Balak by way of transfer.

Answer

The Companies Act, 2013 does not prescribe any qualification for membership. Membership entails an agreement enforceable in a court of law. Therefore, the contractual capacity as envisaged by the Indian Contract Act, 1872 should be taken into consideration.

It was held in the case of *Mohori Bibi Vs. DharmadasGhose (1930) 30 Cal. 531 (P.O.)* that since minor has no contractual capacity, the agreement with a minor is void. Therefore, a minor or a lunatic cannot enter into an agreement to become a member of the company.

However, it is an established matter of law as evidenced in a number of cases, that in case a minor is bound in a contractual relationship he shall enjoy the benefits under the contract without being liable for anything.

Hence, if the company registers the minor as a member, he will incur no liability for the company as long as he is a minor. Going by practical legal application, companies do not register minor as members at all.

In view of the above, M/s Honest Cycles Ltd may still give membership to Balak through the transfer of 1000 shares, as the shares are fully paid up and no further liability is attached to them in any case.

Question 45

RSP Limited, allotted 500 fully paid-up shares of ₹100 each to Z, a minor, in response to his application without knowing that he was a minor and entered his name in the Register of Members. Later on, the company came to know of this fact. The company cancelled the allotment and struck-off his name from the Register of Members and also forfeited his entire share money. He filed a suit against the action of the company. Decide whether Z would be given any relief by the court under the provisions of the Companies Act, 2013

Answer

The issue of membership of a minor is not covered in the Companies Act, 2013 and the legal implications of a minor's membership will have to be examined from the Indian Contract Act, 1872.

Under section 11 of the Indian Contract Act, 1872 a minor, being incompetent to contract, cannot become member of a company. Any contract entered into by a minor is void ab initio as was held in *Mohri Bibi vs Dhramadas Ghosh* (1930)

In the case *Palaniappa vs Official Liquidator AIR 1942*, it was observed that if the directors allot shares to a minor in response to his application, without knowing that he was a minor and enter his name in the Register of Members, as soon as the company comes to know of this fact, it can eschew / cancel the allotment and strike the name of the minor off the Register of Members. However, as a contract with a minor is void, the company cannot be allowed to take undue advantage under the contract. Hence the company must refund the entire money to the minor.

On the basis of above the contention of Z is not valid. The company is empowered to cancel the allotment and strike the name of Z off the Register of Member. But the decision of the company to forfeit the entire share money of Z is wrong. The company must refund the money to the Z.

Question 46

"Every shareholder of a company is also known as a member, while every member may not be known as a shareholder." Examine the validity of the statement and point out the distinction between a 'member' and a 'shareholder'.

Or

In what way a 'Member' of a company is different from that of a 'shareholder' of the company?

Answer

Under section 2 (55) of the Companies Act, 2013 a "member", in relation to a company, means —

(i) the subscriber to the memorandum of the company who shall be deemed to have agreed to become member of the company, and on its registration, shall be entered as member in its register of members;

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

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

From the above definition of a member it is clear that in a company having a share capital, the only way to become a member is through holding shares of the company. Further, the membership becomes effective only when the name of the person is entered in the register of

members. Therefore, if a person has purchased shares in the stock exchange, from the period of purchase till the registration, though he is a shareholder he is not a member and enjoys no privileges of a member.

Similarly, in the case of companies not having share capital, the members would not be shareholders.

Question 47

Explain the provisions of the Companies Act, 2013 relating to the 'Service of Documents' on a company and the members of the company. When is service of document deemed to be effective in case the document is sent by post? Explain.

Answer

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

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

The Companies Act, 2013 does not lay down provisions relating to the service of documents either on the company or on members by the company. By drawing parallels from the Indian Contract Act, 1872 and other applicable laws, the service of any document which is sent by post is complete against the sender when it is put in course of transmission or in post to be out of the power of the sender.

Therefore, where a document is sent by post, it is enough if the letter containing the document is properly addressed and sent by ordinary post.

Question 48

The Articles of Association of Mars Company Ltd. provides that documents may be served upon the company only through Fax. Ramesh dispatches a document to the company by post, under certificate of posting. The company does not accept it on the ground that it is in violation of the Articles of Association. As a result Ramesh suffers loss. Explain with reference to the provisions of the Companies Act, 2013:

(i) What refusal of document by the company is valid?

(ii) Whether Ramesh can claim damages on this basis?

OR

The Articles Association of PQR Ltd. provided that documents upon the company may be served only through E-mail. Arvind sent a document to the company by registered post. The company did not accept the document on the ground that sending documents to the company by post was in violation of the Articles. As a result Arvind suffered loss. Decide the validity of argument of the company and claim of Arvind for damages in the light of provisions of the Companies Act, 2013.

Answer

Problem on refusal of service of document upon a company: The given case is covered by section 20 of the Companies Act, 2013 under which a document may be served on a company or an officer thereof by sending it to the company or the officer at the registered office of the company by registered post or by speed post or by courier service or by leaving it at its registered office or by means of such electronic or other mode as may be prescribed. Hence, the Company cannot refuse to accept the document merely because it was not sent by Fax as required by its Articles and its act of refusal is invalid.

In the second part of the problem, Ramesh/ Arvind can claim damages on this basis from the Company as his loss is the direct result of such refusal by the company.

Question 49

Discuss the provisions of law contained in the Companies Act, 2013 as regards to the service of documents.

Answer

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

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

Hence, it can be seen from above that the Companies Act, 2013 provides various modes to sending communications and serving documents both to the company and by the company to the Registrar and members. It may be noted that even if a particular mode is prescribed in the Articles by the company, a service of document by any other mode permissible under section

20 cannot be refused by the company merely on grounds that it is not in the prescribed mode. The Articles of the company cannot override the provisions of the Companies Act.

Question 50

MNO Private Limited, a subsidiary of PQR Limited, decides to give a loan of ₹ 4,00,000 to the HR (Human Resource) Manager, who is not a Key Managerial Personnel (KMP) of MNO Private Limited, drawing salary of ₹ 30,000 per month, to buy 500 partly paid-up Equity Shares of ₹ 1000 each in MNO Private Limited. Examine the validity of company's decision under the provisions of the Companies Act, 2013.

Answer

Restrictions on purchase by company or giving of loans by it for purchase of its share: As per section 67 (3)[8] of the Companies Act, 2013 a company is allowed to give a loan to its employees subject to the following limitations:

(a) The employee must not be a Key Managerial Personnel;

(b) The amount of such loan shall not exceed an amount equal to six months' salary of the employee.

(c) The shares to be subscribed must be fully paid shares

Section 2 (51) of the Companies Act, 2013 defines the "Key Managerial Personnel" (KMP) whereby a KMP includes the Chief Executive, Company Secretary, Whole Time Director, Chief Financial Officer or any other officer who may be prescribed.

In the given instance, HR Manager is not a KMP of the MNO Private Ltd. He is drawing salary of ₹ 30, 000 per month and loan taken to buy 500 partly paid up equity shares of ₹ 1000 each in MNO Private Ltd.

Keeping the above provisions of law in mind, the company's (MNO Private Ltd.) decision is invalid due to two reasons:

i. The amount of loan being more than 6 months' salary of the HR Manager, which should have restricted the loan to ₹ 1.8 Lakhs.

ii. The shares subscribed are partly paid shares where as the benefit is available only for subscribing fully paid shares.

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[8]Ministry Vide **Notification G.S.R. 464 (E) dated 5th June 2015**, directed that section 67 shall not apply to private companies-

(i) in whose share capital no other body corporate has invested and money;

(ii) if the borrowings of such company from banks/financial institutions. Anybody corporate is less than twice its paid up share capital/ 50 crore rupees, whichever is lower; and

(iii) Such a company is not in default in repayment of such borrowings subsisting at the time of making transactions under this section.

Question 51

Define the term "Free Reserves" as contained in the Companies Act, 2013.

Answer

Free reserve- As per section 2(43) of the Companies act, 2013, "Free Reserves" 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 unrealized gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise or

ii. Any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value shall not be treated as free reserves.

Question 52

Examine the validity of the following referring to the provisions of the Companies Act, 2013 and/or Rules:

"The Articles of Association of X Ltd. contained a provision that upto 4% of issue price of' the shares may be paid as underwriting commission to the underwriters. The Board of Directors of X Ltd. decided to pay 5% underwriting commission.

Answer

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

In the given problem, the articles of X Ltd. have prescribed 4% underwriting commission but the directors decided to pay 5% underwriting commission.

Therefore, the decision of the Board of Directors to pay 5% commission to the underwriters is invalid.

Question 53

When is an allotment of shares treated as an irregular allotment? Briefly state the effects of an irregular allotment.

Answer

Irregular allotment: The Companies Act, 2013 does not separately provide for the term "Irregular Allotment" of securities. Hence, one will have to examine the requirements of a proper issue of securities and consider the consequences of non fulfilment of those requirements.

In broad terms, an allotment of shares is deemed to be irregular when it has been made by a company in violation of Sections 23, 26, 39 and 40. Irregular allotment therefore arises in the following instances:

1. *Where a company does not issue a prospectus in a public issue as required by section 23; or*
2. *Where the prospectus issued by the company does not include any of the matters required to be included therein under section 26 (1), or the information given is misleading, faulty and incorrect; or*
3. *Where the prospectus has not been filed with the Registrar for registration under section 26 (4);*
4. *The minimum subscription as specified in the prospectus has not been received in terms of section 39; or*
5. *The minimum amount receivable on application is less than 5% of the nominal value of the securities offered or lower than the amount prescribed by SEBI in this behalf; or*
6. *In case of a public issue, approval for listing has not been obtained from one or more of the recognized stock exchanges under section 40 of the Companies Act, 2013*

Effects of irregular allotment: The consequences of an irregular allotment depend on the nature of irregularity. However, the Companies Act, 2013 does not mention (unlike the previous Companies Act) that in case of an irregular allotment the contract is voidable at the option of the allottee.

Under section 26 (9) of the Companies Act, 2013 if a prospectus is issued in contravention of the provisions of section 26, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

Similarly, in case the company has not received the minimum subscription amount within 30 days of the date of issue of the prospectus, it must refund the application money received by it within the stipulated time. Any allotment made in violation of this will be void and the defaulting company and officers will be liable to further punishment as provided in section 39 (5).

Under section 40 (5) any default made in respect of getting the approval to listing of securities in one or more recognized stock exchange in case of a public issue, will render the company punishable with a fine which shall not be less than five lakh rupees but which may extend to fifty lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year

or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

Hence, under various provisions of the Companies Act, 2013 stringent punishment has been provided for against irregular allotment of securities but the option of going ahead with such allotment even if desired by the allottee is not specifically permitted.

Exercise

1. *A minor by false declaration of his age in the share application form acquired fully paid up shares. The company on coming to know of the fact wants to remove his name. Can they do so?*

   [**Hints***:* Yes, because minor has no contractual capacity]

2. *X applied for 500 shares in a limited company in a fictitious name. The shares were allotted in that fictitious name. Referring to the relevant provisions of Companies Act, 2013 state whether X will incur any liability.*

   [**Hints:** X shall be punishable as per Section 38 (1) of The Companies Act, 2013]

3. *A limited company willing to purchase a tea estate in Assam. Extracts from experts report mentioning number of tea plants and other relevant information was incorporated in the prospectus. The expert report was found to be incorrect. Does any prospective applicant shareholder buying the shares on the basis of false information has any remedy against the company?*

   [**Hints:** Yes, as per Section 65 of the Companies Act, 2013].

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

   [**Hints**: Yes allottee can avoid the contract as per the provision given under the Section 35 (1) of the Companies Act, 2013]

5. *The Articles of Association of Star Company Ltd. provides that documents may be served upon the company only through Fax. Vikasdespatches a document to the company by post, under certificate of posting. The company does not accept it on the ground that it is in violation of the Articles of Association. As a result Vikas suffers loss. Explain with reference to the provisions of the Companies Act, 2013:*

   (i) Whether refusal of document by the Company is Valid?

   (ii) Whether Vikas can claim damages on this basis?

   [**Hints:**Refusal is not valid under section 20 (1) of the Companies Act, 2013 and Vikas can claim damages]

6. *A Public Limited Company wants to increase its subscribed share capital by offering the new shares to the persons who are not the members of the company. Referring to the provisions of the Companies Act, 2013, advice the company about the procedure the company has to adopt to give effect to the above proposal.*

   [**Hints**: Yes, company can offer the new shares to the non-members as per the provisions of the Companies Act, 2013 contained in Section 62]

7. *A company issued 20 partly paid equity shares and registered them in the name of the minor describing him as minor. The father of the minor signed the application on the minor's behalf. After some time company went into liquidation. The company filed a suit against father of the minor to recover the remaining amount on the shares. Whether the company will succeed? Advice.*

   [**Hints**: No, as the transaction was void and the father who signed the application on the minor's behalf could not be treated as having contracted for the shares (*Palaniappa B. Official Liquidator AIR 1942 Mod. 470)]*

8. *State whether television advertisements and visual clips giving all required details can be treated as a prospectus?*

   [**Hints**: No, because a prospectus must be in writing. Also refer to section 25 (prospectus is a document)]

UNIT – 3: SHARE CAPITAL

Question 1

Explain in brief 'Equity Share Capital' and 'Preference Share Capital'.

Answer

As per the [9]Section 43 of the Companies Act 2013, the share capital of a company limited by shares shall be of two types:

(i) equity share capital; and

(ii) preferential share capital.

Further the section provides for two kinds of Equity Share Capital as:

(i) those with voting rights; or

(ii) those with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed.

Explanation to section 43 of the Companies Act, 2013 defines the "preference share capital" with reference to the share capital of a company as that part of the issued share capital of the company which carries a preferential right with respect to:

a. the payment of dividend, either as a fixed amount or as a fixed percentage and which may be tax free or subject to tax;

b. repayment in the event of the winding up of the company or repayment of capital.

Under section 47 (1) of the Companies Act, 2013 every member of the company limited by shares, who holds equity shares therein, shall have the right to vote on every resolution placed before the company and his voting right on a poll shall be proportionate to his share in the paid up equity capital of the company. On the other hand under section 47 (2) of the Act, every member of a company limited by shares who is holding preference shares shall be entitled to vote on only those resolutions placed before the company which affect directly the rights attached to preference shares held by him. Further, in case of any resolution by a poll on the winding up of the company or for the repayment or reduction of equity or preference share capital, his voting right shall be proportionate to his share in the paid up preference share capital of the company.

The Companies Act, 2013 vide section 55 (1) further provides that no company limited by shares shall, after the commencement of this Act, issue any preference shares which are not redeemable. Hence, under the new company law, preference shares must be redeemed.

[9]Vide Notification G.S.R. 464 (E) dated 5th June 2015, in case of private companies section 43 and 47, shall not apply where memorandum/ articles of private company so provides.

Question 2

What are the rights of preference shareholders if dividends remained unpaid? Would your answer be different if preference shares are non-cumulative?

Or

ABC Ltd. has not given dividend to its preference shareholders. In this regard state the rights of preference shareholders and non-cumulative Preference Shareholders on dividend.

Answer

Under section 47 (2) of the Act, every member of a company limited by shares who is holding preference shares shall be entitled to vote on only those resolutions placed before the company which affect directly the rights attached to preference shares held by him. Further, in case of any resolution by a poll on the winding up of the company or for the repayment or reduction of equity or preference share capital, his voting right shall be proportionate to his share in the paid up preference share capital of the company.

Provided that where the dividend in respect of a class of preference shares hasnot been paid for a period of two years or more, such class of preference shareholders shall have a right to vote on all the resolutions placed before the company.

The above provision lays down the rights of preference shareholders who have not been paid dividend for a continuous period of 2 years and this does not change whether the shares are cumulative or noncumulative.

[Note: Vide Notification G.S.R. 464 (E) dated 5th June 2015, in case of private companies section 47, shall not apply where memorandum/ articles of private company so provides. Also Vide Notification G.S.R. 465 (E) dated 5th June 2015, in case of Nidhis, Section 47(1)(b) which deals with the right of equity shareholders, shall apply subject to modification that no member shall exercise voting rights on poll in excess of 5% of total voting rights of equity shareholders]

Question3

Examine the different aspects of the voting rights of a member.

Answer

Voting rights of a member: Section [10]47 governs the voting rights of members. Under section 47 (1) every holder of an equity share has the right to vote, on every resolution placed before the company. if the voting on the resolution is put to a poll his voting right in that case shall be

[10]Note: Vide Notification G.S.R. 464 (E) dated 5th June 2015, in case of private companies section 47, shall not apply where memorandum/ articles of private company so provides. Also Vide Notification G.S.R. 465 (E) dated 5th June 2015, in case of Nidhis, Section 47(1)(b) which deals with the right of equity shareholders, shall apply subject to modification that no member shall exercise voting rights on poll in excess of 5% of total voting rights of equity shareholders.

in proportion to his share in the paid up capital of the company. A member may exercise his right to vote personally or through a proxy.

Section 47 (2) provides for every holder of preference shares in the share capital of the company has a right to vote only on a resolution which directly affects the rights attached to the preference share capital.

The sub section further provides that in the case of any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital, the preference shareholder's voting right on a poll shall be in proportion to his share in the paid-up preference share capital of the company.

Further, the proportion of the voting rights of equity shareholders to the voting rights of the preference shareholders shall be in the same proportion as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares.

Provided further that where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, such class of preference shareholders shall have a right to vote on all the resolutions placed before the company.

Question4

When can a Public Company offer the new shares (further issue of shares) to persons other than the existing shareholders of the Company? Can these shares be offered to the Preference Shareholders?

Answer

Issue of Further Shares: Section 62 (1) (a) of the Companies Act, 2013 provides that if, at any time, a company having a share capitalproposes to increase its subscribed capital by the issue of further shares, such shares should be offered to the existing equity shareholders of the company as at the date of the offer, in proportion to the capital paid up on those shares.

However, certain exceptions have been provided in the Companies Act, 2013 when such further shares of a company may-be offered to other persons as well. These are as under-

(a) Under section 62 (1) (b) issue of further shares may be offered to employees under a scheme of employees' stock option subject to a [11]special resolution passed by the company and subject to such conditions as may be prescribed.

(b) Under section 62 (1) (c) such shares may be offered to any persons, if it is authorised by a special resolution, either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

[11]Provisions related to further issue of share capital given under section 62(1)(b) for the words "special resolution", the words "ordinary resolution" shall be substituted in case of private companies vide notification G.S.R. 464 (E) dated 5th June 2015.

(c) if any equity shareholder to whom the shares are offered in terms of section 62 (1) (a) as described above, declines such offer, the Board of Directors may dispose of the shares in such manner as is not disadvantageous to the shareholders or to the company.

Preference Shareholders - whether (Further Issue of Capital) can be offered to: From the wordings of Section 62 (1) (c), it is quite clear that these shares can be issued to any persons who may be preference shareholders as well provided such issue is authorized by a special resolution of the company and are issued on such conditions as may be prescribed**.**

Question5

VRS Company Ltd. is holding 45% of total equity shares in SV Company Ltd. The Board of Directors of SV Company Ltd. (incorporated on January 1, 2007) decided to raise the share capital by issuing further Equity shares. The Board of Directors resolved not to offer any shares to VRS Company Ltd, on the ground that it was already holding a high percentage of the total number of shares already issued, in SV Company Ltd. The Articles of Association of SV Company Ltd. provides that the new shares be offered to the existing shareholders of the company. On March 1, 2007 new shares were offered to all the shareholders except VRS Company Ltd. Referring to the provisions of the Companies Act, 2013 examine the validity of the decision of the Board of Directors of SV Company Limited of not offering any further shares to VRS Company Limited.

Answer

The legal issues in the presented problem in the question is covered under Section 62 (1) of the Companies Act, 2013 and pertains to the case *Gas Meter Co. Ltd. Vs Diaphragm & General leather co. Ltd.*

Section 62 (1) (a) of the Companies Act, 2013 provides that if, at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares should be offered to the existing equity shareholders of the company as at the date of the offer, in proportion to the capital paid up on those shares. The company cannot ignore a section of the existing shareholders and must offer the shares to the existing equity shareholders in proportion to their holdings.

Further in case of *Gas Meter Ltd. Vs Diaphragm, & General; leather Co. Ltd* where the facts of the case were similar to those given in the present case, the articles of Diaphagm Co. provided that the new shares should first be offered to the existing shareholders. However,the company offered new shares to all shareholders excepting Gas Co., which held its controlling shares. It was held that Diaphagm company had no legal authority under the Companies Act to do so.

Therefore, in the given case, SV Ltd.'s decision not to offer any further shares to VRS Co. Ltd on the ground that VRS Co. Ltd already held a high percentage of shareholding in SV Co. Ltd. is not valid for the reason that it is violative of the provisions of Section 62 (1) (a) as also substantiated by the ruling in the above referred case.

Question6

A listed company at Bombay Stock Exchange, intends to offer its new shares to non-members. State whether it is permitted under the Companies Act, 2013.

Answer

Issue of Shares to Non-Member: As per the provisions of the Companies Act, 1956 contained in section 62 (1) (a) (iii), (b) and (c)further shares in a company limited by shares may be issued to non members under certain circumstances. These are as explained below:

(a) Under section 62 (1) (b) issue of further shares may be offered to employees under a scheme of employees' stock option subject to a [12]special resolution passed by the company and subject to such conditions as may be prescribed.

(b) Under section 62 (1) (c) such shares may be offered to any persons, if it is authorised by a special resolution, either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

(c) if any equity shareholder to whom the shares are offered in terms of section 62 (1) (a) as described above, declines such offer, the Board of Directors may dispose of the shares in such manner as is not disadvantageous to the shareholders or to the company.

Question 7

The Directors of Mars India Ltd. desire to alter capital clause of Memorandum of Association of their company. Advise them, under the provisions of the Companies Act, 2013 about the ways in which the said clause may be altered and the procedure to be followed for the said alteration.

Answer

Alteration of Capital [Section 61 (1) read with section 13 of the Companies Act, 2013]: Under section 61 (1) a limited company having a share capital may, if authorized by its Articles, alter its Memorandum in its general meeting as under:

(i) it may increase its authorized share capital by such amount as it thinks expedient;

(ii) it may consolidate and divide all or any of its share capital of a larger amount than its existing shares

(iii) convert all or any of its paid up shares into stock and reconvert that stock into fully paid shares of any denomination

[12]Provisions related to further issue of share capital given under section 62(1)(b) for the words "special resolution", the words "ordinary resolution" shall be substituted in case of private companies vide notification G.S.R. 464 (E) dated 5th June 2015.

(iv) sub-divide the whole or any part of its shares into shares of smaller amount than is fixed by the Memorandum

(v) cancel those shares which,at the time of passing of the resolution in that behalf have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

Further, under section 64 where a company alters its share capital in any of the above mentioned ways, the company shall file a notice in the prescribed form with the Registrar within a period of thirty days of such alteration or increase or redemption, as the case may be, along with an altered memorandum.

Section 13 provides for the procedure to be followed for alteration of the Memorandum, as under:

a. A special resolution must be passed to effect the alteration. For this purpose a Board Meeting must be held to convene a general meeting of the members and all legal provisions in this behalf followed including the circulation of a detailed explanatory note on the proposed change alongwith the notice for the general meeting;

b. The company must file with the Registrar the special resolution passed by the company to effect an alteration in the capital clause of the Memorandum;

c. No alteration to the Memorandum will have effect unless it has been registered with the Registrar as above.

Question 8

Can a Public Limited Company reduce its Share Capital? If so, when and how? Also state the procedure it has to follow for doing so.

Answer

Reduction of Share Capital:A company is allowed to reduce its share capital subject tospecial safeguards. Section 100 of the Companies Act, 1956 provides that a company, limited by shares or guarantee and having share capital, if so authorised by the articles, may by special resolution and the confirmation of the Court, reduce its share capital in any way and in particular by.

(a) extinguishing or reducing the liability of members in respect of the capital not paid up;

(b) writing off or cancellation any paid-up capital which is in excess of the needs of thecompany,

(c) paying off any paid-up share capital which is in excess of the needs of the company.

Reduction in (b) and (c) may be made either in addition or without extinguishing or reducingthe liability of the member for uncalled capital

Reduction of share capital may in reality take three forms, viz.

1. Reducing the value of shares in order to absorb the accumulated losses suffered by thecompany without any payment to the shareholders.
2. Extinction of liability of capital not paid; and
3. Paying off any paid up share capital,

The interest of creditors is involved only in the cases stated in 2 and 3.

Procedure to be adopted

1. A special resolution is to be passed under Section 100.
2. An application is to be made under Section 101 to the Court for an order confirming the reduction.
3. After the petition for Court's confirmation is filed, the Court must settle the list of creditors who are entitled to object such as creditors having a debt or a claim admissible on a winding up.
4. The Court must ascertain the names of those creditors and the nature and amount of their debts or claims.
5. The Court may publish notices fixing a day or days within which the creditors not enteredon the list are to claim to be so entered or are to be excluded from the right of objecting to the reduction.
6. The Court has power to dispense with the consent of the dissenting creditor, on the company securing the paying of the debt or claim by appropriating the full amount of theamount fixed by the Court.

However, the Court has discretionary power having regard to any special circumstances of thecase to direct that the provisions of Section 101(2) shall not apply as regards any classes ofcreditors. The special circumstances should be convincing to the Court.

After being satisfied the Court may make an order confirming the reduction on such terms and conditions as it thinks fit. The company then has to put the words "and reduced" to the name of the company.

[Note: This section 100 of the Companies Act, 1956 is still in existence for May 2016 examination as the corresponding section 66 of the Companies Act, 2013 is not notified till 31stof October 2015]

Question 9

Can a company issue shares at discount? What is the law, in this relation, laid down in the Companies Act, 2013?

Or

What are the rules relating to issue of shares at a discount?

Or

Whether a company may issue shares at discount? State the conditions which must be fulfilled before issuing the shares at discount contained in the Companies Act, 2013.

Answer

Under section 53 (1) of the Companies Act, 2013 a company cannot issue shares at a discount except as provided in section 54.

Under section 53 (2) any share issued by a company at a discounted price shall be void.

Hence, the general rule under section 53 is that a company cannot issue shares at a discount. However, section 54 provides that notwithstanding anything contained in section 53, a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely:—

(a) the issue is authorised by a special resolution passed by the company;

(b) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

(c) not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and

(d) where the equity shares of the company are listed ona recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

Thus only sweat equity shares can be issued at a discount under section 54.

Section 2 (88) further defines "sweat equity shares" as such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Question 10

Explain the meaning of 'Sweat Equity Shares' and state the conditions a company has to fulfill for issuing such shares.

Answer

Meaning of Sweat Equity Shares: Section 2 (88) of the Companies Act, 2013 defines "sweat equity shares"as those equity shares which are issued by a company to its directors or employees at a discount or for consideration other than cash for providing their know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.

Conditions to be fulfilled before issue of Sweat Equity Shares:Notwithstanding anything contained in Section 53 (Providing for issue of shares at a discount), a company may under section 54 of the Companies Act, 2013 issue sweat equity shares if the following conditions are fulfilled:

1 The shares being issued belong to a class of shares which have already been issued.

2. The issue should be authorised by a special resolution passed by the company in general meeting.

3. The resolution should specify number of shares, current market price, consideration, if any and the class or classes of directors or employees to whom such shares areto be issued.

4. Not less than one year has elapsed at the date of such issue, since the date on which the company had commenced business.

5. Where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed. Under section 54 (2) the rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank *paripassu* with other equity shareholders.

Question 11

Whether a company can issue shares at premium?

State the purposes for which the Share Premium account can be used under the provisions of the Companies Act, 2013.

Or

Explain the provisions of the Companies Act, 2013, relating to the utilization, by a company, of the amount standing to the credit of Securities Premium Account.

Answer

There is no restriction contained in the Companies Act, 2013 on the sale of shares at a premium, i.e, at a price higher than their nominal value.

However, SEBI guidelines have to be observed as they indicate when an issue has to be at a premium.

According to the guidelines issued by SEBI a company may offer shares to the public at a premium under the following circumstances:

1. The company or its promoter company has a minimum of three year consistent record of profitable workings;

2. The promoters take up at least 50% of the shares offered in the issue;
3. The entire issue is on the same terms including the premium charged;
4. The justification for the proposed premium is fully justified and explained in the prospectus.

The premium on any shares issued may either be received in cash or in kind.

Section 52 (1) of the Companies Act, 2013 requires a company which issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account".

Under section 52 (2) the Securities Premium Account may be applied by the company only for the following purposes:

(a) Towards theissue of unissued shares of the company to the members of the company as fully paid bonus shares; or

(b) In writing off the preliminary expenses of the company; or

(c) In writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; or

(d) In providing for the premium payable on the redemption of any redeemable preference shares or debentures of the company; or

(e) For the purchase of its own shares or other securities under section 68 of the Companies Act, 2013

Question 12

Ramesh, who is a resident of New Delhi, sent a transfer deed, for registration of transfer of shares to the company at the address of its Registered Office in Mumbai. He did not receive the shares certificates even after the expiry of four months from the date of dispatch of transfer deed. He lodged a criminal complaint in the Court at New Delhi. Decide, under the provisions of the Companies Act, 2013, whether the Court at New Delhi is competent to take action in the said matter?

Answer

Jurisdiction of Court, now Tribunal, the Companies Act, 2013: According to Section 56 (4) of the Companies Act, 2013 every company, unless prohibited by any provision of law or of any order of court, Tribunal or other authority, shall deliver the certificates of all shares transferred within a period of one month from the date of receipt by the company of the instrument of transfer.

Further under section 56 (6) Where any default is made in complying with the provisions of sub-sections (1) to (5) of section 56 (which deals with transfer and transmission of shares), the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in

default shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees

The jurisdiction binding on the company is that of the state in which the registered office of the company is situated. Hence, in the given case the Delhi court is not competent to take action in the matter.

The facts of the given case are similar to *H.V. Jaya Ram Vs. ICICI Ltd., 1998*. In this case the Special Court for Economic Offences in the State of Karnataka rejected the appellant's complaint against the respondent company on the ground that since the company had its registered office at Mumbai it is only the court which has territorial jurisdiction over the registered office of the company that can entertain the petition and not the court located in the State of Karnataka where the shareholder is residing. The High Court also upheld the order of the Special Court. On appeal Supreme Court held that cause of action for failure to deliver share certificate arises where the registered office of the company is situated and not in the jurisdiction of the Court located in the place where the complaint resides.

Question 13

Differentiate between 'Share Warrant' and 'Share Certificate' under the Companies Act, 2013.

Answer

Distinction between a share warrant and a share certificate:

Sl. No.	SHARE CERTIFICATE	SHARE WARRANT
(i)	A share certificate is a prima facie evidence of document of title, stating that the holder is entitled to specified number of shares	A share warrant is a bearer document stating that the holder is entitled to certain number of shares specified therein.
(ii)	Share certificate can be issued by a public and private company	Share warrant can be issued only by public companies.
(iii)	A share certificate can be issued for a fully paid and partly paid up shares	A share warrant can be issued only with respect of fully paid up shares
(iv)	The holder of a share certificate is normally a member of the company	The bearer of a share warrant can be a member only if the articles provide.
(v)	A share certificate is not a negotiable instrument	A share warrant is by mercantile usage a negotiable instrument
(vi)	The shares can be transferred by execution of a transfer deed and its delivery along with the share certificate. The transfer is complete when it is registered by the company.	A share warrant can be transferred by mere delivery and no registration of transfer with the company is required.

(vii)	Stamps duty is payable on transfer of shares specified in a share certificate	No stamp duty is payable on transfer of a share warrant
(viii)	In order to qualify as a Director, the person should acquire shares in his own name.	This is not applicable to share warrants.

[Note: Refer RBI circular on Warrants dated 14th July 2014]

Question 14

Mr. 'Y', the transferee, acquired 250 equity shares of BRS Limited from Mr. 'X', the transferor. But the signature of Mr. 'X', the transferor, on the transfer deed was forged. Mr. 'Y' after getting the shares registered by the company in his name, sold 150 equity shares to Mr. 'Z' on the basis of the share certificate issued by BRS Limited. Mr. 'Y' and 'Z' were not aware of the forgery. State the rights of Mr. 'X', 'Y' and 'Z' against the company with reference to the aforesaid shares.

Answer

According to Section 46(1) of the Companies Act, 2013, a share certificate once [13]***issued under the common seal, if any, of the company or signed by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary"***, specifying the shares held by any person, shall be prima facie evidence of the title of the person to such shares. Therefore, in the normal course the person named in the share certificate is for all practical purposes the legal owner of the shares therein and the company cannot deny his title to the shares.

However, a forged transfer is a nullity. It does not give the transferee (Y) any title to the shares. Similarly any transfer made by Y (to Z) will also not give a good title to the shares as the title of the buyer is only as good as that of the seller.

Therefore, if the company acts on a forged transfer and removes the name of the real owner (X) from the Register of Members, then the company is bound to restore the name of X as the holder of the shares and to pay him any dividends which he ought to have received (*Barton v. North Staffordshire Railway Co. 38 Ch D 456*).

In the above case, 'therefore, X has the right against the company to get the shares recorded in his name. However, neither Y nor Z' have any rights against the company even though they are bona fide purchasers.

However, since X seems to be the perpetrator of the forgery, he will be liable both criminally and for compensation to Y and Z.

[13]Vide Notification No. S.O.1440(E) dated 29th May 2015 through the Companies (Amendment) Act, 2015 in sub-section (1), for the words "issued under the common seal of the company", the words "issued under the common seal, if any, of the company or signed by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary" shall be substituted.

Question 15

What is the law and procedure for issuing a duplicate share certificate under the provisions of the Companies Act, 2013 in case the original share certificate is lost or destroyed?

Answer

Undersection 46(2) of the Companies Act,2013 a company may issue a duplicate certificate of shares if it is proved to have been lost or destroyed or having been defaced, mutilated or torn, is surrendered to the company.

Further under section 46 (3) notwithstanding anything contained in the articles of a company

a. the manner of issue of a certificate of shares or the duplicate thereof,

b. the form of such certificate;

c. the particulars to be entered in the register of members;and

d. other matters

shall be such as may be prescribed.

Procedure: The Companies Act, 2013 does not lay down an elaborate procedure for the issue of duplicate certificates.

In case of a lost or destroyed share certificate, an application is required by the company alongwith an affidavit and an indemnity bond to issue a duplicate share certificate to the shareholder.

In case of a mutilated or torn share certificate the application with the original certificate in its mutilated or torn form sent to the company will get the shareholder a duplicate one.

Once the duplicate share certificate is issued, necessary record of the same will be made by the company in its register of members.

Question 16

"Moonstar Ltd" is authorised by its articles to accept the whole or any part of the amount of remaining unpaid calls from any member although no part of that amount has been called up. 'A', a shareholder of the Moonstar Ltd., deposits in advance the remaining amount due on his shares without any calls made by "Moonstar Ltd.".

Referring to the provisions of the Companies Act, 2013, state the rights and liabilities of Mr. A, which will arise on the payment of calls made in advance.

Answer

Section 50 (1) of the Companies Act, 2013 states that a company may, if so authorised by its articles, accept from any member, the whole or a part of the amount remaining unpaid on any shares held by him, even if no part of that amount has been called up. Hence, the Companies Act recognizes the right of a company to receive calls in advance provided it is authorized by its Articles to do so.

In the given case Mr. A, a shareholder of the 'Moonstar Ltd'., has deposited in advance the remaining amount due on his shares without any calls made by 'Moonstar Ltd'. 'Moonstar Ltd' was authorized to accept the unpaid calls by its articles. Hence, there is no irregularity in the transaction.

However, section 50 (2) further provides that a member of the company limited by shares shall not be entitled to any voting rights in respect of the amount paid by him under sub-section (1) until that amount has been called up. Hence, Mr A will not derive any additional voting rights by virtue of such advance calls paid by him.

When a company receives payment in advance of calls, the rights and liabilities of the shareholder will be as follows:

(i) The shareholder is not entitled to voting rights in respect of the moneys so paid by himuntilthe same is called up[Section 50(2)].

(ii) The shareholder's liability to the company in respect of the call for which the amount is paid is distinguished.

(iii) The shareholder is entitled to claim interest on the amount of the call to the extent payable according to the articles of association. If there are no profits, it must be paid out of capital, because shareholder becomes the creditor of the company in respect of this amount.

(iv) The amount received in advance of calls is not refundable.

(v) In the event of winding up the shareholder ranks after the creditors, but must be paid his amount with interest, if any before the other shareholders are paid off.

(vi) The power to receive the payment in advance of calls must be exercised in the general interest and for the benefit of the company.

Question17

State the differences in restrictions in transfer and effect of refusal to transfer of shares in a public and a private company?

Answer

In simple words the restriction in a transfer of shares means the conditions that must be met before shares can be transferred by a shareholder to another person. Such restrictions are applicable to private companies within the definition of such companies under section 2(68) of the Companies Act, 2013. Restrictions reduce the freedom in transferring shares.

Refusal to transfer of shares on the other hand, means an irregularity in a particular transaction which renders the registration of the transfer of shares impossible until the irregularity is removed.

Refusal to register a transfer of shares is an act of an other wise permitted transaction whereas a restriction on a transfer is an obstacle to the transaction itself. Therefore, a

shareholder may appeal to the Tribunal under section 58 (5) against a refusal to transfer but there is no remedy against a restriction imposed on transfer of shares in the Articles.

It may be mentioned that restrictions on transfer are a distinguishing feature of private companies whereas under section 58 (2) the securities of a public company are freely transferable.

Question 18

Examine the provisions of the Companies Act, 2013 regarding 'nomination' in case of transmission of shares.

Answer

Under section 56 (2) of the Companies Act, 2013 a company is required to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted. This means that a person who has acquired the right to the securities of a member by the operation of any law can further transfer those shares to a third person without being registered as a member himself. This is further reiterated in section 56 (5) whereby the transfer of any security or other interest of a deceased person in a company made by his legal representative shall, even if the legal representative is not a holder thereof, be valid as if he had been the holder at the time of the execution of the instrument of transfer.

Transmission of shares generally happens when a person acquires the shares of a deceased member by virtue of being his legal representative.

Under the Companies Act, 2013 the company must register the shares either in favour of the legal representative as the nominee of the deceased member or in favour of a third person to whom the shares have been transferred by the legal representative.

The Companies Act recognises the ownership of the shares with the legal representative whether registered or not. In case the shares are not registered in the name of the legal representative though his ownership is undisputed, he will not have any voting rights unless the shares are registered in his name.

Question 19

How nomination facility shall operate in case of transmission of shares under the provisions of the Companies Act, 2013?

Answer

In terms of the Companies Act, 2013 when any person who becomes a nominee or legal representative of a member by virtue of the operation of any law,he may, upon the production of such evidence as may be required by the Board and subject to any other applicable law, either

(a) get himself registered as holder of the securities; or

(b) transfer the securities, in favour of a third person who shall be entitled to get the securities registered in his name with the company.

If the person being a nominee, so becoming entitled, elects to be registered as holder of the securities, he shall deliver or send to the company a notice in writing signed by him stating that he so elects and such notice shall be accompanied with the death certificate of the deceased member.

Question 20

Explain the following with reference to transfer of shares in a company registered under the Companies Act,2013:

(i) Blank Transfers

(ii) Forged Transfers.

Or

"A forged transfer of shares is a nullity." Comment.

Answer

(i) Blank Transfers:A blank transfer is an instrument of transfer signed by the transferor in which the name of the transferee and the date of the transfer are not filled. The ownership of the shares in a company is generally transferred from one person to another by the execution of a document by the seller and the buyer. This document is variously described as a "transfer instrument" or "transfer deed" or simply "transfer". But in a blank transfer, the seller fills in his name and signs it. Neither the buyers' name nor his signature and the date of sale is filled in the transfer. This practice enables the buyer to sell it again and the subsequent buyer also can sell these shares again by the same transfer deed. This process can be used for a number of times. For such ultimate transfer and registration the first seller will be treated as the transferor.

However, under section [14]56 (1) of the Companies Act, 2013 a company shall not register a transfer of securities of the company, or the transfer of interest of a member in the

[14]Vide Notification G.S.R. 463 (E) dated 5th June 2015, in case of Government companies in section 56(1), after the given proviso, further following provisos shall be inserted- Provided further that the provisions of this sub-section, in so far as it requires a proper instrument of transfer, to be duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee, shall not apply with respect to bonds issued by a Government company, provided that an intimation by the transferee specifying his name, address, and occupation, if any, has been delivered to the company along with the certificate relating to the bond; and if no such certificate is in existence, along with the letter of allotment of the bond:

Provided also that the provisions of this sub-section shall not apply to a Government company in respect of the securities held by nominees of the government.

company in the case of a company having no share capital, unless a proper instrument of transfer, in such form as may be prescribed, duly stamped, dated and executed by or on behalf of the transferor and the transferee and specifying the name, address and occupation, if any, of the transferee hasbeen delivered to the company by the transferor or the transferee within a period of sixty days from the date of execution, along with the certificate relating to the securities, or if no such certificate is in existence, along with the letter of allotment of securities.

Therefore, blank transfers are no longer valid and no company will register such transfers.

(ii) Forged Transfers: According to Section 46(1) of the Companies Act, 2013, a share certificate once [15]***issued under the common seal, if any, of the company or signed by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary"***, specifying the shares held by any person shall be prima facie evidence of the title of the person to such shares. Therefore, in the normal course the person named in the share certificate is for all practical purposes the legal owner of the shares therein and the company cannot deny his title to the shares.

A Forged transfer is a nullity. It does not give the transferee concerned any title to the shares. If the company acts on a forged transfer and removes the name of the real owner from the Register of Members, then it is bound to restore the name of the real owner on the register as the holder of the shares and to pay him dividends which he ought to have received.

Question 21

'A' commits forgery and thereby obtains a certificate of transfer of shares from a company and transfers the shares to 'B' for value acting in good faith. Company refuses to transfer the shares to 'B'. Whether the company can refuse? Decide the liability of 'A' and of the company towards 'B'.

Answer

A forged transfer is a nullity in law. It does not give the transferee concerned any title to the shares. Since the forgery is an illegality therefore it cannot be a source of a valid transfer of a title. Although the innocent purchaser acting in good faith could validly and reasonably assume that the person named in the certificate as the owner of the shares was really the owner of the shares represented by the certificate. Even then the illegality cannot be

[15] Vide Notification No. S.O.1440(E) dated 29th May 2015 through the Companies (Amendment) Act, 2015 in section 46 (1), for the words "issued under the common seal of the company", the words "issued under the common seal, if any, of the company or signed by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary" shall be substituted.

converted into legality. Therefore, in this case company is right to refuse to do the transfer of the shares in the name of the transferee B without any liability.

As regards the liability of A incurs a criminal liability under the Indian Penal Code punishable both by imprisonment and also being liable to compensate both the Company and B for losses suffered by them.

Question22

X, a registered shareholder of Y Limited left his share certificates with his broker. A forged the transfer deed in favour of Z, accompanied by these share certificates lodged the transfer deed alongwith the share certificates with the company for registration. The Company Secretary who had certain doubts, wrote to X informing him of the proposed transfer and in the absence of a reply from him (X) within the stipulated time, registered the transfer of shares in the name of Z. Subsequently, Z sold the shares to J and J's name was placed in the register of shareholders. Later on, X discovered that forgery has taken place.

Referring to the provisions of the Companies Act, 2013, state the remedy available to X in the given case. Explain.

Answer

A forgery is a nullity in law and does not give any title to the persons who acquire an asset by forgery even if they have acted in good faith irrespective of the number of transactions done. In the present case, inspite of all transactions happening, X will be restored as the member by the company.

Remedies available to X:Since a forged transfer is a nullity, it does not pass any legal title to the transferee. The true owner can have his name restored on the register of member. A forged document can never have any legal effect.

X can also claim any dividend, which may not have been paid to him during the intervening period. *(Barton V North Staffordshire)*

Question 23

Explain the meaning of "transmission of Shares" under the Companies Act, 2013. In what ways is "transmission of shares" different from "Transfer of Shares"?

Answer

Transmission and transfer of shares: Under Section 56 of the Companies Act, 2013, transmission of shares takes place when shares are transferred under the operation of law, either on the death of the registered shareholder or on his being adjudged as insolvent. Where the holder is a company and it goes into liquidation the shares held by it are transmitted to its official liquidator. Upon the death of a member, the shares of the deceased vest in his legal representatives and his estate becomes liable for calls if the shares are not fully paid up. In a like manner the official assignee or the receiver, as the case may be, is also entitled to be

registered as a member in the place of shareholder who has been adjudged as insolvent *[R. W. Key and Sons (1902) IC, 467]*.

However,the executors or administrators as also the legal representative of a deceased member, may decline to be registered as members for various reasons. In that event the legal representatives, or the liquidators in case of the winding up of a corporate shareholder by virtue of Section 56 (5) shall be entitled to transfer the shares directly.

Distinction between transfer and transmission of shares

	Transfer of shares		Transmission of shares
1.	It is effected by a voluntary/deliberate act of the parties by way of a contract.	**1.**	It takes place by operation of law e.g. due to death, insolvency or lunacy of a member.
2.	It takes place for consideration.	**2.**	No consideration is involved.
3.	The transferor has to execute a valid instrument of transfer.	**3.**	There is no prescribed instrument of transfer.
4.	As soon as the transfer is complete, the liability of the transferor ceases.	**4.**	Shares continue to be subject to the original liabilities.

Question 24

What conditions as required under the Companies Act, 2013 must be satisfied by a company for the forfeiture of shares of a member, who has defaulted the payment of calls? What are the consequences of such forfeiture?

Answer

Forfeiture of Shares and the Consequences

The Companies Act, 2013 prescribes the rules and procedures of forfeiture of shares to be mentioned in the Articles of Association. Therefore, the forfeiture of shares is governed by the Articles rather than the Act itself. However, Table F of the First Schedule of the Act lays down the draft Articles of a company limited by shares which may be adopted either in full or with some modifications. In accordance with the Act and Table F the conditions and applicable rules for forfeiture of shares are as under-

1. In accordance with the Articles: Forfeiture-must be authorized by the Articles of the company and must be for the benefit of the company.
2. Notice prior to forfeiture: Before shares can be forfeited, the company must serve a notice on the defaulting shareholder requiring payment of unpaid call together with any interest which may have accrued. (Article 28:Table F).
3. Give not less than 14 days time from the date of service of notice for the payment of the amount due (Article 29 of Table F);

4. State that in the event of non-payment of the amount due within the period mentioned in the notice, the shares in respect of which the call was made will be liable to be forfeited, (Article 29. Table F). The notice of forfeiture must also specify the exact amount due from the shareholder. If the notice is defective in any respect, the forfeiture will be invalid.
5. Resolution of the Board: If a defaulting shareholder does not pay the amount within the specified time as required by the notice, the directors must pass a resolution forfeiting the shares (Article30). If the resolution is not passed, the forfeiture is invalid. If, however, the notice threatening the forfeiture incorporates the resolution of forfeiture as well, e.g., when it states that in the event of default the shares shall be deemed to have been forfeited, no further resolution is necessary.
6. Good faith: The power to forfeit shares must be exercised by the directors in good faith and for the benefit of the company.

Effect of forfeiture*:*

1. Cessation of membership: A person whose shares have been forfeited ceases to be a member in respect of the shares so forfeited. He, however, remains liable to pay to the company all moneys which, at the date of forfeiture were payable by him to the company in respect of the shares.
2. Cessation of liability: The liability of the person whose shares have been forfeited ceases if and when the company receives payment in full of all such money in respect of the shares,
3. Forfeited shares become the property of the company and may be reissued or otherwise disposed of on such terms and in such manner as the Board thinks fit. The purchaser would be liable to pay all the calls due on the shares including the call for which shares were forfeited. But where the articles provide that a shareholder whose shares have been forfeited is to remain liable for the call occasioning the forfeiture, the purchaser is liable only for the difference between the amount of the call and the sum realized on reissue, should this be less than the call.

Question 25

What are the conditions and procedure whereunder shares may be forfeited under the Companies Act, 2013?

Answer

Procedure and Conditions for Effecting Forfeiture:

Shares can be forfeited if the following conditions are fulfilled:-

(1) Shares can be forfeited only if authorised by Articles of Association of the Company. Ordinarily forfeiture of shares can take place only for the non-payment of calls due to company and in such cases, calls must have been validly made. But articles may provide

other grounds for forfeiture. *(Naresh Chandra Sanyal V. Calcutta Stock Exchange Association Ltd.)*

(2) Forfeiture is in the nature of penal proceedings. It is valid if only if the provisions of the Articles are strictly complied with.

(3) The power of forfeiture must be exercised bonafide, in the interests of the company.

Procedure: The procedure to be followed is laid down in Table F of Schedule I to the Companies Act, 2013. Articles of a company, usually, contain similar provisions. The procedure to be followed is narrated below.

(1) The company must serve a notice on the defaulting shareholder requiring payment of the unpaid call together with any interest which may have accrued (Articles 28 of Table F).

(2) The notice must -

(a) give not less than 14 days time from the date of service of notice for the payment of the amount due.

(b) state that in the event of non-payment of the amount due within the period mentioned in the notice, the shares in respect of which the call was made will be liable to be forfeited (Article 30 of Table A).

The notice of forfeiture must also specify the exact amount due from the shareholder. If the notice is defective in any respect e.g. where it does not specify the amount claimed by the company, or where it claims a wrong amount, the forfeiture will be invalid.

(3) If the defaulting share holder does not make the payment of amount within the specified time as required by the notice, the directors must pass a resolution forfeiting the shares (Article 30 of Table F).

Question 26

Explain the meaning and significance of the 'PariPassu' clause in a debenture. State the particulars to be filed with the Registrar of Companies in case of such debentures secured by a charge on certain assets of the company.

Answer

'PariPassu': *PariPassu* clause in a debenture means that all the debentures of that particular series are to be paid rateably, if, therefore, security is insufficient to satisfy the whole debts secured by the series of debentures, the amounts of debentures will abate proportionately. If this clause is not included, the debentures will rank in priority for payment in accordance with the date of issue, and if they are all issued on the same date they will be payable according to their numerical order. A company, however, cannot issue a new series of debentures so as to rank *'paripassu'* with any prior series unless the power to do so is expressly reserved and contained in the document of offer.

Registration of charge: Under section 77 (1) of the Companies Act, 2013, it shall be the duty of every company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise, and situated in or outside India, to register the particulars of the charge signed by the company and the charge-holder together with the instruments, if any, creating such charge in such form, on payment of such fees and in such manner as may be prescribed, with the Registrar within thirty days of its creation.

In terms of Rule 3 of the Companies (Registration of Charges), Rules 2014 for the registration of charge in respect of debentures the following documents should be submitted to the Registrar:

a. The particulars of charge;

b. Instrument for the creation or the modification of the charge;

c. Application in prescribed Form

Question27

What are the provisions of the Companies Act, 2013relating to the appointment of 'Debenture Trustee' by a company? Whether the following can be appointed as 'Debenture Trustee':

(i) A shareholder who has no beneficial interest.

(ii) A creditor whom the company owes ₹499 only.

(iii) A person who has given a guarantee for repayment of amount of debentures issued by the company.

Answer

Appointment of Debenture Trustee: Under section 71 (5) of the Companies Act, 2013, no company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.

The rules framed under the CompaniesAct for the issue of secured debentures provide that before the appointment of debenture trustee or trustees, a written consent shall be obtained from such debenture trustee or trustees proposed to be appointed and a statement to that effect shall appear in the letter of offer issued for inviting the subscription of the debentures.

Further according to the rules, no person shall be appointed as a debenture trustee, if he-

(i) Beneficially holds shares in the company;

(ii) Is a promoter, director or key managerial personnel or any other officer or an employee of the company or its holding, subsidiary or associate company;

(iii) Is beneficially entitled to moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;

(iv) Is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

(v) Has furnished any guarantee in respect of the principal debts secured by the debentures or interest thereon;

(vi) Hasany pecuniary relationship with the company amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(vii) is a relative of any promoter or any person who is in the employment of the company as a director or key managerial personnel;

Thus based on the above provisions answers to the given questions are:

(i) A shareholder who has no beneficial interest, can be appointed as a debenture trustee.

(ii) A creditor whom company owes ₹499 cannot be so appointed. The amount owed is immaterial.

(iii) A person who has given guarantee for repayment of principal and interest thereon in respect of debentures also cannot be appointed as a debenture trustee.

Question 28

Explain briefly the distinction between shares and debentures and state whether a company can issue debentures with voting rights.

Answer

The distinction between a share and a debenture is as under:

(i) Shares are a part of the capital of a company whereas debentures constitute a loan.

(ii) The shareholders are the owners of the company whereas debenture holders are creditors.

(iii) Shareholders generally enjoy voting right whereas debenture holders do not have any voting right.

(iv) Interest on debentures is payable even if there are no profits. Dividend can be paid to shareholders only out of the profits of the company.

(v) Debentures have generally a charge on the assets of the company but shares do not carry any such charge.

(vi) The rate of interest is fixed in the case of debentures whereas on equity shares the dividend may vary from year to year.

(vii) Debentures get priority over shares in the matter of repayment in the event of liquidation of the company.

Issue of Debentures with voting rights: Under section 71 (2) of the companies Act, 2013 no company can issue any debentures carrying voting rights.

Question29

Is registration of a charge compulsory? If not, what are the effects of non-registration?

Answer

Section 77 (1) clearly provides that it shall be the duty of every company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise, and situated in or outside India, to register the particulars of the charge signed by the companyand the charge-holder together with the instruments, if any, creating such charge in such form, on payment of such fees and in such manner as may be prescribed, with the Registrar within thirty days of its creation or such extended period as has been approved by the Registrar.

Under section 78 where a company fails to register the charge within the period specified in section 77, without prejudice to its liability in respect of any offence under this Chapter, the person in whose favour the charge is created may apply to the Registrar for registration of thecharge along with the instrument created for the charge, within such time and in such form and manner as may be prescribed and the Registrar may, on such application, within a period of fourteen days after giving notice to the company, unless the company itself registers the charge or shows sufficient cause why such charge should not be registered, allow such registration on payment of such fees, as may be prescribed.

Provided that where registration is effected on application of the person in whose favour the charge is created, that person shall be entitled to recover from the company the amount of any fees or additional fees paid by him to the Registrar for the purpose of registration of charge.

Question 30

ABC Limited realised on 2nd May, 2014 that particulars of charge created on 12th March, 2014 in favour of a Bank were not filed with the Register of Companies for Registration, what procedure should the Company follow to get the charge registered with the Registrar of Companies? Would the procedure be different if the charge was created on 12th February, 2014 instead of 12th March, 2014? Explain with reference to the relevant provisions of the Companies Act, 2013.

Answer

The prescribed particulars of the charge together with the instrument, if any by which the charge is created or evidenced, or a copy thereof shall be filed with the Registrar within 30 days after the date of the creation of charge. [Section 77 (1)]. In this case particulars of charge have not been filed within the prescribed period of 30 days.

However, the Registrar is empowered under proviso to section 77 (1) to extend the period of 30 days by another 300 days on payment of such additional fee as may be prescribed. Taking

advantage of this provision, ABC Ltd., should immediately file the particulars of charge with the Registrar and satisfy the Registrar that it had sufficient cause, for not filing the particulars of charge within 30 days of creation of charge.

There will be no change in the situation if the charge was created on 12th February,2014.

Question 31

A charge requiring registration with Registrar of Companies was created on 1st February, 2015 by XYZ Limited. The Secretary of the Company realised on 15th March, 2015 that the charge was not filed with the Registrar. State the steps to be taken by the Secretary to get the charge registered with the Registrar.

Answer

Registration of Charge: Steps for belated registration (Section 77 of the Companies Act, 2013): A charge should be registered within 30 days after the date of its creation. In this case the charge was created on 1st Feb, 2015. Hence the particulars of charge are required to be filed with the Registrar on or before 2nd March, 2015 [Section 77 (1)].

The Secretary of the company realised only on 15th March, 2015 that the charge was not filed with the Registrar. It is, however, open to the Registrar to extend the time for filing of the charge within 300 days if the company satisfies the Registrar that it had sufficient cause for not filling the particulars within 30 days. [Proviso to Section 77(1)]. The Secretary may take advantage of this provision and immediately file the particulars of charge with the Registrar giving adequate reasons for the delay. If the Registrar is satisfied, he may allow registration on payment of additional fee.

Question 32

What is the concept of "charge" under the provisions of the Companies Act, 2013? Point out the circumstances where under a floating charge becomes a fixed charge.

Answer

The word "Charge" defined under section2(16), has not been adequately defined in the Companies Act, 2013. So, the meaning of the term should be drawn from its use in normal parlance. A charge means a lien or a claim on an asset against a loan taken, providing that the owner cannot dispose off the asset without clearing off the loan. It also provides that in case the borrower defaults on the loan, the lender may dispose of the asset and use the proceeds to adjust his claim on the loan and pay the excess amount received to the borrower. Since, physical possession of the asset as a security is not possible in respect of all assets, those assets which cannot be physically taken over the by lender as securities, are charged in favour of the lender by executing a loan and a charge document.

Section 77 (1) clearly provides that it shall be the duty of every company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise, and situated in or outside India, to register the particulars of the charge signed by

the company and the charge-holder together with the instruments, if any, creating such charge in such form, on payment of such fees and in such manner as may be prescribed, with the Registrar within thirty days of its creation or such extended period as has been approved by the Registrar.

Crystallisation of a Floating Charge

Floating charge crystallizes under the following circumstances:

1. When the company goes into liquidation, or
2. When the company ceases to carry on business, or
3. When a receiver is appointed, or
4. When default is made in paying the principal and/or interest and the holder of the charge brings an action to enforce his security.

Question 33

Distinguish between "fixed Charge" and "Floating charge".

Answer

Distinction between fixed charge and floating charge:

	Fixed charge		Floating charge
1.	It is a legal charge.	1.	It is an equitable charge.
2.	It is a charge on specific, ascertained and existing asset.	2.	It is a charge on present and future assets. No specific assets.
3.	Company cannot deal with the assets except with the consent of the charge holder.	3.	Company is free to use or deal with the assets the way it likes until the charge becomes fixed.
4.	Registration of fixed charge on movable assets is not compulsory.	4.	Registration of all floating charge on all kinds of assets is compulsory by law.
5.	Fixed charge has always priority over floating charge.	5.	Ambulatory and shifting in character.

Question 34

What is meant by a floating charge? State the characteristics of a floating charge. When does a floating charge crystallise?

Answer

Floating charge: A floating charge is an equitable charge which is not a specific charge on any property of the company. Thus, the company may, despite the charge, deal with any of the assets in the ordinary course of business. It is of the essence of a floating charge that it

remains dormant until the undertaking charged ceases to be a going concern or until the person in whose favour the charge is created, intervenes.

The main characteristics of a floating charge as described in *Re.Yorkshirewool combers Association* are as follows:

(i) It is a charge on a class of the company's assets, present and future, that class being one which, in the ordinary course of the business is changing from time to time.

(ii) Generally, it is contemplated that the company carry on its business in an ordinary way with such a class of assets till some event occurs on which the charge is to settle down on the property as then existing and the charge becomes fixed. The moment the charge crystallises, it becomes a fixed charge.

A floating charge crystallises or gets fixed when:

(i) The company goes into liquidation or

(ii) The company ceases to carry on business

(iii) A receiver is appointed or

(iv) A default is made in paying the principal and/ or interest and the holder of the charge brings an action to enforce his security.

Question35

Explain briefly the provisions relating to registration, modification and satisfaction of charges.

Answer

Registration of charges:

Under section 77 (1) of the Companies Act, 2013 it shall be the duty of every company creating a charge:

a. within or outside India,

b. on its property or assets or any of its undertakings,

c. whether tangible or otherwise, and

d. situated in or outside India,

to register the particulars of the charge signed by the company and the charge-holder together with the instruments, if any, creating such charge in such form, on payment of such fees and in such manner as may be prescribed, with the Registrar within thirty days of its creation

Provided that the Registrar may, on an application made by the company, allow such registration to be made within a period of three hundred days of such creation on payment of such additional fees as may be prescribed.

Provided further that if registration is not made within a period of three hundred days of such creation, the company shall seek extension of time in accordance with section 87 which

empowers the Central Government to grant extension of time for filing of charges on an application made to it and under specified circumstances.

Provided also that any subsequent registration of a charge shall not prejudice any right acquired in respect of any property before the charge is actually registered.

Section 77 (2) provides that where a charge is registered with the Registrar under sub-section (1) (as explained above), he shall issue a certificate of registration of such charge in such form and in such manner as may be prescribed to the company and, as the case may be, to the person in whose favour the charge is created.

Section 77 (4) further provides that nothing shall prejudice any contract or obligation for the repayment of the money secured by a charge. This means that the obligation of a company to repay the debt is not affected by the non registration of the charge.

Section 78 further provides that if the company fails to register the charge, the same can be done by the person in whose favour the charge is created by following the prescribed conditions.

Modification of charge: The term 'modification' includes variation of any of the terms of the agreement including variation of rate of interest which may be by mutual agreement or by operation of law. Even if the rights of a charge holder are assigned to a third party, it will be regarded as a modification.

Section 79 of the Companies Act, 2013 provides that "whenever the terms or conditions or the extent or operation of any charge registered under section 77 of the Act are modified, it shall be the duty of the company to send to the Registrar the particulars of such modifications and get such modification registered. The provisions applicable to the registration of a charge under section 77 shall apply to modification of the charge." **Some examples of modification are as under:**

1. where the charge is modified by varying any terms and conditions of the existing charge by agreement;
2. where the modification is in pursuance of an agreement for enhancing or decreasing the limits;
3. where the modification is by ceding a paripassu charge;
4. change in rate of interest (other than bank rate);
5. change in repayment schedule of loan; (this is not applicable in working loans which are repayable on demand) and
6. partial release of the charge on a particular asset or property.

Satisfaction of charge: The term satisfacation of charge means that the company has either paid off the debt against which the charge was created or the assets charged have been disposed off and the debt paid off. In either case, the full payment of the debt results in the satisfaction of charge and when this happens the charge must be got vacated.

Under section 82 (1) a company shall give intimation to the Registrar in the prescribed form, of the payment or satisfaction in full of any charge registered under this Chapter within a period of thirty days from the date of such payment or satisfaction.

Section 82 (2) provides that the Registrar shall, on receipt of intimation under sub-section (1), send a notice to the holder of the charge calling upon him to show cause within such time not exceeding fourteen days, as may be specified in such notice, as to why payment or satisfaction in full should not be recorded as intimated to the Registrar. If no cause is shown, by such holder of the charge, the Registrar shall order that a memorandum of satisfaction shall be entered in the register of charges and shall inform the company that he has done so:

Section 83 (1) states that the Registrar may, on evidence being given to his satisfaction with respect to any registered charge

(a) that the debt for which the charge was given has been paid or satisfied in whole or in part; or

(b) that the part of the property or undertaking charged has been released from the charge or has ceased to form part of the company's property or undertaking,

enter in the register of charges a memorandum of satisfaction in whole or in part, or of the fact that part of the property or undertaking has been released from the charge or has ceased to form part of the company's property or undertaking, as the case may be

Section 82 (2) further requires the Registrar to inform the affected parties within thirty days of making the entry in the register of charges kept under sub-section (1) of section 81.

Part payment or satisfaction of charge need not be intimated to the Registrar; only satisfaction in full has to be reported within 30 days from the date of such payment of satisfaction.

Question 36

Define the term "charge" and also explain what is the punishment for default with respect to registration of charge as per the provisions of the Companies Act, 2013.

Answer

Charge- When parties agree that property shall be made available as security for the payment of debt in a transaction for value, this is termed as that charge is created.

The term charge has been defined in section 2 (16) of the Companies Act, 2013 as an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage.

Every company is under an obligation to keep at its registered office a register of charges and enter therein all charges specifically affecting property of the company and all floating charges on the undertaking or any property of the company.

Punishment for contravention – According to section 86 of the Companies Act, 2013, if a company makes any default with respect to the registration of charges covered under chapter VI, a penalty shall be levied, ranging from ₹ 1 lakh to 10 lakhs.

Every defaulting officer is punishable with imprisonment for a term not exceeding 6 months or fine which shall not be less than 25,000 rupees, but not exceeding 1 lakh rupees or both.

Question 37

Board of Directors of PQR Limited wants to create a 'Debenture Redemption Reserve (DRR)' for the redemption of debentures issued by the company under the provisions of the Companies Act, 2013. Explain the provisions of the Companies (Share Capital and Debenture) Rules, 2014 in this regard.

Answer

Debenture Redemption Reserve Account [Section 71 of the Companies Act, 2013; Companies (Share Capital and Debentures) Rules, 2014]: Where debentures are issued by a company under Section 71 of the Companies Act, 2013, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.

As per the Companies (Share Capital and Debentures) Rules, 2014, the company shall create a Debenture Redemption Reserve for the purpose of redemption of debentures, in accordance with the conditions given below:

(a) The Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend;

(b) The company shall create Debenture Redemption Reserve (DRR) in accordance with the following conditions:

- ***(i) No DRR is required for debentures issued by All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures. For other Financial Institutions (FIs) within the meaning of clause (72) of Section 2 of the Companies Act, 2013, DRR will be as applicable to NBFCs registered with RBI.***
- ***(ii) For NBFCs registered with RBI under Section 45-1A of the RBI (Amendment) Act, 1997 for Housing Finance Companies registered with the National Housing Bank, the adequacy of DDR will be 25% of the value of debentures issued through public issue as per present SEBI (issue and Listing of Debt Securities) Regulations, 2008, and no DRR is required in the case of privately placed debentures.***
- ***(iii) For other companies including manufacturing and infrastructure companies the adequacy of DRR will be 25% of the value of debentures issued through public issue as per present SEBI (Issue and Listing of Debt Securities) Regulations, 2008 and also 25% DRR is required in the case of privately placed debentures by listed companies. For unlisted companies issuing***

debentures on private placement basis, the DRR will be 25% of the value of debentures.

(c) Every company required to create Debenture Redemption Reserve shall on or before 30th day of April in each year, as the case may be, a sum which shall be not less than 15%, of the amount of its debentures, maturing during the year ending on 31st day of March of the next year, in any one or more of the following methods, namely:

(i) in deposits with any scheduled bank, free from any charge or lien;

(ii) in unencumbered securities of the Central Government or any State Government;

(iii) in unencumbered securities mentioned in sub-clauses (a) to (d) and (ee) of Section 20 of the Indian Trust Act, 1882;

(iv) in unencumbered bonds issued by any other company which is notified under sub-clause (f) of Section 20 of the Indian Trust Act, 1882;

(v) the amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above: Provided that the amount remaining invested or deposited, as the case may be, shall not at any time fall below 15% of the amount of the debentures maturing during the year ending on the 31st day of March of that year.

(d) in case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture issue in accordance with this sub-rule.

(e) the amount credited to the Debenture Redemption Reserve shall not be utilised by the company except for the purpose of redemption of debentures.

Question 38

A company refuses to register transfer of shares made by Mr. X to Mr. Y. The company does not even send a notice of refusal to Mr. X. or Mr. Y respectively within the prescribed period. Has the aggrieved party any right(s) against the company for such refusal? Advise as per the provisions of the Companies Act, 2013.

Answer

Refusal of registration and appeal against refusal: The problem as asked in the question is governed by Section 58 of the Companies Act, 2013 dealing with the refusal to register transfer and appeal against refusal.

In the present case the company has committed the wrongful act of not sending the notice of refusal of registering the transfer of shares.

Under section 58 (4), if a public company without sufficient cause refuses to register the transfer of securities within a period of thirty days from the date on which the

instrument of transfer is delivered to the company, the transferee may, within a period of sixty days of such refusal or where no intimation has been received from the company, within ninety days of the delivery of the instrument of transfer, appeal to the Tribunal.

Section 58 (5) further provides that the Tribunal, while dealing with an appeal made under sub-section (4), may, after hearing the parties, either dismiss the appeal, or by order—

(a) direct that the transfer or transmission shall be registered by the company and the company shall comply with such order within a period of ten days of the receipt of the order; or

(b) direct rectification of the register and also direct the company to pay damages, if any, sustained by any party aggrieved;.

In the present case Mr. X can make an appeal before the tribunal and claim damages.

Exercise

1. *XYZ Limited realised on 3rd May, 2010 that particulars of charge created on 11th July, 2010 in favour of a bank were not filed with the Registrar of Companies for registration. What procedure should the company follow to get the charge registered with the Registrar of Companies? Would the procedure be different if the charge was created on 11th June, 2010 instead of 11th July, 2010? Explain with reference to the relevant provisions of the Companies Act, 2013.*

   [**Hints**: As per the provisions given under Section 77 of the Companies Act,2013]

2. *X had applied for the allotment of 1,000 shares in a company. No allotment of shares was made to him by the company. Later on, without any further application from X, the company transferred 1,000 partly-paid shares to him and placed his name in the Register of Members. X, knowing that his name was placed in the Register of Members, took no steps to get his name removed from the Register of members. The company later on made final call. X refuses to pay for this call. Referring to the provisions of the Companies Act, 2013, examine whether his (X's) refusal to pay for the call is tenable and whether he can escape himself from the liability as a member of the company.*

   [**Hints** Section 88 and 89 of the Companies Act,2013]

3. *State whether the following statements are correct or incorrect. Give reasons:*

   (i) Right shares means shares which are issued by a newly formed company.

   (ii) A bearer of a share warrant of a company is not member of the company.

   (iii) Debenture with voting rights can be issued only if permitted by the Articles of Association.

   [**Hints**: (i) incorrect,as per Section 62 of the Companies Act,2013 (ii)Correct, Please read RBI Circular on Share Warrants July 2014 (iii) incorrect, as per Section 71 (2) of the Companies Act,2013]

4. *X purchased 100 equity shares of ABC ltd. from Y. Though the amount of transaction was paid to the seller, the transferee name is not appearing in the list of members. Subsequently, the*

company declared dividend. Referring to the provisions of the Companies Act, 1956 state to whom the company will be paying the dividend

[**Hints:** According to section 123 (5) of the Companies Act,2013 dividend shall be paid only to the registered holder of shares or to his order or to his bankers or to the bearer of a share warrant.]

5. *T, a share broker at Bombay Stock Exchange, is also the Secretary of XYZ Ltd. He applied for the allotment of 1000 equity shares being issued by the Company and paid the full amount. M, one of the clerks of T, owning no shares executed a transfer deed in favour of T without enclosing the share certificate. The Company without asking for the share certificate from M (the clerk) registered the transfer and issued a new share certificate. On declaration of dividend by the Company T was denied the right to get dividend on the grounds that the share certificate issued to T had no validity. T moves the Court praying the Court to declare the share certificate as valid and also claims for damages.*

   Examine the case and decide whether T's claim is valid.

   [**Hints**: T's claim is invalid, read section 123 (5). Also read 56 (1). It is impossible to get the shares registered in favor of M without the documnets specified in section 56 (1). It shows fraud on the part of M and gross negligence on the part of T. Read section 56 (6) and 57 also]

6. *State whether the given statements are true or false with reasons-*

   (i) Deferred shares also called founders' shares.

   (ii) To authorise the issue of shares at a discount, a special resolution is required.

   [**Hints:** (i) True. Since deferred shares are often held by the promoters of the company, they are called so.

   (ii) False, as per Section 54 of the Companies Act, 2013]

UNIT – 4: MEETINGS AND PROCEEDINGS

Question 1

In what way does the Companies Act, 2013 regulate the holding of an Annual General Meeting by a company? Explain.

Answer

Provisions relating to regulation of AGM under the Companies Act, 2013:

Section 96 of the Companies Act, 2013 regulates the holding of an Annual General Meeting by a company. Accordingly, section provided that:

1. Every company, other than a one person company, shall in each year hold in addition to any other meetings,an annual general meeting and shall specify the meeting as such in the notices calling it; and not more than 15 months shall elapse between the date of one annual AGM of a company and that of the next.

   A company may hold its first AGM within a period of nine months from the date of closing of its first financial year and in every other case within a period of six months from the date of closing of the financial year;

   Further, if a company holds its first annual general meeting as aforesaid, it shall not be necessary for the company to hold any AGM in the year of its incorporation.

   However, the Registrar may, for any special reason, extend the time within which any AGM (not being the first AGM) shall be held, by a period not exceeding 3 months.[Section 96(1)]

2. [16]Every AGM shall be called during business hours,i.e. between 9 am and 6 pm on any day that is not a National holiday, and shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situated.

   The Central Government may however; exempt any company from the provisions of this sub-section subject to such conditions as it may impose.[Section 96(2)]

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[16]Vide Notification G.S.R. 463 (E) dated 5th June 2015, in case of Government Companies in section 96(2), for the words "some other places within city, town, or village in which the registered office of the company is situate", the words "such other place as the Central Government may approve in this behalf" shall be substituted.
Vide Notification G.S.R. 466 (E) dated 5th June 2015, in case of section 8 companies in section 96(2),after the proviso and before explanation, the following proviso shall be inserted-
Provided further that the time, date and place of each AGM are decided upon before-hand by the Board of Directors having regards to the directions, if any, given in this regards by the company in its general meeting.

Further, section 167 of the Companies Act, 1956***(Corresponding section 97 of the Companies Act, 2013 not notified till 31stOctober, 2015)***provides for the power of the Company Law Board to call annual general meeting under certain circumstances:

(1) If default is made in holding an AGM in accordance with Section 166 of the Companies Act, 1956 (i.e., **section 96 of the Companies Act, 2013**), the CLB may, notwithstanding anything in the Act or in the articles of the company, on the application of any member of the company, call, or direct the calling of, a general meeting of the company and give such ancillary or consequential directions as the CLB thinks expedient in relation to the calling, holding and conducting of the meeting.

(2) A general meeting held in pursuance of sub-section (1) shall, subject to any directions of the CLB, be deemed to be an AGM of the company.

Further Section 168 of the Companies Act, 1956 **(*Corresponding Section 99 of the Companies Act, 2013 not notified till 31stOctober, 2015*)** provides that if default is made in holding a meeting of the company in accordance with Section 166 of the Companies Act, 1956 (i.e., **section 96 of the Companies Act, 2013)**, or in complying with any directions of the CLB under sub-section (1) of Section 167, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to ₹50,000 and in the case of *a* continuing default, with a further fine which may extent to ₹2,500 for every day after the first during which such default continues

[Note: Section 167 and 168 of the Companies Act, 1956 is still in force as their corresponding sections 97 &99 of the Companies Act, 2013 are not notified till 30th April, 2016]

Question 2

Explain the provisions of the Companies Act, 2013 relating to holding of Annual General Meeting of the Company with regard to the following:

(i) Period within which the first and the subsequent Annual General Meetings must be held.

(ii) Business which may be transacted at an Annual General Meeting.

Answer

(i) Period Within which first and the subsequent AGM must be held:

(a) Under the first proviso to section 96 (1) of the Companies Act, 2013

(1) A company may hold its first AGM within a period of nine months from the date of closing of its first financial year;

(2) Every subsequent annual general meeting must be held within a period of six months from the date of closing of the financial year.

(3) However, the third proviso to section 96 (1) empowers the Registrar, for any special reason, to extend the time within which any AGM (other than the first

AGM) shall be held, by a period not exceeding 3 months. Hence, the Registrar is not empowered by the Act to extend the time for holding the first annual general meeting of a company even under special circumstances.

(b) Further Section 168 of the Companies Act, 1956 provides that if default is made in holding a meeting of the company in accordance with Section 166(i.e., section 96 of the Companies Act, 2013), or in complying with any directions of the CLB under sub-section (1) of Section 167, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to ₹50,000 and in the case of *a* continuing default, with a further fine which may extent to ₹2,500 for every day after the first during which such default continues.

[**Note: Sections 168 & 167 of the Companies Act, 1956 is still in existance as the corresponding Sections 97 &99 of the Companies Act, 2013 not notified till 30th April, 2016]**

(ii) [17]**Business to be transacted at an Annual General Meeting:**Under section 102 (2) of the Companies Act, 2013 the following businesses may be transacted at an annual general meeting:

1. Ordinary Business; Viz.
   (a) The consideration of the financial statements and the report of the Board of Directors and the Auditors;
   (b) The declaration of any dividend;
   (c) The appointment of directors in place of those retiring; and
   (d) The appointment of and the fixing of the remuneration of the auditors.
2. Special Business: Any business other than the above mentioned four shall be deemed to be a special business, which may be transacted at any AGM.

Question 3

M/s Low Esteem Infotech Ltd. was incorporated on 1.4.2014. No General Meeting of the company has been held so far. Explain the provisions of the Companies Act, 2013 regarding the time limit for holding the first annual general meeting of the Company and the power of the Registrar to grant extension of time for the First Annual General Meeting.

Answer

According to Section 96 of the Companies Act, 2013, every company shall be required to hold its first annual general meeting within a period of 9 months from the closing of its first financial year.

[17]Vide Notification G.S.R. 464 (E) dated 5th June 2015, in case of private companies section 102 shall apply unless otherwise specified in respective sections or the articles of the company provide otherwise.

Presuming that the first financial year of Low Esteem Infotech Ltd is for the period 1st April 2014 to 31st March 2015, the first annual general meeting of the company should be held on or before 31st December, 2015.

Even though the Registrar of Companies is empowered to grant extension of time for a period not exceeding 3 months for holding the annual general meetings, such power does not apply in the case of the first annual general meeting. Thus, the company and its directors will be liable under section 168 of the Companies Act, 1956 for the default if the annual general meeting was held after 31st December, 2004.

[**Note: Section 168 of the Companies Act, 1956 is still in existence as corresponding section 99 of the Companies Act, 2013, is not notified till 30th April, 2016]**

Question 4

Can an annual general meeting be held on a national holiday?

Answer

An annual general meeting cannot be held on a national holiday. Under section 96 (2) of the Companies Act, 2013 every annual general meeting shall be called during business hours, that is, between 9 a.m. and 6 p.m. on any day that is not a National Holiday. A national holiday has been defined in the explanation to section 96 as a day declared as National Holiday by the Central Government.

A day may be declared to be a national holiday after the notices calling the meeting for the day have already been issued. To avoid the difficulties that may be caused from such a situation, no day declared by the Central Government to be a national holiday shall be deemed to be such a holiday in relation to any meeting, unless the declaration was notified before the issue of the notice convening such meeting.

Question 5

State with reason whether the following statement is correct or incorrect:

A company should file its annual return within six months of the closing of the financial year.

Answer

The statement is incorrect in terms of section 92 (4) of the Companies Act, 2013.

Section 92 (4) states that every company shall file with the Registrar a copy of the annual return, within sixty days from the date on which the annual general meeting is held or where no annual general meeting is held in any year within sixty days from the date on which the annual general meeting should have been held together with the statement specifying the reasons for not holding the annual general meeting, with such fees or additional fees as may be prescribed.

Question6

To remove the Managing Director, 40% members of Global Ltd. submitted requisition for holding extra-ordinary general meeting. The company failed to call the said meeting and hence the requisitionists held the meeting. Since the Managing Director did not allow the holding of meeting at the registered office of the Company, the said meeting was held at some other place and a resolution for removal of the Managing Director was passed.

Examine the validity of the said meeting and resolution passed therein in the light of the Companies Act, 2013.

Answer

Section 100 (2) of the Companies Act, 2013 makes it obligatory on the Board of Directors to convene an extra ordinary meeting of members if requisitioned by the stipulated number of members. 40% of members constitute the required number and the board of directors have violated the provisions of law by not calling the meeting.

However, section 100 (4) of the Companies Act, 2013 provides that if Boardfail to proceed to call a meeting within 21 days from the date of receipt of a valid requisition for a date within 45 days of the receipt of the requisition, the requisitionists may themselves call a meeting within 3 months of the date of the requisition.

Moreover, where a meeting is called by the requisitionists and the registered office is not made available to them, it was decided in *R. Chettiar v. M. Chettiar* that the meeting may be held any where else.

Further, resolutions properly passed at such a meeting, are binding on the company.

Thus, in the given case, since all the above mentioned provisions are duly complied with. Hence the meeting with the resolution removing the managing director shall be valid.

Question 7

Examine the validity of the following with reference to the relevant provisions of the Companies Act, 2013:

(i) The Board of Directors of a company refuse to convene the extraordinary general meeting of the members on the ground that the requisitionists have not given reasons for the resolution proposed to be passed at the meeting.

(ii) The Board of Directors refuse to convene the extraordinary general meeting on the ground that the requisitions have not been signed by the joint holder of the shares.

(iii) Adjournment of extraordinary general meeting called upon the requisition of members on the ground that the quorum was not present at the meeting.

Answer

As per Section 100 (2) of the Companies Act 2013, the Board of directors must convene a general meeting upon requisition by the stipulated minimum number of members. Further

section 100 (3) the requisition, made under sub-section (2) for convening an extra ordinary general meeting of members, shall set out the matters for the consideration of which the meeting is to be called and shall be signed by the requisitionists and sent to the registered office of the company. The requisitioning members are not required to give reasons for the resolutions proposed so long as the matters are to be dealt with at the meeting are disclosed and the statement in terms of section [18]102 (1), setting out all material facts relating to each item of business to be transactedis attached to the requisition. This is essential as each such business transacted will be a special business and will require such statement to be sent along with the notice for the meeting.

Based on the above provisions of the Companies Act, 2013 the validity of the cases presented in the question would be as under:

(i) In view of the above law, the board of directors cannot refuse to convene the meeting if the reasons for the resolution are not given. What is required to be stated is the objects of the meeting, i.e., the matters for the consideration of which the meeting and resolutions to be passed. It is also reasonable to assume that the statement of all material facts on the proposed resolution should also be given by the requisitionistsas the Board may not be able to prepare such statement as it is not proposing the resolution in the first place. The material information regarding the resolution basically means the justification for the resolution which need not be given.

In given problem (i) the Board of Directors cannot refuse to convene the meeting because reasons for the resolution is not given.

(ii) Where two or more persons hold any shares or interest in a company jointly, a requisition, or notice calling a meeting, signed by one or some of them shall, for the purposes of this section, have the same force and effect as if it had been signed by all of them. On the basis of above section the Board of Directors has no right to refuse to convene the meeting in the given problem (ii).

(iii) As per Section [19]103 (2) (b) of the Companies Act, 2013, if the quorum is not present within half an hour from the appointed time for holding a meeting of the company, the meeting, if called on the requisition of members, shall stand cancelled.Therefore,the meeting stands cancelled and the stand taken by the Board of Directors to adjourn it,is not proper in the given problem (iii).

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[18]Vide Notification G.S.R. 464 (E) dated 5th June 2015, in case of private companies section 102 shall apply unless otherwise specified in respective sections or the articles of the company provide otherwise.

[19]Vide Notification G.S.R. 464 (E) dated 5th June 2015, in case of private companies section 103 shall apply unless otherwise specified in respective sections or the articles of the company provide otherwise.

Question8

What are the requirements for the conduct of valid general meetings?

Answer

The business at a meeting of members of a company is said to have been "validly transacted" if the members, whether present personally or through proxies, have voted on the resolutions with the required majority. Once the resolutions have been validly passed all members are bound by them. However, they cannot be so bound unless the meeting is validly held.

The essentials of a valid meeting are that the meeting should be:

(a) *Properly convened:, i.e.* a proper notice must be sent by the proper authority to every person entitled to attend.

(b) *Properly constituted*, i.e. the proper person must be in the chair, the rules as to quorum must be observed, and the regulations governing the meeting must be complied with.

(c) *Properly conducted*, i.e. the chairman must conduct the proceeding in accordance with the law relating to general meetings under the various provisions of the Companies Act 2013.

Question 9

Dinesh, a director in a company, gave in writing to the company that notice for any General Meeting and the Board of Directors' Meeting be sent to him at his address in India only by Registered Mail and for which he paid sufficient money. The company sent two notices to him, of such meetings, by ordinary mail, and under certificate of posting. Dinesh did not receive the said notices and could not attend the meetings and the proceedings thereof on the ground of improper notice. Decide in the light of the provisions of the Companies Act, 2013:

(i) Whether the contention of Dinesh is valid?

(ii) Would you answer be still the same in case Dinesh remained outside India for two months (when such notices were given and meetings held).

Answer

The problem as asked in the question is based on the provisions of the Companies Act, 2013 as contained in Section [20]101. Accordingly, the notice may be served personally or sent through post to the registered address of the members and, in the absence of any registered office in India, to the address, if there be any within India furnished by him to the company for the purpose of servicing notice to him. Service through post shall be deemed to have effected by correctly addressing, preparing and posting the notice. If, however, a member wants the notice to be served on him under a certificate or by registered post with or with acknowledgement due and has deposited money with the company to defray the incidental

[20]Vide Notification G.S.R. 464 (E) dated 5th June 2015, in case of private companies section 101 shall apply unless otherwise specified in respective sections or articles of the company provide otherwise.

expenditure thereof, the notice must be served accordingly, otherwise service will not be deemed to have been effected.

Accordingly, the questions as asked may be answered as under:

(i) The contention of Dinesh shall be tenable, for the reason that the notice was not properly served and meetings held by the company shall be invalid.

(ii) In view of the provisions of the Companies Act, 2013, the company is not bound to send notice to Dinesh at the address outside India. Therefore, answer in the second case shall differ from the first one.

Question 10

Dev Limited issued a notice for holding of its Annual General Meeting on 7th November, 2015. The notice was posted to the members on 16.10.2015. Some members of the company allege that the company had not complied with the provisions of the Companies Act, 2013 with regard to the period of notice and as such the meeting was not validly called. Referring to the provisions of the Act, decide:

(i) Whether the meeting has been validly called?

(ii) If there is a short fall in the number of days by which the notice falls short of the statutory requirement, state and explain by how many days does the notice fall short of the statutory requirement?

(iii) Can the short fall, if any, be condoned?

Answer

(i) 21 Days clear notice of an AGM must be given [[21]Section 101 (1), Companies Act, 2013]: In case of notice by post, the notice shall be deemed to have been received on expiry of 48 hours from the time of its posting. Besides, for working out clear 21 days, the day of the notice and the day of the meeting shall be excluded. Accordingly, 21 clear days notice has not been served (only 19 clear days notice is served) and the meeting is, therefore, not validly convened.

(ii) As explained in (i) above, notice falls short by 2 days.

(iii) According to proviso to Section 101 (1), an AGM called at a notice shorter than 21 clear days shall be valid if consent is given in writing or by electronic mode by not less than ninety-five per cent. of the members entitled to vote at such meeting.

Question11

Company served a notice of General Meeting upon its members. The notice stated that a resolution to increase the share capital of the Company would be considered at such meeting.

[21]Vide Notification G.S.R. 466 (E) dated 5th June 2015 in case of section 8 companies in Section 101(1), for the words "twenty one days", the words "fourteen days" shall be substituted.

A shareholder complaints that the amount of the proposed increase was not specified in the notice. Is the notice valid?

Answer

Under section 102(2)(b) in the case of any meeting other than an AGM, all business transacted thereat shall be deemed to be special business.

Further under section 102 (1),a statement setting out the following material facts concerning each item of special business to be transacted at a general meeting, shall be annexed to the notice calling such meeting, namely:—

(a) the nature of concern or interest, financial or otherwise, if any, in respect of each items, of:

  (i) every director and the manager, if any;

  (ii) every other key managerial personnel; and

  (iii) relatives of the persons mentioned in sub-clauses (i) and (ii);

(b) any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

Thus, the objection of the shareholder is valid since the details on the item to be considered are lacking. The information about the amount is a material fact with reference to the proposed increase of share capital. The notice is, therefore, not a valid notice under Section [22]102 of the Companies Act, 2013.

Question 12

Who are entitled to get notice for the general meeting called by a Public Limited Company registered under the Companies Act, 2013? Does the non-receipt of a notice of the meeting by any one entitled to such notice invalidate the meeting and the resolution passed thereat? What would be your answer in case the omission to give notice to a member is only accidental omission?

Answer

Under section 101 (3) of the Companies Act, 2013 "Notice" of every meeting of the company shall be given -

(i) to every member of the company, legal representative of any deceased member, or the assignee of an insolvent member;

(ii) to every director of the company;

(iii) to a auditor or auditors and,

[22]Vide Notification G.S.R. 464 (E) dated 5th June 2015, in case of private companies section 102 shall apply unless otherwise specified in respective sections or articles of the company provide otherwise.

The private company, which is not, a subsidiary of a public company may prescribe, by its Articles, persons to whom the notice should be given.

Any accidental omission or the non receipt of notice by any member or other person entitled to such notice shall not invalidate the proceedings in the meeting [Section 101 (4)].

However, omission to serve notice of meeting on a member on the mistaken ground that he is not a shareholder cannot be said to be an accidental omission. Accidental omission means that the omission must be not only designed but also not deliberate. *[Maharaja Export Vs. Apparels Exports Promotion Council (1986)].*

Question 13

M. H. Company Limited served a notice of general meeting upon its shareholders. The notice stated that the issue of sweat equity shares would be considered at such meeting. Mr. 'A', a shareholder of the M. H. Company Limited complains that the issue of sweat equity shares was not specified fully in the notice. Is the notice issued by M. H. Company Limited regarding issue of sweat equity shares valid according to the provisions of the Companies Act, 2013? Explain in detail.

Answer

Under section 102 (2) (b) in the case of any meeting other than an AGM, all business transacted thereat shall be deemed to be special business.

Further under section 102 (1) a statement setting out the following material facts concerning each item of special business to be transacted at a general meeting, shall be annexed to the notice calling such meeting:

(a) the nature of concern or interest, financial or otherwise, if any, in respect of each items, of every director and the manager, if any or every other key managerial personnel and relatives of such persons; and

(b) any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

Thus, the objection of the member is valid since the complete details about the issue of sweat equity should be sent with the notice. The notice is, therefore, not a valid notice under Section 102 of the Companies Act, 2013.

Question14

ABC Ltd. called its annual general meeting on 7th April, 2015. The notice of AGM was posted on 16th March, 2015. One member holding 20 shares wishes to challenge the resolutions passed at the AGM on the ground that the notice was not valid. What advise would you give to him?

Answer

According to Section 101(1) of the Companies Act, 2013 a general meeting of a company may be called by giving not less than 21 clear days notice in writing or through electronic mode. 21 clear days means that the notice period will exclude both the date on which the notice was served and the date of the meeting.

In case the notice of the general meeting is sent by post, service of notice of the meeting shall be deemed to have been effected at the expiry of 48 hours after it was posted.

In the instant case, the notice was short of twoday as per the section:

16th March to 7th April	23 days
Less date of service and date of meeting	2 days
Clear number of days of notice	21 days
Less 48 hours of posting	2 day
	19 days

Therefore, the meeting was invalid and the resolutions passed were invalid. However in case AGM, where at least 95% of the members entitled to vote consent to a shorter notice in writing or by electronic mode, have so consented the meeting may be held on shorter notice.

In *SalieshHarilal Shah v. Matushree Textiles Ltd. (1994) 2CLJ, 291,* the Bombay High Court [in contrast to the Madras High Court decision in *N. Chettair(v) the Madras Race Club (1951]* held that the requirement of the section as length of notice is directly only and not mandatory. A couple of shareholders cannot be permitted to defeat the interest of the large body of shareholders by saying that the duration of the notice was not sufficient even if the short notice does not indicate any prejudice to the complaining shareholders.

Therefore, the member may be advised to explore whether he has suffered any prejudice by the short notice before proceeding to challenge the validity of the resolution.

Question15

The annual general meeting for 2012-2013 and 2013-14 were convened on 7-10-20015 belatedly and with great difficulty. The notice of the meeting was published in a newspaper of Calcutta on 12-9-2015. The shareholders received the notice 22-9-2015 which was shown to have been posted on 16-9-2015. The notice was dated 9-9-2015. D sought an injunction that the resolutions passed at the meetings are not given effect to, on the ground that the notice was received by him on 22-9-2015. D held only seven shares of ₹10 in the company and was a resident of Kolkata where the meeting was to be held.

State whether the shortness of the notice invalidated the meeting?

Answer

Section 101 (4) of the Companies Act, 2013 makes it abundantly that it is not a condition precedent to the holding of the annual general meeting of a company that a clear 21 days

notice must be given to each and every member of the company. The accidental omission to give notice to any member or non-receipt of notice by any member shall not invalidate the proceedings at the meeting.

In the present case therefore, the contention of D cannot be upheld. He cannot hijack the proceedings of the entire meeting for an accidental delay in receipt of notice by him.

Question16

Mr. DP, Secretary, of City Handicrafts Ltd. called an extraordinary general meeting of the company on the requisition of some members. Mr. DP, Secretary of the Company, issued notice of the meeting without the authority of the Board of Directors. Discuss on the validity of the notice issued by Mr. DP, Secretary of the City Handicrafts Ltd.

Answer

The Annual General Meeting or Extra-ordinary General Meeting can be called only with authority of Board of Directors i.e. by passing necessary resolution in the Board Meeting or by Circular resolution. An Annual General Meeting or Extra-ordinary General Meeting cannot be called by an individual director or some of the directors or by secretary. Now, in the instant case, Mr. DP, Secretary of City Handicrafts Ltd., called an extraordinary general meeting on requisition of some members. He issued notice of the meeting without the authority of the Board of Directors. The Secretary of the company does not have the power to call the meeting by himself by issuing notices. Unless the Secretary is specifically authorized either by the board of directors or by the articles, any meeting called by him and the business done there at it would be null and void *(Al Amin Seatrans Ltd. Vs. Owners and Party Interested in Vessel M V "Loyal Bird").*

However, the notice of the meeting may be ratified by the Board of Directors of the company before the meeting is held to make it good (Hooper Vs. Kerr. Stuart & Co.). Thus, the notice issued by Mr. DP may be ratified by the Board of Directors of City Handicrafts Ltd., to make it valid.

Question 17

Referring to the provisions of the Companies Act, 2013 state the matters relating to 'Ordinary Business' which may be transacted at the Annual General Meeting of a Company. What kinds of resolutions need to be passed to transact the 'Ordinary Business' and the 'Special Business' at the Annual General Meeting of the Company? Explain.

OR

State the ordinary business which may be transacted at an Annual General Meeting of a public limited company incorporated under the Companies Act, 2013.

Answer

(i) Ordinary Business [Section 102 (2)]: In accordance with the provision of Companies Act, 2013 as contained in Section 102 (2), the only ordinary business can be transacted at an AGM and comprises of the following business:

(a) Consideration of financial statements and the reports of the Board of Directors and auditors.

(b) Declaration of dividend.

(c) Appointment of Directors in place of those retiring; and

(d) appointment of auditors and fixation of their remuneration.

(ii) Special Business: Any other business transacted at the annual general meeting or at any other meeting of the members shall be deemed to be special business.

Ordinary business can be passed by an ordinary resolution. However, special business may be transacted either by passing ordinary resolution or special resolution, depending upon the requirements of Companies Act, 2013.

Question 18

State what is meant by "Quorum" and when does quorum be considered immaterial under the provisions of the Companies Act, 2013.

Answer

Quorum means the minimum number of members that must be present in person in order to constitute a meeting and transact business thereat. Thus quorum represents the minimum number of members on whose presence the meeting of a company can commence its business. Under section 103 (2) in case the quorum is not present within half-an-hour from the time appointed for holding a meeting of the company the meeting shall stand adjourned to the same day in the next week at the same time and place, or to such other date and such other time and place as the Board may determine; or the meeting, if called by requisitionists under section 100, shall stand cancelled. Therefore, the quorum is an extremely important element of a validly held meeting.

Under the Companies Act, 2013 quorum is never considered immaterial in the holding of a valid meeting. However, under only one situation a meeting will be validly held even if the quorum is not present. If all the members are present, it is immaterial that the quorum required by the Articles is more than the total number of members and in such a case the meeting will be validly held even if the quorum as laid out in the Articles is not present. If for example, the Articles of a private company provide that 4 members personally present shall be a quorum and the number of members is reduced to 3, the meeting of members will be validly held when all the 3 members attend the meeting.

Question 19

The Articles of Association of X Ltd. require the personal presence of 7 members to constitute quorum of General Meetings. The following persons were present in the extra-ordinary meeting to consider the appointment of Managing Director:

(i) A, the representative of Governor of Madhya Pradesh.

(ii) B and C, shareholders of preference shares,

(iii) D, representing Y Ltd. and Z Ltd.

(iv) E, F, G and H as proxies of shareholders.

Can it be said that the quorum was present in the meeting?

Answer

Quorum: In this case the quorum for holding a general meeting is 7 members to be personally present. For the purpose of quorum, only those members are counted who are entitled to vote on resolution proposed to be passed in the meeting.

Again, only members present in person and not by proxy are to be counted. Hence, proxies whether they are members or not will have to be excluded for the purposes of quorum.

If a company is a member of another company, it may authorize a person by resolution to act as its representative at a meeting of the latter company, then such a person shall be deemed to be a member present in person and counted for the purpose of quorum Where two or more companies which are members of another company, appoint a single person as their representative then each such company will be counted as quorum at a meeting of the latter company.

Further the President of India or Governor of a State, if he is a member of a company, may appoint such a person as he thinks fit, to act as his representative at any meeting of the company. A person so appointed shall be deemed to be a member of such a company and thus considered as member personally present.

In view of the above there are only three members personally present.

'A' will be included for the purpose of quorum. B & C have to be excluded for the purpose of quorum because they represent the preference shares and since the agenda being the appointment of Managing Director, their rights cannot be said to be directly affected and therefore, they shall not have voting rights. D will have two votes for the purpose of quorum as he represents two companies ' Y Ltd.' and 'Z Ltd.' E, F, G and H are not to be included as they are not members but representing as proxies for the members.

Thus it can be said that the requirements of quorumhas not been met and it shall not constitute a valid quorum for the meeting.

Question 20

DJA Company Ltd. has only 50 preference shareholders. A meeting of the preference shareholders who called by the company for amending the terms of these shares. Mr. A, was the only preference shareholder who attended the meeting. He, however, held proxies from all other shareholders. He took the Chair, conducted the meeting and passed a resolution for amending the terms of the issue of these shares. Referring to the provisions of the Companies Act, 2013, examine the validity of the meeting and the resolution passed thereat.

Answer

Under section 103 (1) unless the articles of the company provide for a larger number, in case of a public company, five members personally present shall be the quorum for a meeting of the company, if the number of members as on the date of meeting is not more than one thousand.

The case given in the question corresponds to the decision.This question was decided in *Sharp Vs., Dawes*wherein it was held that "The word meeting prima facie means coming together of more than one person." In this given case, only one shareholder was present and it was held that the meeting was not validly held.

Further in *East Vs. Bennet Brothers Ltd. (1911)* it has been held that in case of a meeting of a particular class of members if all the shares of that particular class are held by one person, then that one person shall form the quorum.

In the given case therefore, the applicable quorum will be 5 members and since all the shares are not held by one person but there are 50 members, no quorum is therefore present. The meeting and the resolution passed there shall not be valid.

Question 21

State the legal position in the following circumstance with reference to the provisions in the Companies Act, 2013.

At an adjourned extraordinary general meeting of a Public Ltd. Company adjourned for want of quorum, only 3 members are personally present.

Answer

In the given case the quorum is not present even at the adjourned meeting as under section 103 (1) the quorum in a public company shall be five members personally present if the number of members as on the date of meeting is not more than one thousand. Such a meeting stands adjourned to the same day in the next week at the same time and place, or to such other date and such other time and place as the Board may determine

Further, under section 103 (3) of the Companies Act, 2013 if at the adjourned meeting also, a quorum is not present within half-an-hour from the time appointed for holding meeting, the members present shall be the quorum. Hence, the 3 members personally present at the adjourned meeting shall constitute a valid quorum to conduct the meeting.

Question22

The quorum for a General meeting of a public company is 15 members personally present according to the provisions of the articles of association of the company. Examine with reference to the provisions of the companies Act, 2013 whether there is proper quorum at a General meeting of the company which was attended by the following persons:

(i) 13 members personally present

(ii) 2 members represented by proxies who are not members of the company

(iii) One person representing two member companies.

Answer

In the given case the Articles of the company provide for 15 members personally present to form the quorum of a general meeting.In determining the quorum, members personally present or deemed to be personally present shall be counted only. In the present case therefore, the present members counted will be 13 + 2 (the person representing two member companies will be counted as 2 and not as 1) = 15. Hence, the quorum is present and the meeting can be validly held.

Question23

A general meeting of a public company was adjourned by the chairman for want of quorum. Fresh notice was not served for the adjourned meeting. Do you feel that notice is required for the adjourned meeting? Referring to the provisions of the Companies Act, 2013 state the minimum number of members required to be present in the adjourned meeting.

Answer

As per section 103 (2) of the Companies Act, 2013, if the quorum is not present within half an hour from the time appointed for holding a meeting, the meeting, shall stand adjourned to the same day in the next week, at the same time and place unless the directors determine otherwise. No fresh notice is, therefore, required to hold the adjourned meeting.

Further, under section 103 (3) of the Companies Act, 2013,if at the adjourned meeting also, a quorum is not present within half-an-hour from the time appointed for holding meeting, the members present shall be the quorum. Therefore, there is no necessity for a minimum number of members to be present in the adjourned meeting.

Question 24

The articles of X & Co. Ltd provide that in the event of the quorum being not present within half-an- hour- from the time scheduled for the annual general meeting, the meeting shall stand dissolved. At the AGM of X &Co. Ltdthe quorum is not formed within half-an-hour from the time fixed therefor.

Give the answers of the following-

(a) In the above circumstance, what further steps are necessary to hold the annual general meeting?

(b) If it is to be convened afresh, will a fresh resolution of the Board be needed?

(c) What will be the position of retiring directors-will they cease to be directors from the date on which the general meeting could not be held for want of quorum and consequently stood dissolved as per the articles as aforesaid or will they remain directors till the date of the fresh annual general meeting which was convened subsequent to the first one?

Answer

(a) Under section 103 (2) of the Companies Act, 2013 if the quorum is not present within half-an-hour from the time appointed for holding a meeting of the company, the meeting shall stand adjourned to the same day in the next week at the same time and place, or to such other date and such other time and place as the Board may determine. The law does not give any flexibility to the Articles in deciding the date of an adjourned meeting. The right exists with the Board of Directors. In the present case therefore, the act of dissolution of the AGM for want of quorum is invalid. The meeting automatically gets adjourned to the same time and place on the same day next week. The Board, as per the facts in the question, has not exercised their option of holding the meeting at a different place and time.

(b) In case of an adjourned meeting or of a change of day, time or place of meeting, the company shall give not less than three days notice to the members either individually or by publishing an advertisement in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated.Hence, no board resolution will be required but a notice from the company as mentioned will have to be sent. However, it may be noted that the decision to change the date, time and venue by the Board will have to be taken by a resolution of the Board, it will be in practicality be passed.

(c) The provision in the Article dissolving a meeting for want of quorum is not legally valid. The meeting will be adjourned and hence the retiring directors will continue to hold office till the adjourned meeting is held and the required decision taken.

Question 25

Whether the following persons can be counted for the purposes of quorum in a general meeting of a public company-

(a) a person representing three member companies;

(b) both the joint owners of shares present at the meeting;

(c) a single member present at the meeting.

Answer

(a) A person representing three member companies will be counted as 3 in the computation of the quorum. There is no restriction on a member company in appointing a person as a representative who has already been nominated to represent another company member. Each company will be treated as personally present even if the representative is the same person.

(b) For the purpose of quorum, joint shareholders will be collectively regarded as one shareholder.

(c) The single member present at the meeting will be counted as one in the computation of the quorum.

Question 26

What do you mean by Proxy? Explain the provisions relating appointment of Proxy under the Companies Act, 2013

Answer

A proxy is a person appointed by a member of a company, to attend a meeting of the company and vote thereat on his behalf.

The various provisions relating to the appointment of aproxy is contained in section [23]105 of the Companies Act, 2013 are as under:

1. Under section 105 (1) any member of a company entitled to attend and vote at a meeting of the company shall be entitled to appoint another person as a proxy to attend and vote at the meeting on his behalf.
2. A proxy shall not have the right to speak at such meeting and shall not be entitled to vote except on a poll. This means that a proxy cannot vote on a resolution by a show of hands.
3. The Central Government may prescribe a class or classes of companies whose members shall not be entitled to appoint another person as a proxy
4. Under section 105 (6) the instrument appointing a proxy shall be in writing; and be signed by the appointer or his attorney duly authorised in writing or, if the appointer is a body corporate, be under its seal or be signed by an officer or an attorney duly authorised by it.
5. Under section 105 (7) an instrument appointing a proxy, if in the form as may be prescribed, shall not be questioned on the ground that it fails to comply with any special requirements specified for such instrument by the articles of a company.

[23] Vide Notification G.S.R. 464 (E) dated 5th June 2015, in case of private companies section 105 shall apply unless otherwise specified in respective sections or articles of the company provide otherwise.

Question27

Annual General Meeting of a Public Company was scheduled to be held on 15.12.2015. Mr. A, a shareholder, issued two Proxies in respect of the shares held by him, one in favour of Mr. 'X' and the second in favor of Mr. T. The proxy in favour of 'T' was lodged on 12.12.2015 and the one in favour of Mr. X was lodged on 15.12.2015. The company rejected the proxy in favour of Mr. X as the proxy in favour of Mr. T was of dated 12.12.2015 and the one in favour of Mr. X was of dated 13.12.2015. Is the rejection by the company in order?

Answer

In case more than one proxies have been appointed by a member in respect of the same meeting, one which is later time shall prevail and the earlier one shall be deemed to have been revoked. Thus, in the normal course, the proxy in favour of Mr. X, being later in time, should have been upheld as valid.

However, as per Section 105 (4) of the Companies Act, 2013, a proxy should be deposited 48 hours before the time of the meeting. In the given case, the proxies should have, therefore, been deposited on or before 13.12.2015 (the date of the meeting being 15.12.2015). X deposited the proxy on 15.12.2015. Therefore, proxy in favour of Mr. X has become invalid. Proxy in favour of T is valid since it is deposited in time.

Question 28

What is the concept of proxy in relation to the meetings of a Company? Decide the appointment and rights of a proxy, under the Companies Act, 2013 in the following cases:

(i) When a body corporate is a member in the company.

(ii) When a foreign company is a member in the company.

Answer

Under section 105 (1) of the Companies Act, 2013 a proxy is a person, who is appointed by a member of a company to attend a meeting of the company and vote thereat on his behalf. The objective of allowing a proxy to attend a meeting on behalf of a member is to enable a member to exercise his right to vote on a resolution placed before the meeting. However, a proxy cannot speak at the meeting nor can he vote except on a "Poll"

(i) In the present case as the member is a body corporate,in terms of section 105 (6) of the Companies Act, 2013 the instrument appointing a proxy shall be duly authorized in writing and should be under its seal or be signed by an officer or an attorney duly authorized by it.

In terms of the first proviso to section 105 (1), the proxy so appointed shall have the right to attend the meeting of the company on behalf of the body corporate "member" and vote on its behalf at the meeting. However, the proxy shall have no right to speak at the meeting and cannot vote thereat except in a "Poll"

(ii) The Companies Act, 2013 does not distinguish between the appointment and rights of proxies by domestic or foreign companies. The applicable law applies uniformly to both.

Question 29

Annual General Meeting of MGR Limited is convened on 28th December, 2008. Mr. J, who is a member of the company, approaches the company on 28th December, 2008 and demands inspection of proxies lodged with the company. Explain the legal position as stated under the Companies Act, 2013 in this regard.

Answer

Under section 105 (8) of the Companies Act, 2013 every member entitled to vote at a meeting of the company or on any resolution to be moved thereat, shall be entitled during the period beginning 24 hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting, to inspect the proxies lodged, at anytime during the business hours of the company. Provided not less than 3 days' notice in writing of the intention to inspect is given to the company.

In the given case, Mr. J who is a member approaches the company on 28th December and demands inspection of proxies lodged with the company. Based on the above provisions since prior notice of 3 days had not been given by Mr. J to the company for inspecting the proxies, the company may refuse inspection of proxy forms.

Question30

'S', a shareholder, after duly appointing P as his proxy for a meeting, himself attended the meeting and voted on a resolution. P thereafter claimed to exercise his vote. Examine his claim.

Answer

As per law, a shareholder has a right to revoke the proxy's authority by voting himself before the proxy has voted - but once the proxy has voted he cannot retract his authority. In the given case S had voted on the resolution himself and the proxy wanted to exercise his right after he had voted. Therefore P's claim in the given case is invalid. This point was reiterated in *Cousins v. International Brick Co. Ltd* also.

Question31

The Articles of Association of a public company require the instrument appointing a proxy to be received by the company 75 hours before the meeting. Is it a valid requirement? If not, what are its effect?

Answer

According to Section 105 (4) of the Companies Act, 2013, any provision in the Articles of a company which requires a longer period than 48 hours before a meeting of the company for

depositing a proxy, shall have effect as if a period of 48 hours had been specified for such deposit. Therefore in the given case, the answer is a 'no'.

Question32

S, a shareholder, gives a notice for inspecting proxies, five days before the meeting is scheduled and approaches the company two days before the scheduled meeting for inspecting the same. What is the legal position relating to his actions?

Answer

Under section 105 (8) of the Companies Act, 2013 every member entitled to vote at a meeting of the company, or on any resolution to be moved thereat, shall be entitled during the period beginning twenty-four hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting, to inspect the proxies lodged, at any time during the business hours of the company, provided not less than three days' notice in writing of the intention so to inspect is given to the company.

In the given case, S has given proper notice.

However, such inspection can be undertaken only during the period beginning 24 hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting. So S can undertake the inspection only during the above mentioned period and not two days prior to the meeting.

Question33

A General Meeting to be held on 15th April, 2015 at 4.00 P.M. As per the notice the members who areunable to attend the meeting in person can appoint a proxy and the proxy forms duly filled should be sent so as to reach at least 48 hours before the meeting. Mr. A, a member of the company appoints Mr. P as his proxy and the proxy form dated 10.4.2015 was deposited by Mr. P with the company at its Registered Office on 11.04.2015. However, Mr. A changeshis mind and on 12.04.2015 gives another proxy to Mr. Q and it was deposited on the same day with the company. Similarly another member Mr. B also gives to separate proxies to two individuals named Mr. R and Mr. S. In the case of Mr. R, the proxy dated 12.04.2015 was deposited with the company on the same day and the proxy form in favour of Mr. S was deposited on 14.04.2015. All the proxies viz., P, Q, R and S were present before the meeting.

In the light of the relevant provisions of the Companies Act, who would be the persons allowed to represent at proxies for members A and B respectively?

Answer

A Proxy is an instrument in writing executed by a shareholder authorizing another person to attend a meeting and to vote thereat on his behalf and in his absence. As per, the provisions of Section 105 (1) of the Companies Act, 2013 every shareholder who is entitled to attend and vote has a statutory right to appoint another person as his proxy and the proxy need not be a

member of the company. Further, any provision in the articles of association of the companyrequiring instrument of proxy to be lodged with the company more than 48 hours before a meeting shall have effect as if 48 hours had been specified therein. The members has a right to revoke the proxy's authority by voting himself before the proxy has voted but once the proxy has voted the member cannot retract his authority.

Where two proxy instruments by the same shareholder are lodged in respect of the same votes before the expiry of the time for lodging, there the proxies, the second in time will be counted and where one is lodged before and the other after the expiry of the date fixed for lodging proxies, the former will be counted. Thus in case of Member A, the proxy Q (and not Proxy P) will be permitted to vote on his behalf. However, in the case of Member B, the proxy R (and not Proxy S) will be permitted to vote as the proxy authorizing S to vote was deposited in less than 48 hours before the meeting.

Question34

C, a shareholder, after appointing B as his proxy at meeting of the Company, himself attended the meeting and voted on a particular resolution. B thereafter claimed to exercise his vote. Examine his claim in the light of the provisions of the Companies Act,2013.

Answer

B's claim is invalid. Where a shareholder who having appointed a proxy, personally attends and votes at the meeting, the proxy is revoked thereby. Thus in the instant case, B's authority is revoked and he cannot exercise his vote.

Question 35

K, a member of MNO Limited, appoints L as his proxy to attend the general meeting of the company. Later he (K) also attends the meeting. Both K (the member) and L (the proxy) voted on a particular resolution in the meeting. K's vote was declared invalid by the chairman stating that since he has appointed the proxy and L's vote has been considered as valid. K objects to the decision of the Chairman. Decide, under the provisions of the Companies Act, 2013, whether K's objection shall be taxable.

Answer

The given problem is based on *Cousins vs International Brick Company Limited.* In above case the court held that a proxy is appointed to attend a meeting on an implied condition that he will attend if the person appointing the proxy is himself unable to attend the meeting. But if the person appointing also attends the meeting and casts the vote the proxy's stand will be cancelled.

Hence, in the given problem, the decision of chairman is invalid. Here K's vote was valid, L's vote was invalid. Therefore K's objection is legitimate,

Question 36

J held 100 partly paid up shares of LKM Limited. The company asked him to pay the final call money on the shares. Due to some unavoidable circumstances he was unable to pay the amount of call money to the company. At a general meeting of the shareholders, the chairman disallowed him to cast his vote on the ground that the articles do not permit a shareholder to vote if he has not paid the calls on the shares held by him. J contested the decision of the Chairman. Referring to the provisions of the Companies Act, 2013 decide whether the contention of J is valid.

Answer

Section 106 (1) of the Companies Act, 2013 states that the articles of a company may provide that no member shall exercise any voting right in respect of any shares registered in his name on which any calls or other sums presently payable by him have not been paid, or in regard to which the company has exercised any right of lien.

In the present case the articles of the company do not permit a shareholder to vote if he has not paid the calls on the shares held by him. Therefore, the chairman at the meeting is well within its right to refuse him the right to vote at the meeting and J's contention is not valid.

[Note : Vide Notification G.S.R. 464 (E) dated 5th June 2015 in case of Private companies section 106 shall apply unless otherwise specified in respective sections or articles of the company provide otherwise.]

Question37

Outline some eight matters for which an ordinary resolution would suffice.

Answer

A resolution is said to be an ordinary resolution when the votes cast in favour of the resolution are greater than the votes cast against it. In other words, when a resolution is passed with simple majority, it is an ordinary resolution.

Under various provisions of the Companies Act, 2013, an ordinary resolution is sufficient, for conducting any of the following businesses:

(a) Change in name of the company under section 4 (5) (ii) (b) (i) at the direction of the Registrar in case of reservation of wrong or incorrect name ;

(b) Rectification of the name of the company under section 16 (1) after being directed by the Central Government to do so.;

(c) To appoint auditors in an annual general meeting

(d) To appoint directors in an annual general meeting;

(e) Consideration and adoption of the financial statements and the report of the directors and the auditors in an annual general meeting;

(f) To declare dividends at an annual general meeting;

(g) To appoint any person as an auditor other than the retiring auditor under section 140 (4);

(h) Under section 142 (1) the remuneration of an auditor shall be fixed in general meeting by an ordinary resolution;

(i) Appointment of any person as director in case of vacancy created due to removal [section 169 (2)]

(j) Remuneration of cost accountant under section 148 (3) shall be fixed by an ordinary resolution

Question38

Mention any ten acts for which a special resolution is required.

Answer

Acts for which special resolutions are required: Some matters may be so important and outside the ordinary course of the company's business, such as any important constitutional changes, that safeguards should be imposed to ensure that a larger majority than a simple majority of the members approve of them before they are given effect to. The Act requires that the following matters, *inter alia*, have to be resolved by the company, by a special resolution:

(1) To alter any provision contained in the memorandum, [Section 13(1)];

(2) To alter the articles of association [Section 14 (1)];

(3) Variation in the terms of contract or objects in the prospectus [section 27 (1)];

(4) Issue of Sweat Equity [Section 54 (1) (a)]

(5) To purchase its own shares or specified securities [Section 68 (2)];

(6) To reduce the share capital as per section 100 of the Companies Act, 1956[**i.e.,Section66 (1)of the Companies Act,2013, not yet notified**];

(7) To move the registered office of an existing company outside the local limits of any city, town or village where such office is situated at the commencement of this Act [Section 12 (5)(a)]

(8) To move the registered office of any other company outside the local limits of any city, town or village where such office is first situated [Section 12 (5)(b)]

(9) Giving of any loan or guarantee or providing any security in excess of specified limits [Section 186 (3)];

(10) To issue debentures with an option of conversion into shares [Section 71 (1)].

Question39

State with reason, whether the following statement is correct or incorrect, according to the Companies Act, 2013.

A special resolution is one to pass, where the votes cast in favors must be twice the votes cast against it.

Answer

Incorrect. A resolution shall be a special resolution when the votes cast in favour of the resolution by members (whether on a show of hands, or on a poll, or by proxy), are not less than three times the number of votes, if any, cast against the resolution.

Question40

Which one of the following required ordinary resolution?

1. *to change the name of the company*
2. *to alter the articles of association*
3. *to reduce the share capital*
4. *to declare dividends.*

Answer

An ordinary resolution is required to declare dividends;

The declaration of dividend is one of the ordinary businesses conducted at every AGM of a company under section 102 (2) of the Companies Act, 2013 and each ordinary business transacted at an AGM requires an ordinary resolution to approve the same.

Question 41

At a General meeting of a company, a matter was to be passed by a special resolution. Out of 40 members present, 20 voted in favour of the resolution, 5 voted against it and 5 votes were found invalid. The remaining 10 members abstained from voting. The Chairman of the meeting declared the resolution as passed.

With reference to the provisions of the Companies Act, 2013, examine the validity of the Chairman's declaration.

Answer

Under Section 114(2) of the Companies Act, 2013, for a valid special resolution to be passed at a meeting of members of a company, the following conditions need to be satisfied:

(i) The intention to propose the resolution, as a special resolution must have been specified in the notice calling the general meeting or other intimation given to the members;

(ii) The notice required under the Companies Act must have been duly given of the general meeting;

(iii) The votes cast in favour of the resolution (whether by show of hands or electronically or on a poll, as the case may be) by members present in person or by proxy or by postal

ballot are not less than 3 times the number of votes, if any, cast against the resolution by members so entitled and voting.

Thus, in terms of the requisite majority, votes cast in favour have to be compared with votes cast against the resolution. Abstentions or invalid votes, if any, are not to be taken into account.

Accordingly, in the given problem, the votes cast in favour (20) being more than 3 times of the votes cast against (5), and presuming other conditions of Section 114(2) are satisfied, the decision of the Chairman is in order.

Question 42

Explain the provisions of the Companies Act, 2013 relating to 'Resolutions requiring Special Notice'. State the resolutions that require 'Special Notice' under the Act.

Answer

Under section 115 of the Companies Act, 2013 where, by any provision contained in this Act or in the articles of a company, special notice is required of any resolution, notice of the intention to move such resolution shall be given to the company by such number of members holding not less than one per cent. of total voting power or holding shares on which such aggregate sum not exceeding five lakh rupees, as may be prescribed, has been paid-up and the company shall give its members notice of the resolution in such manner as may be prescribed.

Special notice is required to move, the following resolutions and any such further resolutions as may be prescribed by the Articles:

(i) Section 140: a resolution appointing an auditor other than the retiring one.

(ii) Section 140: a resolution providing expressly that the retiring auditor shall not be reappointed.

(iii) Section 169: a resolution purporting to remove a director before the expiry of his period of office.

(iv) Section 169: a resolution to appoint another director in place of the removed director.

Question 43

State the procedure for passing a resolution by Postal Ballot.

OR

Explain the provisions of the Companies Act, 2013 relating to the procedure to be followed for transacting business of the general meeting of members of a company through postal ballot.

Answer

Section 110 of the Companies Act 2013, provides as under:

Sub section (1): Notwithstanding anything contained in this Act, a company—

(a) shall, in respect of such items of business as the Central Government may, bynotification, declare to be transacted only by means of postal ballot; and

(b) may, in respect of any item of business, other than ordinary business and any business in respect of which directors or auditors have a right to be heard at any meeting, transact by means of postal ballot,

In such manner as may be prescribed, instead of transacting such business at a general meeting.

Sub section (2) states that if a resolution is assented to by the requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been duly passed at a general meeting convened in that behalf.

The procedure as laid down in the Rule 22 of the Companies (Management & Administration) Rules, 2014 read with the provisions of section 110 of the Companies Act is as under:

(i) Where a company is required to pass any resolution by way of postal ballot, it shall send a notice to all the shareholders, along with a draft resolution explaining the reasons therefore and requesting them to send their assent within a period of 30 days from the date of posting of the letter;

(ii) The notice shall be sent by registered post or speed post or through electronic means like registered e-mail address or through courier service for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period of thirty days;

(iii) The board of directors shall appoint one scrutinizer, who is not in employment of the company, and who, in the opinion of the board can conduct the postal ballot voting process in a fair and transparent manner. The scrutinizer shall be willing to be appointed and be available for the purpose of ascertaining the requisite majority.

(iv) The scrutinizer shall submit his report as soon as possible after the last date of receipt of postal ballots but not later than seven days thereof.

(v) If a resolution is passed by the requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been passed at a general meeting convened in that behalf.

(vi) If a shareholder sends his assent or dissent in writing on a postal ballot and thereafter any person fraudulently defenses or destroys the ballot paper or declaration of the identity of shareholder, such person shall be punishable with imprisonment for a term which may extend to six months or with fine or both;

(vii) The scrutinizer shall maintain a register either manually or electronically, to record the assent or dissent received, mentioning the particulars of name, address, folio number, number of shares, nominal value of shares, whether the shares have voting, differential

voting or non-rights and the scrutinizer shall also maintain record for postal ballot which are received in defaced or mutilated form and forms which are invalid.

(viii) The postal ballot and all other papers relating to postal ballot will be under the safe custody of the scrutinizer till the Chairman considers, approves and signs the minutes of the meeting. Thereafter, the scrutinizer shall return the ballot papers and other related papers/register to the company so as to preserve such ballot papers and other related papers/registers.

Question 44

In a General Meeting of PQR Limited, the Chairman directed to exclude certain matters detrimental to the interest of the company from the minutes. M, a shareholder contended that the minutes of the meeting must contain fair and correct summary of the proceedings thereat. Decide, whether the contention of M is maintainable under the provisions of the Companies Act, 2013?

Or

The minutes of the meeting must contain fair and correct summary of the proceedings thereat. Can the Chairman direct exclusion of any matter from the minutes? Some of the shareholders insist on inclusion of certain matters which are regarded as defamatory of a Director of the company. The Chairman declines to do so. State how the matter can be resolved.

Answer

Under Section 118 (5) of the Companies Act, 2013 there shall not be included in the Minutes of a meeting, any matter which, in the opinion of the Chairman of the meeting:

(i) is or could reasonably be regarded as defamatory of any person;

(ii) is irrelevant or immaterial to the proceeding; or

(iii) is detrimental to the interests of the company;

Further under section 118 (6) the chairman shall exercise absolute discretion in regard to the inclusion or non-inclusion of any matter in the Minutes on the grounds specified in sub-section (5) above.

Hence, in view of the above, the contention of M, a shareholder of PQR Limited is not valid because the Chairman has absolute discretion on the inclusion or exclusion of any matter in the minutes for aforesaid reasons.

[Note: Ministry Vide Notification G.S.R. 466 (E) dated 5th June 2015, in case of section 8 companies, section 118 shall not apply as a whole except that minutes may be recorded within 30 days of the conclusion of every meeting in case of companies where articles of association provide for confirmation of minutes by circulation]

Question 45

State the procedure for inspection of Minutes Book of General Meetings of a company, by the members.

Answer

Following are the provisions relating to the procedure for inspection of minutes books of general meetings of a company by the members:

(1) Under section 119 (1) of the Companies Act, 2013 the books containing the Minutes of the proceedings of any general meeting of a company shall-

   (a) be kept at the registered office of the company, and

   (b) be open, during business hours, to the inspection of any member without charge, subject to such reasonable restrictions as the company may, by its articles or in general meeting impose, so however that not less than two hours in each day are allowed for inspection.

(2) Section 119 (2) states that any member shall be entitled to be furnished, within seven working days after he has made a requisition in that behalf to the company, and on payment of such fee as may be prescribed, with a copy of any minutes referred to in sub-section (1) above.

(3) Section 119 (3): If any inspection required under sub-section (1) is refused, or if any copy required under sub-section (2) is not furnished within the time specified therein, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to five thousand rupees in respect of each offence.

(4) [24]Section 119 (4): In the case of any such refusal or default, the Tribunal may, by order, direct an immediate inspection of the Minute books or direct that the copy required shall forthwith be sent to the person requiring it.

Question 46

XYZ Limited held its Annual General Meeting on September 15, 2015. The meeting was presided over by Mr. V, the Chairman of the Company's Board of Directors. On September 17, 2015, Mr. V, the Chairman, without signing the minutes of the meeting, left India to look after his father who fell sick in London. Referring to the provisions of the Companies Act, 2013, state the manner in which the minutes of the above meeting are to be signed in the absence of Mr. V and by whom.

OR

The last General Meeting was conducted by the Chairman on 12th August, 2015. Thereafter, on 19th August, 2015, the Chairman died, before the minutes of the said meeting could be

24 This sub-section (4) of section 119 is not yet notified.

signed. In such an eventuality, how are the minutes book to be dated and signed? Discuss in terms of the provisions of the Companies Act, 2013.

Answer

Section [25]118 of the Companies Act, 2013 provides that every company shall prepare, sign and keep minutes of proceedings of every general meeting, including the meeting called by the requisitionists and all proceedings of meeting of any class of share holdersor creditors or Board of Directors or committee of the Board and also resolution passed by postal ballot within thirty days of the conclusion of every such meeting concerned. Minutes kept shall be evidence of the proceedings recorded in a meeting.

By virtue of Rule 25 of the Companies (Management and Administration) Rules 2014 read with section 118 of the Companies Act, 2013 each page of every such book shall be initialled or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed by, in the case of minutes of proceedings of a general meeting, by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.

Therefore, the minutes of the meeting referred to in the case given above can be signed in the absence of Mr V on death of the chairman, by any director who is authorized by the Board.

Question 47

The Board of Directors of Alltronix Ltd, have passed resolution to the effect that no member who is indulging in activities detrimental to the interest of the company be permitted to examine the records or obtain certified copies thereof. A member of the Company, considered by the Company to be acting against the interests of the Company, demands inspection of the register of members and minutes of General Meeting and certified true copies thereof. The Company refuses the inspection etc. on the strength of the resolution referred to above. Examine the correctness of the refusal by the Company referring to the provisions of the Companies Act, 2013.

Answer

According to the provisions contained in Section 119 (1) of the Companies Act, 1956, every member of the Company is entitled to inspect the Register of Members without payment of any fee subject to reasonable restrictions imposed by the company by its Articles. There is no qualification to this right granted to every member of the company and any resolution passed

25 Ministry Vide Notification G.S.R. 466 (E) dated 5th June 2015, in case of section 8 companies, section 118 shall not apply as a whole except that minutes may be recorded within 30 days of the conclusion of every meeting in case of companies where articles of association provide for confirmation of minutes by circulation.

by the Board to the contrary cannot override the provisions of the Act and will therefore be null and void. Therefore the refusal of the company in the present case is illegal.

Question 48

What is E filing? List at least five advantages of E filing under MCA 21.

Answer

The term E-filing indicates the process of getting services electronically with a comprehensive on-line portal.

Some of the advantages of MCA 21 are:

1. Expeditious incorporation of companies;
2. Simplified and ease of convenience in filing of Forms/ Returns ;
3. Better compliance management
4. Total transparency through e-Governance
5. Customer centric approach
6. Increased usage of professional certificate for ensuring authenticity and reliability of the Forms / Returns
7. Building up a centralised database repository of corporate operating
8. Enhanced service level fulfillment
9. Inspection of public documents of companies anytime from anywhere
10. Registration as well as verification of charges anytime from anywhere
11. Timely redressal of investor grievances
12. Availability of more time for MCA employees for monitoring and supervision

Question 49

Explain the 'MCA 21 Program' introduced by the Government of India to develop computerized environment for company law. How does it serve the interest of all the stakeholders of a company, corporate professionals and the public at large?

Answer

This is an innovative project and an initiative of the Ministry of Corporate Affairs to develop a system that would reflect India's Corporate Governance Goals in the 21st Century and create a business friendly environment for both Indian and Foreign Companies.

This project covers all the services provided by the Registrar of Companies (ROC) starting from the incorporation of a new company. The project would provide e-services including registration of new companies, filing of various returns and statutory documents under the Companies Act, 2013(and also with respect to the existing sections of the Companies Act, 1956). The system would also enables filing and access for statutory documents like memorandum of association, articles of association, certificate of incorporation etc.

The project serves the interest of all the key stake holders and the public at large. Also professionals need no longer to visit the officers of ROC and are able to interact with the Ministry using MCA 21 portal from their offices or home. The services of the Ministry of Company Affairs with the introduction of MCA 21 will be e-form driven. Form filing will be done using freely downloadable software and it can be done offline.

The project serves the interest of all the key stakeholders, corporate professionals and the public at large as follows:

- Expeditious incorporation of companies
- Simplified and ease of convenience in filing of Forms/Returns/Statutory documents
- Better compliance management
- total transparency through e-Governance
- Customer centric approach
- Increased usage of professional certificate for ensuring authenticity and reliability of the Forms/Returns.
- Building up a centralized database repository of corporate operatings enhanced service level fulfillment.
- Inspection of public documents of companies anytime from anywhere.
- Registration as well as verification of charges anytime from anywhere
- Timely redressal of investor grievance and to get easy access to relevant records by the public.
- Availability of more time for MCA employees for monitoring and supervision.

Professionals need no longer to visit the officers of ROC and would be able to interact with the Ministry using MCA 21 portal from their offices or home. They are able to provide efficient services to their client companies. Financial Institutions may easily find charges registration and verification. Proactive and effective compliance of relevant laws and corporate governance by the employees.

Question50

What are the steps for e-Filing?

Answer

1. Select a category to download an eForm from the MCA portal (with or with out the instruction kit.
2. At any time, read the related instruction kit to familiarise with the procedures (download the instruction kit with eform or view it under **Help** menu).
3. Fill the downloaded e-Form.

4. Attach the necessary documents as attachments.
5. Use the **Prefill** button in eForm to populate the greyed out portion by connecting to the Internet.
6. The applicant or a representative of the applicant needs to sign the document using a digital signature.
7. Click the **Check Form** button available in the eForm. System will check the mandatory fields, mandatory attachment(s) and digital signature(s).
8. Upload the eForm for pre-scrutiny. The pre-scrutiny service is available under the **Services** tab or under the **eForms**tab by clicking the **Upload eForm**button. The system will verify (pre-scrutinise) the documents. In case of any inadequacies, the user will be asked to rectify the mistakes before getting the document ready for execution (signature).
9. The system will calculate the fee, including late payment fees based on the due date of filing, if applicable.
10. Payments will have to be made through appropriate mechanisms - electronic (credit card, Internet banking) or traditional means (at the bank counter through challan).
    (a) Electronic payments can be made at the Virtual Front Office (VFO)or at PFO
    (b) If the user selects the traditional payment option, the system will generate 3 copies of pre-filled challan in the prescribed format. Traditional payments through cash, cheques can be done at the designated network of banks using the system generated challan. There will be five banks with estimated 200 branches authorised for accepting challan payments.
11. The payment will be exclusively confirmed for all online (Internet) payment transactions using payment gateways.
12. Acceptance or rejection of any transaction will be explicitly communicated to the applicant (including facility to print a receipt for successful transactions).
13. MCA 21 will provide a unique transaction number, the Service Request Number (SRN) which can be used by the applicant for enquiring the status pertaining to that transaction.
14. Filing will be complete only when the necessary payments are made.
15. In case of a rejection, helpful remedial tips will be provided to the applicant.
16. The applicants will be provided an acknowledgement through e-mail or alternatively they can check the MCA portal.

Question 51

Explain the concept of 'electronic voting system' as provided by the Companies Act, 2013.

Answer

Voting through Electronic Means: According to Section 108 of the Companies Act, 2013, the Central Government may prescribe the class or classes of companies and manner in which a member may exercise his right to vote by the electronic means. According to the rules provided on voting through electronic means:

(1) Every listed company or a company having not less than one thousand shareholders, shall provide to its members facility to exercise their right to vote at general meeting by electronic means.

(2) A member may exercise his right to vote at a general meeting by electronic means and the company may pass any resolution by electronic voting system in accordance with the provisions of this rule.

The expression "voting by electronic means" or "electronic voting system" means a secured system based process of display of electronic ballots, recording of votes of the members and the number of votes polled in favour or against, such that the entire voting exercised by way of electronic means gets registered and counted in an electronic registry in a centralized server with adequate cyber security.

The expression "secured system" computer hardware, software and procedure that:

(a) are reasonably secure from unauthorized access and misuse;

(b) provide a reasonable level of reliability and correct operation;

(c) are reasonably suited to performing the intended functions; and

(d) adhere to generally accepted security procedures.

Question 52

The Annual General Meeting of KMP Limited was held on 30th April, 2015. The Articles of Association of the company is silent regarding the quorum of the General Meeting. Only 10 members were personally present in the above meeting, out of the total 2,750 members of the company. The Chairman adjourned the meeting for want of quorum. Referring to the provisions of the Companies Act, 2013, examine the validity of Chairman's decision.

Answer

Quorum; Consequences of no Quorum: Quorum means the minimum number of members who must be present in order to constitute a meeting and transact business thereat. Thus, quorum represents the number of members on whose presence the meeting of a company can commence its deliberations.

Section 103 of the Companies Act, 2013 provides the law with respect to the quorum for the meetings. The said section provides that where the Articles of the company do not provide for a larger number, there the quorum shall depend on number of members as on date of a meeting.

In case of a public company:

(i) five members personally present if the number of members as on the date of meeting is not more than one hundred;

(ii) fifteen members personally present if the number of members as on the date of meeting is more than one thousand but up to five thousand;

(iii) thirty members personally present if the number of members as on the date of the meeting exceeds five thousand;

shall be the quorum for a meeting of the company.

Consequences of no Quorum: If the quorum is not present within half-an-hour from the time appointed for holding a meeting of the company –

(a) the meeting shall stand adjourned to the same day in the next week at the same time and place, or

(b) to such other date and such other time and place as the Board may determine; or

(c) the meeting, if called by requisitions (under section 100), shall stand cancelled.

In the instant case, KMP Limited is a public company with total number of 2750 members, hence atleast 15 members should have been personally present in order to constitute a valid quorum for the Annual General Meeting.

Thus, the meeting shall automatically stand adjourned to the same day in the next week at the same time and place, if the quorum is not present within half –an-hour from the time appointed for holding a meeting of the company. Further, the Board of Directors may decide for such other date and such other time and place, which they may deem fit. Section 103 of the said Act itself provides for automatic adjournment of the meeting to the same day in the next week at the same time and place, rather the Chairman obviating to take a decision on the matter of the meeting. The question of validity of Chairman's decision does not arise.

Exercise

1. *C, a member of LS & Co. Ltd., holding some shares in his own name on which final call money has not been paid, is denied by the company voting right at a general meeting on the ground that the articles of association do not permit a member to vote if he has not paid the calls on the shares held by him.*

   With reference to the provisions of the Companies Act, 2013, examine the validity of company's denial to C of his voting right.

   [**Hints**: The company's restriction on C against his voting right is valid, as per section 106 of the Companies Act,2013]

2. *For a special resolution in a Company's general meeting, 10 voted in favour, 2 against and 4 abstained. The chairman declared the resolution as passed. Is it a valid resolution as per the provisions of the Companies Act, 2013.*

   [**Hints:** Yes, as per Section 114(2)(c) of the Companies Act,2013]

3. *The Chairman of the meeting of a company received a Proxy 54 hours before the time fixed for the start of the meeting. He refused to accept the Proxy on the ground that the Articles of the company provided that a Proxy must be filed 60 hours before the start of the meeting. Decide, under the provisions of the Companies Act, 2013 whether the Proxy holder can compel the Chairman to admit the Proxy?*

   [**Hints:** Yes,the holder of proxy can compel the chairman as per the Section 105(4) of the Companies Act,2013]

4. *State whether the following statements are correct or incorrect. Give reasons:*

   (i) A company should file its annual return within six month of the close of the financial year.

   (ii) The shareholder of the company is general meeting can increase the rate of dividend recommended by the Board of Directors.

   [**Hints:** (I) Incorrect,as per Section 92 (4) of the Companies Act, 2013 (ii) Incorrect as shareholders can decrease the rate but cannot increase the rate of the dividend [Section 102 (2)]

5. *Board of Directors of ABC Ltd., called for EGM on 14th January, 2010. Mr. M who is newly appointed as Company Secretary is confused over the issue of sending notices to joint shareholders of the company. Advise Mr. M by referring to the provisions of Companies Act, 2013.*

   [**Hints***:* In the case of joint shareholders, notices will be deemed to be properly served if the service is effected on the first named of the joint holders as entered in the register of members. Please refer to section 101 and Companies (Management & Administration) Rules 2014].

6. *Annual General Meeting of a Public Company was scheduled to be held on 15.12.2009. Mr. A, a shareholder, issued two Proxies in respect of the shares held by him in favour of Mr. 'X' and Mr. 'Y'. The proxy in favour of 'Y' was lodged on 12.12.2009 and the one in favour of Mr. X was lodged on 15.12.2009. The company rejected the proxy in favour of Mr. Y as the proxy in favour of Mr. Y was of dated 12.12.2009 and thus in favour of Mr. X was of dated 13.12.2009. Is the rejection by the company in order ?*

   [**Hints**: Proxy in favour of Y is valid since it is deposited in time as given section 105 of the Companies Act, 2013]

7. *(i) An annual general meeting of a company was convened in November, 2008. It was adjourned and the adjourned meeting was held in March, 2009. The next general meeting was held in March, 2010. The company was held liable for an irregularity in holding the AGMs. Decide.*

(ii) Reliance Industries Ltd. has its registered office at Mumbai. The company desires to hold an extraordinary general meeting in New Delhi. Examine the validity of the company's desire with reference to the relevant provisions of the Companies Act, 2013.

[**Hints**: (i) The company is guilty of violation of Section 96 of the Companies Act, 2013. However, please also read the power of the Board to determine the time, date and place of the adjourned meeting.

(ii) The company may hold the EGM at any place and no restriction is imposed in the Companies Act, 2013. Read section 100 fully.]

7 Principles of Business Ethics

Question 1

Explain the Social Sins listed by Mahatma Gandhi.

Answer

Mahatma Gandhi, Father of India, promoted non-violence, justice and harmony between people of all faiths. He stressed that people follow ethical principles and listed following seven Social Sins:

(i) Politics without Principles

(ii) Wealth without Work

(iii) Commerce without Morality

(iv) Knowledge without Character

(v) Pleasure without Conscience

(vi) Science without Humanity

(vii) Worship without Sacrifice.

The first deals with the political field. The Kings in Indian tradition were only the guardian executors and servants of 'Dharma'. For Gandhi, Rama was the symbol of a king dedicated to principles. The second dictum deals with the sphere of Economics. Tolstoy and Ruskin inspired Gandhi on the idea of bread-labour. Gandhiji developed the third maxim into the idea of trusteeship. A businessman has to act only as a trustee of the society for whatever he has gained from the society. Everything, finally, belongs to the society. The fourth dictum deals with knowledge. Education stands for the all round development of the individual and his character. Gandhi's system of basic education was the system for development of one's character. In this maxim, Gandhi emphasized on conscience. He said that pleasure without conscience is a sin. In sixth maxim, Gandhi held that science without the thought of the welfare of humanity is a sin. Science and humanity together pave the way for welfare of all. In religion, we worship, but if we are not ready to sacrifice for social service, worship has no value, it is a sin to worship without sacrifice.

Question 2

Answer stating whether the statement is correct or incorrect with brief reason:

'Ethics and morals are synonymous'.

Answer

Incorrect: Both 'ethics' and 'morals' deal with right and wrong conduct. But they are not same. Ethics deals with individual character which is a personal attribute. Ethics is the response of individual to a specific situation e.g. whether in this situation, it is ethical to state the truth. Morals deal with customs set by groups or some authority like religion. Morals are general principles e.g. you should speak truth.

Question 3

What is the difference between 'Morals' and 'Ethics"?

Answer

Moral vs. Ethics: Following are the points of difference between Ethics and Moral :

(i) The word Éthics' is derived from Ancient Greek éthikos' meaning çharacter'. The word 'moral'' is derived from Latin 'mos' meaning çustom'.

(ii) Character is the essence of values and habits of a person or group. It severs the analysis and employment of concepts such as right and wrong, good and evil and acting with responsibility. Moral is defined as relating to principles of right and wrong.

(iii) Character is a personal attitude, while custom is defined by a group over a period of time. For example People have character, Societies have custom.

(iv) Morals are accepted from an authority (such as cultural, religious etc.) while ethics are accepted because they follow from personally accepted principles. An ethical view might be based on an idea of personal property that should not be taken without social consent. Moral norms can usually be expressed as general rules and statements such as 'always tell the truth'.

(v) Morals work on smaller scale than ethics, more reliably, but by addressing human needs for belonging and emulation, while ethics has a much wider scope.

Question 4

Explain the meaning of the terms 'ethics' and 'business ethics' and also state the requirements of 'business ethics'.

Answer

Ethics: The term 'Ethics' has a variety of meanings. One of the meanings is 'Ethics' are the principles of conduct governing an individual or a group. Another definition describes ethics as relating to what is good or bad and having to do with moral duty and obligation.

Business Ethics: In a broad sense, ethics in business refers to the application of day-to-day moral and ethical norms to business. Business ethics are the principles and standards that determine acceptable conduct in business organisation.

Requirements: Being ethical in business requires acting with an awareness of -

(a) The need for complying with rules (e.g) (i) laws of the land, (ii) customs and expectation of the community (iii) principles of morality (iv) policies of the organization and (v) general concerns such as the needs of others and fairness.

(b) How the products, services and actions of a business enterprise, can affect its stakeholders (i.e. employees, customers, suppliers, shareholders and community society as a whole) either positively or negatively.

Question 5

Explain the fundamental principles relating to ethics.

Answer

The fundamental principles relating to ethics may be summarized as under:

1. **The Principle of Integrity:** It calls upon all accounting and finance professionals to adhere to honesty and straightforwardness while discharging their respective professional duties.
2. **The Principle of Objectivity:** This principle requires accounting and finance professionals to stick to their professional and financial judgment.
3. **The Principle of Confidentiality:** This principle requires practitioners of accounting and financial management to refrain from disclosing confidential information related to their work.
4. **The Principle of Professional Competence and due care:** Finance and accounting professionals need to update their professional skills from time to time in order to provide competent professional services to their clients.
5. **The Principle of Professional Behaviour:** This principle requires accounting and finance professionals to comply with relevant laws and regulations and avoid such actions which may result in discrediting the profession.

Question 6

"To maintain social contract between society and business, the trusteeship relations are essential". Describe the role of business ethics in this reference.

Answer

Businesses as trustees: Mahatma Gandhi, the father of the nation, had aptly said that trusteeship provides a means for transforming the present capitalist order of society into an egalitarian one. A business man has to act only as a trustee of the society for whatever he has gained from the society. Everything finally belongs to the society. Society bestows upon business the authority to own and use land and natural resources. In return the society has the right to expect that productive organizations will enhance the general interests of consumers, employees and community.

Business ethics is required to implement the laws of land, customs, expectations of community, principles of morality, etc. The products and services of an organization affect its employees, the community and society as a whole. Business ethics also subserve the management discipline. Business houses may also use their financial and public influence to address social problems like poverty, crime, equal rights, environmental problems, public health and education. Society at large has also come to realize that since businessmen are making profits by using the country's resources, they owe it to the country to work for its development. Sound workplace ethics ensure that a company's employees are highly motivated and identify themselves with their employer. Following ethical business practices safeguard a company from getting entangled with law enforcement agencies. A reputation for highly ethical behaviour also ensures increased sales and customer loyalty. Certain eco-friendly practices also reduce operation costs. Thus, society derives benefits as well as business prospers when businesses are ethically driven.

Question 7

State with reasons whether the following statements are correct or incorrect.

Trusteeship provides a means of transforming the present capitalist order of society into an egalitarian one.

Answer

Correct: Commerce without morality was developed into the idea of Trusteeship by Gandhiji. A businessman has to act only as a trustee of the society for whatever he has gained from the society. Everything, finally, belongs to the society. Hence, "Trusteeship provides a means of transforming the present capitalist order of society into an egalitarian one."

Question 8

Examine the following hypothetical situation and give a brief analytical note on it.

Mr. XYZ is a CEO of a pharmaceutical company. His R&D department, while experimenting with a chemical molecule, sees the possibility that the molecule may be developed into a drug for a rare, painful, life-threatening genetic disease that afflicts only one child in ten million. But to develop the drug, his company may have to invest huge sums of the shareholders' money, despite the drug not having wide salability. Is Mr. XYZ confronted by an ethical dilemma? How should he resolve the issue?

Answer

Mr. XYZ is in a situation where he has to choose between carrying on the development of a drug for a painful and life threatening disease which afflicts one in ten million and the action of spending huge sum of shareholders' money for such development. As we can see, both are positive and ethically right choices. As a socially responsible person he has to think in terms of eliminating a serious illness but at the same time he must be careful in dealing with shareholders' money. This is a classic case of an ethical dilemma. Such an ethical dilemma must be resolved by addressing the following points:

1. Defining the problem clearly.
2. How to define the problem if you stood on the other side of the fence?
3. How did the situation arise?
4. To whom are you loyal as a person and as a member of the organization?
5. What is your intention in making this decision?
6. How does this intention compare with the probable results?
7. Whom could your decision or action injure?
8. Can you discuss the problem with the affected parties before you make your decision?
9. Are you confident that your position will be as valid over a long period?
10. Could you disclose without any doubt your decision or action to your boss, your CEO, the Board of Directors, your family, society as a whole?
11. What is the symbolic potential of your action if understood? Misunderstood?
12. Under what conditions would you allow exceptions to your stand?

Question 9

"To pay proper attention to business ethics is certainly beneficial in the interest of business. Describe four such benefits which may be obtained by paying attention to business ethics.

Answer

Benefits which may be obtained by paying attention to business ethics: Ethics is the concern for good behaviour – doing the right thing. In business, self interest prevails and there is always inconsistency between ethics and business. But it is a well settled principle that ethical behaviour creates a positive reputation that expands the opportunities for profit. The awareness regarding products and services of an organization, and the actions of its employees can affect its stakeholders and society as a whole. Therefore to pay proper attention to business ethics may be beneficial in the interest of business. These benefits may be enumerated as follows:

(1) In the recent past ruthless exploitation of children and workers, trust control over the market, termination of employees based on personalities and other factors had affected society and a demand arose to place a high value on ethics, fairness and equal rights resulting in framing of anti-trust laws, establishment of governmental agencies and recognition of labour unions.

(2) Easier change management: Attention to business ethics is also critical during times of fundamental change. The apparent dilemma may be whether to be non profit or for profit. In such situations, often there is no clear moral compass to guide leaders about what is

right or wrong. Continuing attention to ethics in the workplace sensitises leaders and staff for maintaining consistency in their actions.

(3) Strong team work and greater productivity: Ongoing attention and dialogues regarding ethical values in the workplace builds openness, integrity and a sense of community which leads to, among the employees, a strong alignment between their values and those of the organisation resulting in strong motivation and better performance.

(4) Enhanced employee growth: Attention to ethics in the workplace helps employees face the reality - both good and bad in the organisation and gain the confidence of dealing with complex work situations.

(5) Ethical programmes help guarantee that personnel policies are legal: A major objective of personnel policies is to ensure ethical treatment of employees. In matters of hiring, evaluating, disciplining, firing etc. An employer can be sued for breach of contract for failure to comply with any promise. The gap between corporate culture and actual practice has significant legal and ethical implications. Attention to ethics ensures highly ethical policies and procedures in the work place. Ethics management programmes are useful in managing diversity. Such programmes require the recognition and application of diverse values and perspectives which are the basis of a sound ethics management programme. Most organisations feel that cost of mechanisms to ensure ethical programme may be more helpful in minimizing the costs of litigations.

(6) Ethical programmes help to detect ethical issues and violations early, so that criminal acts "of omission" may be avoided.

(7) Ethical values help to manage values associated with quality management, strategic planning and diversity management.

Question 10

Answer whether the statement is correct or incorrect with brief reasons.

In the long run those business firms which do not respond to society's needs favourably will survive.

Answer

Incorrect. Society gives business its license to exist and this can be amended or revoked at any time if it fails to live up to society's expectations. Therefore, if a business intends to retain its existing role and power it must respond to society's needs constructively.

Question 11

State with reasons whether the following statement is correct or incorrect:

Business ethics helps to promote public reputation.

Answer

Correct: Ethics helps to promote a strong public image. An organization that pays attention to its ethics can portray a strong and positive image to the public. People see such organizations

as valuing people more than profit and striving to operate with the integrity and honour.

Question 12

State with reasons whether the following statement are correct or incorrect:

Ethics programs are not helping to manage values associated with quality management, strategic planning and diversity management.

Answer

Incorrect: Ethics programs help identifying the preferred values and ensuring that organizational behaviors are aligned with those values. This includes recording the values, developing policies and procedures to align behaviors with preferred values and then training all personnel about the policies and procedures. This overall effort is very useful for several other programs in the workplace that require behaviors to be aligned with values, including quality management strategic planning and diversity management. For example, total quality management initiatives include high priority on certain operating values, e.g. trust among stakeholders, performance, reliability, measurement and feedback.

Question 13

State with reasons whether the following statements are correct or incorrect:

(i) 'Fairness and Justice' are two different approaches as a source of ethical standards.

(ii) Inclusion of environmental consideration as a part of corporate strategy improves corporate performance.

Answer

(i) INCORRECT: The given statement "Fairness and Justice" are two different approaches as a source of ethical standards is incorrect.

Aristotle and other Greek philosophers have contributed the idea that all equals should be treated equally. Today we use this idea to say that ethical actions treat all human beings equally or if unequally, then fairly based on some standard that is defensible. We pay people more based on their harder work or the greater amount that they contribute to an organization, and say that is fair. But there is a debate over CEO salaries that are hundreds of times larger than the pay of others; may ask whether the huge disparity is based on a defensible standard or whether it is the result of an imbalance of power and hence is unfair.

(ii) CORRECT: Inclusion of environmental consideration as a part of corporate strategy improves corporate performance is a correct statement.

Environmental consideration is a part of corporate strategy, which means incorporating environmental issues in the process of developing a product, in new investments and in the organizational set up. A good environmental practice

improves corporate performance. In many industries it has been found that environmental friendly practices have resulted in more saving; for example the process of recycling the waste. Thus, environmental considerations play a key role in corporate strategy. Markets of new millennium will be able to create wealth if they respond to the challenges of sustainable development, as unsustainable products will become obsolete.

Question 14

Explain any four sources of ethical standard.

Answer

Sources of Ethical Standards:

1. *The Utilitarian Approach: Some ethicists emphasize that the ethical action is the one that provides the most good or does the least harm, or, to put it another way, produces the greatest balance of good over harm. The ethical corporate action, then, is the one that produces the greatest good and does the least harm for all who are affected - customers, employees, shareholders, the community, and the environment. The utilitarian approach deals with consequences; it tries both to increase the good done and to reduce the harm done.*
2. *The Rights Approach (The Deontological Approach): Other philosophers and ethicists suggest that the ethical action is the one that best protects and respects the moral rights of those affected. This approach starts from the belief that humans have a dignity based on their human nature per se or on their ability to choose freely what they do with their lives. On the basis of such dignity, they have a right to be treated as ends and not merely as means to other ends. The list of moral rights -including the rights to make one's own choices about what kind of life to lead, to be told the truth, not to be injured, to a degree of privacy, and so on-is widely debated; some now argue that non-humans have rights, too. Also, it is often said that rights imply duties-in particular, the duty to respect others' rights.*
3. *The Fairness or Justice Approach: Aristotle and other Greek philosophers have contributed the idea that all equals should be treated equally. Today we use this idea to say that ethical actions treat all human beings equally-or if unequally, then fairly based on some standard that is defensible. We pay people more based on their harder work or the greater amount that they contribute to an organization, and say that is fair. But there is a debate over CEO salaries that are hundreds of times larger than the pay of others; many ask whether the huge disparity is based on a defensible standard or whether it is the result of an imbalance of power and hence is unfair.*
4. *The Common Good Approach: The Greek philosophers have also contributed the notion that life in community is a good in itself and our actions should contribute to that life. This approach suggests that the interlocking relationships of society*

are the basis of ethical reasoning and that respect and compassion for all others-especially the vulnerable-are requirements of such reasoning. This approach also calls attention to the common conditions that are important to the welfare of everyone. This may be a system of Laws, effective police and fire departments, health care, a public educational system, or even public recreational areas.

5. ***The Virtue Approach: A very ancient approach to ethics is that ethical actions ought to be consistent with certain ideal virtues that provide for the full development of our humanity. These virtues are dispositions and habits that enable us to act according to the highest potential of our character and on behalf of values like truth and beauty. Honesty, courage, compassion, generosity, tolerance, love, fidelity, integrity, fairness, self-control, and prudence are all examples of virtues. Virtue ethics asks of any action, "What kind of person will I become if I do this?" or "Is this action consistent with my acting at my best?"***

Exercise

1. *Explain the Utilitarian Approach as the ethical standards?*

   [**Hints:** Some ethicists emphasize that the ethical action is the one that provides the most good or does the least harm, or, to put it another way, produces the greatest balance of good over harm. The ethical corporate action, then, is the one that produces the greatest good and does the least harm for all who are affected - customers, employees, shareholders, the community, and the environment. The utilitarian approach deals with consequences; it tries both to increase the good done and to reduce the harm done.]

2. *Enumerate the nature of Ethics.*

   [**Hints:** Simply stated, ethics refers to standards of behavior that tell us how human beings ought to act in the many situations in which they find themselves-as friends, parents, children, citizens, businesspeople, teachers, professionals, and so on. Thus Ethics is not a feelings or a religion or culturally accepted norms or is a science

8 Corporate Governance and Corporate Social Responsibility

Question 1

What is meant by corporate governance? Explain the benefits of good corporate governance.

Answer

Meaning: According to J. Wolfensohn, President of the **World bank,** "Corporate governance is about promoting corporate fairness, transparency and accountability". It is concerned with structures and processes for decision-making, accountability, control and behavior at the top level of organizations. It influences how the objectives of an organisation are set and achieved, how risk is monitored and assessed and how performance is optimized.

Corporate Governance can also be defined "as the formal system of accountability and control for ethical and socially responsible organizational decisions and use of resources."

Benefits of goods Corporate Governance:

1. Protection of investor interests and strong capital markets,
2. Studies show clear evidence that good governance is rewarded with a higher market valuation.
3. Ensure commitment of the board in managing the company in a transparent manner.

Question 2

Answer whether the statement is correct or incorrect with brief reason:

Company management has responsibility only towards its shareholders.

Answer

Incorrect: Company management is responsible not only to the shareholders, but also to other stakeholders i.e. people who have an interest in the conduct of the business of the company. These include employees, customers, vendors, the local community and even society as a whole. These stakeholders have certain rights with regard to how the business operates.

Question 3

Answer whether the statement is correct or incorrect with brief reason:

'The Governance Model positions management as accountable solely to investors'.

OR

The responsibility of the corporate management lies towards shareholders only.

Answer

Incorrect: The traditional governance model positions management as accountable not to investors only but a growing number of corporations in the late part of the 20th century accept that constituents like employees, trade unions, customers, suppliers along with the investors are affected by corporate activity and therefore the corporate must be answerable to them also. Such constituents of an organization are also called the stakeholders.

Question 4

What is meant by 'Stakeholders'? Describe those stakeholders who are affected by or can affect the organization?

OR

What is meant by 'Stakeholders'? Give the list of such stakeholders.

Answer

Meaning of Stakeholders: The traditional governance model positions management as accountable solely to investors or shareholders. But an increasing number of corporations accept that constituents other than shareholders are affected by corporate activity, and that the corporation must therefore be answerable and accountable to them. The word stakeholders describes such constituents of an organization – the individuals, groups or other organization(s) which are affected by, or can affect the organization in pursuit of its goals. A typical list of stakeholders of a company would be employees, trade unions, customers, shareholders and investors, suppliers, local communities, government and competitors.

Question 5

What is meant by 'Corporate Governance'? State the major 'characteristics' of good corporate governance.

Answer

Corporate Governance: Simply stated, 'Governance' means the process of decision making and the process by which decisions are implemented. The term corporate governance' is understood and defined in various ways. Corporate governance can be defined as the formal system of accountability and control for ethical and socially responsible organisational decisions and use of resources and accountability relates to how well the content of workplace decisions is aligned with the organisations strategic direction. Control involves the process of auditing and improving organisation decisions and actions. Good corporate governance has the following major characteristics:

(i) Participatory

(ii) Consensus oriented

(iii) Accountable

(iv) Transparent

(v) Responsive

(vi) Effective and efficient

(vii) Equitable and inclusive and

(viii) Follows the rule of law.

Question 6

What is Corporate Social Responsibility? Why it is needed in Indian Business environment?

Answer

The concept of Corporate Social Responsibility (CSR) focuses on the idea that beyond making profit, a business has social obligations. It is the responsibility of the companies to produce an overall positive impact on the society. CSR is pursued by business to balance their economic, environmental and social objectives while at the same time addressing stakeholders' expectations and enhancing shareholders' values. Stakeholders, including shareholders, analysts, regulators, labour unions, employees, community organisations and mass media expect companies to be accountable not only for their own performance but for the performance of their entire supply chain. Issues such as peace, sustainable development, security, poverty alleviation, environmental quality and human rights have a profound effect on business and its environment.

Corporate Social Responsibility is the continuing commitment by businesses to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large.

Need for social responsibility:

1. The iron law of responsibility
2. To fulfil long term self-interest
3. To establish a better public image
4. To avoid government regulation and control
5. To avoid misuse of National Resources and Economic Power
6. To convert Resistances into Resources
7. To minimise Environmental damage.

Question 7

State with reasons whether the following statement is correct or incorrect:

Corporate Social Responsibility is closely linked with the principles of sustainable development.

Answer

Corporate Social Responsibility (CSR) is a concept that organizations, have an obligation to consider the interests of customers, employees, shareholders, communities and ecological considerations in all aspects of their operations. This obligation is seen to extend beyond their statutory obligation to comply with legislation. CSR is closely linked with the principles of

Sustainable Development, which argues that enterprises should make decisions based not only on financial factors such as profits or dividends, but also based on the immediate and long-term social and environmental consequences of their activities. It is an integrated combination of policies, programs, education, and practices that extend throughout a corporation's operations and into the communities in which they operate, about how companies voluntarily manage the business processes to produce on overall positive impact on society.

Question 8

State the "Common Corporate Social responsibility" (CSR) policies for business organizations.

Answer

Common Policies under CSR are as under:

- Commitment to diversity in hiring employees and barring discrimination;
- Adoption of internal controls reform in the wake of Enron and other accounting scandals;
- Management teams that view employees as assets rather than costs;
- High performance workplaces that integrate the views of line employees into decision-making processes;
- Adoption of operating policies that exceed compliance with social and environmental laws;
- Advanced resource productivity, focused on the use of natural resources in a more productive, efficient and profitable fashion (such as recycled content and product recycling); and
- Taking responsibility for conditions under which goods are produced directly or by contract employees domestically or abroad.
- Management teams that view employees as assets rather than costs;
- High performance workplaces that integrate the views of line employees into decision-making processes;
- Adoption of operating policies that exceed compliance with social and environmental laws;
- Advanced resource productivity, focused on the use of natural resources in a more productive, efficient and profitable fashion (such as recycled content and product recycling); and
- Taking responsibility for conditions under which goods are produced directly or by contract employees domestically or abroad.

Question 9

Write a note on "Social Accountability-8000".

Answer

Social Accountability 8000: SA 8000 is a comprehensive, global, verifiable performance standard for auditing and certifying compliance with corporate responsibility. The heart of the standard is the belief that all workplaces should be managed in such a manner that basic human rights are supported and that management is prepared to accept accountability for this. SA8000 is an international standard for improving working conditions. This standard is based

on the principles of the international human rights norms as described in International Labour Organization conventions, the United Nations Convention on the Rights of the Child and the Universal Declaration of Human Rights. The requirements of this standard apply regardless of geographic location, industry sector, or company size.

Question 10

Explain the role played by different committees in regulating the 'Corporate Governance'.

Answer

Role of different committees in regulating corporate governance: The core roles of the various committees in regulation of corporate governance are as follows:

1. **Board of Directors:** The Board's role is that of trusteeship to protect and enhance shareholders value through strategic supervision. The strategy should aim at accountability and fulfillment of goals.
2. **Audit Committee:** They have to provide assurance to Board on adequacy of internal control systems and financial disclosures.
3. **Compensation Committee:** The committee has to recommend to the Board compensation terms for executive Directors and the senior most level of management below the Executive Directors.
4. **Nomination Committee:** It is to recommend to the Board nominations for membership of the Corporate Management Committee and the Board, and oversee succession to the senior most level of management below the Executive Directors.
5. **Investor Services Committee:** It is to look into redressal of Shareholders' and Investors' grievances, approval of transmissions, sub-division of shares, issue of duplicate shares etc.
6. **Corporate Management Committee:** Its primary role is strategic management of company's businesses within Board's approved direction/framework.
7. **Divisional Management Committee:** It is to realize tactical and strategic objectives in accordance with Corporate Management Committee/Board approved plan.

Question 11

State the benefits of socially responsible corporate performance.

Answer

Socially Responsible Corporate Performance: The benefits arising out of socially responsible corporate performance include the following:

1. Enhanced brand image and reputation.
2. Reduced Government regulations and controls.
3. Helps to minimize ecological damage.

4. Improved financial performance.
5. Reduced operating costs.
6. Increased sales and customer loyalty.
7. Increased productivity and quality of work life.
8. Increased ability to attract and retain employees.
9. Achievement of certain other objectives like easier access to capital including international capital.

Question 12

Explain how corporate social responsibility minimises the ecological damage and helps in achieving long-term objectives, so that the business may gain long-term profit maximization.

Answer

Corporate social responsibility and ecological damage: The business institution exists and flourishes only because it performs invaluable services to society. Society gives business its license to exist which may be revoked and amended at any time if they do not fulfill the society's expectations. Therefore, if a business intends to retain its existing social role and power, it must serve society's needs constructively.

A business organization acts in its own self interest and uses natural resources also. The effluents of many businesses damage the surrounding environment. By their own socially responsible behaviour, they can prevent government intervention if they are proactive in recognizing their ecological responsibility towards society. Companies must recognize that a strategy for corporate responsibility can play a valuable role not only in meeting the challenges of globalization by mitigating risks domestically and internationally, but also in providing benefits beyond risk management.

Question 13

*Explain the meaning of the **"Iron Law of Responsibility"**. State the resulting benefits which may be acquired by achieving the long-term objectives through the business activities.*

Answer

The Iron Law of Responsibility: The institution of business exists only because it performs invaluable services for society. Society gives business its license to exist and this can be amended or revoked at any time if it fails to live up to society's expectations. Therefore, if a business intends to retain its existing social role and power, it must respond to society's needs constructively. This is known as the "Iron Law of Responsibility". In the long-term those who do not use power in a manner that society considers responsible, will tend to lose it.

Businesses have been delegated economic power and have access to productive resources of a community. They are obliged to use these resources for the common good of society so that more wealth for its betterment may be generated. Technical and creative resources are also

helpful to it. A business organisation sensitive to community needs would in its own self interest like to have a better community within which the business may be conducted. This way, the resulting benefits would be:

(a) Decrease in crime

(b) Easier labour recruitment

(c) Reduced employee absenteeism.

(d) Easier access to international capital, better conditions for loans on international money markets.

(e) Dependable and preferred as supplier, exporter, importer and retailer of responsibly manufactured components and products.

This way a better society would produce a better environment in which the business may gain long term profit maximization.

Question 14

State with reasons whether the following statements are correct or incorrect:

The phrase 'Iron Law of Responsibility" means that the institution of business exists only because it performs invaluable services towards its promoters.

Answer

Incorrect: The phrase "Iron Law of Responsibility" means the institution of business exists only because it performs invaluable services for society. Society gives business its license to exist and this can be amended or revoked at any time if it fails to live upto society's expectations. Therefore, if a business intends to retain its existing social role and power, it must respond to society's needs constructively rather than it performs invaluable services towards its promoters.

Question 15

State with reasons whether the following statements are correct or incorrect:

"The institution of business exists only if it fulfils the society's expectations"

Answer

The given statement is Correct. It is the society which bestows upon businesses the authority to own and use land and natural resources. In return, society has the right to expect the productive organizations, enhancing the general interest of consumers, employees and community. Society may also expect that organizations to honour existing rights and limit their activities within the bounds of justice. So, under this 'social contract' between society and business, Business ethics provide the guidance as to regulation of the behavior of business enterprises and the minimal duties of the business professionals, including the consequences and complications of their actions. Thus, business ethics is that set of principles or reasons which should govern the conduct of business – whether at the individual or collective level by

the application of ethical reasoning to specific business situations and activities. Thus, it can be said that the institution of business exists only if it fulfills the society's expectations.

Question 16

Explain briefly the key strategies which can be used at the time of implementation of Corporate Social Responsibility policies and practices in a company.

Answer

Each company differs in how it implements Corporate Social Responsibility (CSR). The distinction depends on such factors as the company's size, sector, culture and the commitment of its leadership. Below are some key strategies that companies can use when implementing CSR policies and practices in a company.

(i) Mission, Vision and Value Statements

(ii) Cultural Values

(iii) Management Structures

(iv) Strategic Planning

(v) General Accountability

(vi) Employee Recognition and Rewards

(vii) Communications, Education and Training

(viii) CSR Reporting

Question 17

Examine the concept of Corporate Social Responsibility (CSR) and also explain in brief some of the key strategies which can be used by companies while implementing CSR policies and practices.

Answer

CSR Concept- Some companies have established committees that are specifically responsible for identifying and addressing social or environmental issues, or have broadened the scope of more traditional standing committees to include responsibility for CSR; while others have strategically appointed directors on the board based on the unique expertise and experience they bring on specific issues, who then serve as advisors to others on the board. Moreover, companies are finding that a board that is diverse in terms of gender, ethnicity and professional experience is better equipped to grapple with emerging and complex challenges.

Companies implement CSR by putting in place internal management systems that generally promote:

i. Adherence to labour standards by them as well their business patterns;

ii. Respect for human rights;

iii Protection of the local and global environment;

iv. Reducing the negative impacts of operating in conflict zones;

v. Avoiding bribery and corruption and;

vi. Consumer protection.

key strategies which can be used by companies while implementing CSR policies and practice-Some of the key strategies which can be used by companies when implementing CSR policies and practices are as follows:

(a) Mission, vision and values statements

(b) Cultural values

(c) Management structures

(d) Strategic planning

(e) General accountability

(f) Employee recognition and rewards

(g) Communication, education and training

(h) CSR reporting

Question 18

State with reason whether the following statement is correct or incorrect:

Inclusion of environmental consideration as a part of corporate strategy improves corporate performance.

Answer

CORRECT: Inclusion of environmental consideration as a part of corporate strategy improves corporate performance is a correct statement.

Environmental consideration is a part of corporate strategy, which means incorporating environmental issues in the process of developing a product, in new investments and in the organizational set up. A good environmental practice improves corporate performance. In many industries it has been found that environmental friendly practices have resulted in more saving; for example the process of recycling the waste. Thus, environmental considerations play a key role in corporate strategy. Markets of new millennium will be able to create wealth if they respond to the challenges of sustainable development, as unsustainable products will become obsolete.

Question 19

What is meant by 'Corporate Governance'? State the 'measures of Corporate Governance' with reference to Indian companies.

Answer

Meaning and Measures of Corporate Governance :

Meaning: "Corporate governance is about promoting corporate fairness, transparency and accountability. It is concerned with the structures and processes for decision-making, accountability, control and behavior at the top level of organizations. It influences how the objectives of an organization are set and achieved, how risk is monitored and assessed and how performance is optimized.

Measures: In general, corporate governance measures include appointing non-executive directors, placing constraints on management power and ownership concentration, as well as ensuring proper disclosure of financial information and executive compensation. Many companies have established ethical and/or social responsibility committees on their Boards to review strategic plans, assess progress and offer guidance on social responsibilities of their business. In addition to having committees and Boards, some companies have adopted guidelines governing their own policies around such issues like board diversity, independence, and compensation. Indian companies are also required to comply with Clause 49 of the listing agreement.

Exercise

1. *Write short notes on:*

   (i) Code of Conduct on Insider Trading

   (ii) (APEC) Business Code of Conduct

   [Hints:

   (i) In pursuance of the Securities and Exchange Board of India ((Prohibition of Insider Trading) Regulations, 1992 (duly amended), the Board has approved the Code of Conduct for Prevention of Insider Trading. The objective of the Code is to prevent purchase and/or sale of shares of the Company by an Insider on the basis of unpublished price sensitive information.]

   (ii) APEC is known as the primary international organization for promoting open trade and economic cooperation among 21 member countries. The Code, issued as a draft in 1999, is a standard that draws significantly on a variety of other internationally recognized codes and standards. The drafting of the Code was initiated by business leaders from companies operating in APEC countries and is designed to supplement and support companies existing codes of conduct]

2. *Explain the meaning of Corporate citizenship.*

   [Hints: The term corporate citizenship denotes the extent to which businesses meet the legal, ethical, economic and voluntary responsibilities placed on them by their stakeholders. Companies can best benefit their stakeholders by fulfilling their economic, legal, ethical, and discretionary responsibilities. The benefits of good corporate citizenship, include:

   - A stable socio-political-legal environment for business as well as enhanced competitive advantage through better corporate reputation and brand image.
   - improved employee recruitment, retention and motivation, improved stakeholder relations and a more secure environment in which to operate]

9 Workplace Ethics

Question 1

Explain the factors that influence ethical behaviour of an employee. List out some examples of various ethical issues faced in a workplace.

Or

State some examples of ethical issues faced by an individual at the workplace.

Or

State the ethical issues which are being faced by an individual at the workplace of an industrial organization.

Answer

Ethical decisions are influenced by three key factors: Individual moral standards, the influence of managers and co-workers and the opportunity to engage in misconduct. While one may have great control over personal ethics outside the workspace, co-workers and the management exert significant control on one's choices at work. The activities and examples set by co-workers along with rules and policies are critical in gaining consistent ethical compliance in an organization. If a company fails to provide good examples and direction for appropriate conduct, confusion and conflict will develop and result in the opportunity for unethical behaviour. *Example:* If the boss or co-workers leave work early, one may be tempted to do so as well. If one sees co-workers making personal long distance phone calls at work and charging them to the company, one may be more likely to do so also. In addition having sound personal values contributes to an ethical work place.

Some examples of ethical issues faced by an individual in the workplace are:

1. Relationships with suppliers and business partners
    a. Bribery and immoral entertainment
    b. Discrimination between suppliers
    c. Dishonesty in making and keeping contracts
2. Relationship with customers
    a. Unfair pricing

b. Cheating customers

c. Dishonest advertising

3. Relationship with employees

a. Discrimination in hiring, promoting, etc

b. Unequal treatment

4. Management of resources

a. Misuse of official funds

b. Tax evasion

Question 2

Describe the factors which influence the ethical behaviour at work in an organization

Answer

Factors which influence the ethical behaviour at work- Ethical decisions in an organization are influenced by three key factors:

1. Individual moral standards: One may have great control over personal ethics outside workplace.
2. The influence of managers and co-workers: The activities and examples set by co-workers along with rules and policies established by the firm are critical in gaining consistent ethical compliance in an organization.
3. The opportunity to engage in misconduct: If a company fails to provide good examples and direction for appropriate conduct; confusion and conflict will develop and result in the opportunity for unethical behavior.

Question 3

State with reasons whether the following statement is correct or incorrect:

Fairness and honesty are the pillars of success in business.

Answer

Correct: The success of the business depends very much on fairness and honesty in the business. Fairness and honesty are at the heart of the business ethics and relate to the general values of decision makers. At a minimum, business professionals and persons are expected to follows all applicable laws and regulation. Even then, they are expected not to harm customers, employees, clients or competitors knowingly through deception, misrepresentation, coercion or discrimination.

One aspect of fairness and honesty is related to disclosure of potential harm caused by product use. For *example*, Mitsubishi Motors, a Japanese automaker, faced criminal charges

and negative publicity after executives admitted that the company had systematically covered up customer complaints about tens of thousands of defective automobiles over a 20 year period in order to avoid expensive and embarrassing product recalls.

Another aspect of fairness relates to competition. Although numerous laws have been passed to foster competition and make monopolistic practices illegal, companies sometimes gain control over markets by using questionable practices that harm competition.

Rivals of Microsoft, for *example,* accused the software giant of using unfair and monopolistic practices to maintain market dominance with its Internet Explorer browser.

These aforesaid *examples* show that fairness and honesty pay in the long run; they secure the stability of the business and overall reputation in the business world. Therefore, we may say that fairness and honesty are the pillars of success in the business.

Question 4

Answer whether the statement is correct or incorrect with brief reason:

Promotion policies based on individual merit and not purely on the basis of seniority is discriminatory.

Answer

Incorrect: Discrimination is action based on prejudice resulting in unfair treatment of people. To discriminate socially is to make a distinction between people on the basis of class or category without regard to individual merit. Examples of such discrimination include racial, religious or gender-based discrimination. Distinctions between people which are based just on individual merit (such as personal achievements, skill or ability) are generally not considered socially discriminatory. So seniority alone cannot be the deciding factor for promotion, if the senior person is not fit for the job.

Question 5

What do you understand by the term 'discrimination' in employment as sometime found in an establishment? Explain the basic elements of 'discrimination'.

OR

State the elements which create discrimination in employment in the business organizations.

Answer

The root meaning of the term discriminate is “to distinguish one object from another”. Employment discrimination is treating one person better than another because of their age, gender, race, religion or other protected class of status. Discrimination in employment is wrong because it violates the basic principle of equality. Discrimination is to treat people differently. It is usually intended to refer to the wrongful act of making a difference in treatment or favour on a basis other than individual merit.

Elements of Discrimination: Generally, the discrimination means to distinguish one object from another or treating people differently. It is usually intended to refer to the wrongful act of making a difference in treatment or favour on a basis other than individual merit. Such discrimination may also be related in employment in business organization. The elements which create discrimination may be summarized as follows:

(i) If the decision against one or more employees is taken which is not based on individual merit, such as the ability to perform a given job, seniority or other morally legitimate qualification.

(ii) If the decision has been derived solely from racial or sexual prejudice, false stereotypes other kind of morally unjustified attitude against members of which the employee belongs.

(iii) If the decision has a harmful or negative impact on the interests of the employees, perhaps costing them jobs, promotions or better pay.

Discrimination in employment is wrong because it violates the basic principle of justice by differentiating between people on the basis of characteristics (race or sex) that are not relevant to the tasks they must perform. Looking to these aspects law has also been changed to conform to these moral requirements and to minimize the discrimination in employment in this respect.

Question 6

Write a note on harassment at workplace.

Answer

Harassment is "tormenting by subjecting to constant interference or intimidation". Law prohibits harassing acts and conduct that "creates an intimidating hostile or offensive working environment," which could be a term or condition of an individual's employment, either explicitly or implicitly or such conduct which has the purpose or effect of unreasonably interfering with an individual's work performance or creating an intimidating, hostile or offensive working environment. Another type of harassment is sexual harassment – situations in which an employee is coerced into giving in to another employee's sexual demands by the threat of losing some significant job benefit, such as a promotion, raise or even the job. Sexual harassment is prohibited and an employer is held responsible for all sexual harassment engaged in by employees, "regardless of whether the employer knew or should have known" the harassment was occurring and regardless of whether it was "forbidden by the employer."

Question 7

Explain the concept of "Sexual harassment" in relation to work place

Answer

Concept of Sexual harassment: Sexual harassment is a situation in which an employee is coerced into giving into another employee's sexual demands by the threat of losing some significant job benefit, such as a promotion, raise, or even the job. This kind of degrading coercion exerted on employees who are vulnerable and defenseless inflicts great psychological harm on the employee, violates the employee's most basic right to freedom and dignity and is an unjust misuse of the unequal power that an employer can exercise over the employee. Sexual harassment is prohibited, and an employer is held responsible for all sexual harassment engaged in by employees.

Question 8

Answer whether the statement is correct or incorrect with brief reasons.

Ethical behaviour is not essential to working environment at the workplace.

Or

Explain the importance of ethical behavior at the workplace.

OR

What problems may arise at work place when ethical behaviour is not adopted?

Answer

Incorrect. Every organization, whether a business or a government agency, is first and foremost a human society. In all these setups, ethical behaviour is essential to working environment. If an employer does not take steps to create a working environment where the employees have a clear, common understanding of what is right and wrong, and feel free to discuss and ask questions about ethical issues and report violations, some significant problems may arise namely:

(i) Increased risk of employees making unethical decisions.

(ii) Increased tendency of employees to report violations to outside regulatory authorities (whistle blowing) because they lack an adequate internal forum.

(iii) Inability to recruit and retain top people.

(iv) Diminished reputation in the industry and the community.

(v) Significant legal exposure and loss of competitive advantage in the market place. Therefore, ethical behaviour is essential to working environment at the workplace.

Question 9

Explain in brief the measures to ensure ethics in the Work place.

Or

State in brief the guidelines for managing ethics and to prevent the need for whistle-blowing in the work place.

Answer

Managing ethics and preventing whistle-blowing: The focus on core values and sound ethics, the hall mark of ethical management, is being recognized as an important way to ensure the long term effectiveness of governance structures and procedures and to avoid the need for whistle blowing.

Employers, who understand the importance of work place ethics, provide their work force with an effective framework and guiding principles of identity and address ethical issues as they arise. These guidelines for managing ethics and to avoid the need for whistle-blowing in the work place may be summarized as follows:-

(a) Have a Code of Conduct and ethics.

(b) Establishment open communication.

(c) Make ethical decisions in group and make decision public whenever appropriate.

(d) Integrate ethics with other management practices.

(e) Use of cross functional teams when developing and implementing the ethics management programme.

(f) Appointing an ombudsman.

(g) Creating an atmosphere of trust.

(h) Regularly updating of policies and procedures

(i) Include a grievance policy for employees

(j) Set an example from the top.

Question 10

Explain the various socio-psychological factors responsible for developing negative attitude by an individual at workplace.

Answer

Socio-Psychological Factors Responsible for Developing Negative Attitude by an Individual at Work Place:

An ethical issue is an identifiable problem, situation or opportunity that requires a person to choose from several actions which could be evaluated as right or wrong. Values reflect enduring beliefs that one holds that influences attitude, action and the choices one make. As individuals, our values are shaped by our personal beliefs. Values developed in childhood and youth are constantly tested and on-the-job decisions reflect the employee's understanding of ethical responsibility. Various socio-

psychological factors that could be responsible why individuals could develop negative attitudes or lose personal motivation are:

(i) Negative work or life experiences.

(ii) Employees failing to respect each others unique personalities.

(iii) Overly aggressive financial or business targets.

(iv) Pressures to perform and take quick decisions.

Question 11

Explain the practices widely recognized as discriminatory in employment.

Answer

Discriminatory Practices in Employment: Discrimination in employment is wrong because it violates the basic principle of justice by differentiating between people on the basis of characteristics (race or sex) that are not relevant to the tasks they must perform.

It is consequently understandable that the law has gradually been changed to conform to these moral requirements, and that there has been a growing recognition of the various ways in which discrimination in employment occurs. Among the practices now widely recognized as discriminatory are the following:

Recruitment Practices: Firms that rely solely on the word-of-mouth referrals of present employees to recruit new workers tend to recruit only from those racial and sexual groups that are already represented in their labor force. Also, when desirable job positions are only advertised in media that are not used by minorities or women or are classified as for men only, recruitment would also tend to be discriminatory.

Screening Practices: Job qualifications are discriminatory when they are not relevant to the job to be performed (e.g., requiring a high school diploma or a credential for an essentially manual task.). Job interviews are discriminatory if the interviewer routinely disqualifies certain class of people - for example assumptions about occupations "suitable for women" or the propriety of putting women in "male "environments.

Promotion Practices: Promotion, job progression, and transfer practices are discriminatory when employers place males on job tracks separate from those open to women and minorities. When promotions rely on the subjective recommendations of immediate supervisors.

Conditions of Employment: Many times wages and salaries are discriminatory to the extent that equal wages and salaries are not given to people who are doing essentially the same work. Another issue is related to fair wages and treatment to workers. Companies subcontracting manufacturing operations abroad are now aware of the ethical issues associated with supporting facilities like child labour that abuse and/or underpay their work forces. Such facilities have been termed "sweatshops."

Dismissal: Firing an employee on the basis of his or her race or sex is a clear form of discrimination. Less blatant but still discriminatory are layoff policies that rely on a seniority system, in which women and minorities have the lowest seniority because of past discrimination.

Exercise

1. *Explain the importance of Ombudsperson in the workplace?*

   [**Hints:** The ombudsperson is responsible to help & coordinate development of the policies and procedures to institutionalise moral values in the workplace. This establishes a point of contact where employees can go to ask questions in confidence about the work situations they confront and seek advice]

2. *Eloborate 'Communication as an ethical issues'.*

   [**Hints:** Communications is another area in which ethical concerns may arise. False and misleading advertising, as well as deceptive personal-selling tactics, anger consumers and can lead to the failure of a business. Truthfulness about product safety and quality and product labelling are also important to consumers].

10 Environment and Ethics

Question 1

What is meant by 'Sustainable Development'? State the special responsibilities of the industries that are based on natural resources. How the adoption of Green Accounting System helps in avoiding policy decisions which are non-sustainable for the country?

OR

The industries that are based on natural resources, like minerals, timber, fibre and foodstuffs, have some special responsibility for making "environment-friendly products". Examine this statement and also explain in brief the concept of Green Accounting System.

Answer

Sustainable Development: Literally sustainable development refers to maintaining development over time. It may be defined as development that meets the needs of the present without compromising the ability of future generations to meet their own needs. A nation or society should satisfy its requirements – social, economic and others – without jeopardizing the interests of future generations.

Special responsibilities of industries based on natural resources: Industries that are based on natural resources, like minerals, timber, fibre, and foodstuffs etc. have a special responsibility for :

(1) adopting practices that have built-in environmental consideration

(2) introducing processes that minimize the use of natural resources and energy, reduce waste, and prevent pollution.

(3) making products that are 'environment-friendly', with minimum adverse impact on people and ecosystem.

Green accounting systems: Conventional accounts may result in policy decisions which are non-sustainable for the country. Green accounting on the other hand is, focused on addressing such deficiencies in conventional accounts with respect to environment. If the environmental costs are properly reflected in the prices paid for goods and services then companies and ultimately the consumer would adjust market behaviour in a way that would reduce damage to environment, pollution and waste production. Such measures would facilitate the approach of 'polluter pays principle'. Removing subsidies that encourage environmental damage is another measure.

There is no doubt, that with the public opinion moving towards accountable socio-economic structures, ethical and eco-friendly business practices would be standard corporate norms.

Question 2

Answer whether the statement is correct or incorrect with brief reasons.

'There is no economic growth without ecological costs'.

Answer

Correct. Economic growth has to be environmentally sustainable. There is no economic growth without ecological costs. Industrialization and rapid development have affected the environment. Everybody should realize that such development is related to environmental damage and resource depletion.

Therefore, an element of resource regeneration and positive approach to environment has to be incorporated in development programs. Sustainable development refers to maintaining development over time. Sustainable development is development that meets the needs of the present without comprising the ability of future generations to meet their own needs. A nation or society should satisfy its social, economic and other requirement without jeopardizing the interest of future generations.

High economic growth means high rate of extraction, transformation and utilization of non-renewable resources. Therefore, it is suggested that economic growth has to be environmentally sustainable because it is sure that there is no economic growth without ecological cost.

Question 3

State with reason whether the following statement is correct or incorrect:

Creation of proper ethical environment requires a proper understanding of the reasons which lead to an unethical behavior.

Answer

Correct: A creation of a proper ethical environment requires a proper understanding of the reasons which lead to an unethical behavior. The reasons may be summarized as follows:

(a) Emphasis on short term results

(b) Ignoring small unethical issues

(c) Economic Cycles

(d) Change in accounting rules.

Question 4

Write a note on ecological ethics.

Answer

Note on Ecological Ethics: The problem of pollution and other environmental issues can best be framed in terms of our duty to recognize and preserve the ecological systems within which we live. An ecological system is an interrelated and interdependent set of organisms and environments, such as a lake, in which the fish depend on small aquatic organisms, which in turn live off decaying plant and fish waste products. Since the various parts of an ecological system are interrelated, the activities of one of its parts will affect all other parts. Business and all social firms are parts of a larger ecological system.

Business firms depend on the natural environment for their energy, material resources, waste disposal and that environment in turn is affected by the commercial activities of business firms. Unless business recognize the interrelationship and interdependencies of the ecological systems within which they operate and unless they ensure that their activities will not seriously injure these systems one cannot hope to deal with the problem of pollution.

Ecological ethics is based on the idea that the environment should be protected not only for the sake of human being but also for its own sake. The issue of environmental ethics goes beyond the problem relating to protection of environment or nature in terms of pollution, resource utilization or waste disposal. It is the issue of exploitive human nature and attitudes that should be addressed in a rational way. Problems like global warming, ozone depletion and disposal of hazardous waste that concern the entire world. They require international co-operation and have to be tackled at the global level.

Question 5

State with reason whether the following statement is correct or incorrect:

A nation should satisfy its social and economic requirements without damaging the interest of future generations.

Answer

Correct: An element of resource regeneration and positive approach to environment has to be incorporated in developmental programmes. Sustainable development is necessary because it meets the needs of the present without compromising the ability of future generations to meet their own needs.

Question 6

Answer whether the statement is correct or incorrect with brief reason:

Depletion of Ozone layer will have adverse effect on human beings and not on vegetation.

Answer

Incorrect: Ozone depletion results in the increase of ultraviolet rays. Experts believe that this could cause several hundred thousands of new cases of skin cancer and could also lead to

considerable destruction of 75% of the world's major crops that are sensitive to ultraviolet light.

Question 7

Answer whether the statement is correct or incorrect with brief reason:

Water pollution is also a kind of resource depletion.

Answer

Correct: Water pollution is also a kind of resource depletion because contamination of air, water or land diminishes their beneficial qualities. Oceanographers have found traces of plutonium, cesium and other radioactive materials in seawater that have apparently leaked from the sealed drums in which radioactive wastes are disposed. An increase in population and economic activity in urban area has also resulted in increased demands of water. The ground water is also shrinking because of the decreasing rainfall and wastage of water.

Question 8

What is meant by 'Environmental ethics'? How does its non-adoption lead to 3 Ps Viz., Polluter Pays and Principles? Explain.

Answer

Ecological ethics is based on the idea that the environment should be protected not only for the sake of human beings but also for its own sake. The issue of environmental ethics goes beyond the problems relating to protection of environment or nature in terms of pollution, resource utilization or waste disposal.

Business and Industry are closely linked with environment and resource utilization. Production process and strategy for eco-friendly technologies throughout the product life cycle and minimization of waste play major role in protection the environment and conservation of resources. Business, Industry and multinational corporations have to recognize environmental management as the priority area and a key determinant to sustainable development. Sound management of wastes is among the major environmental issues for maintaining the quality of Earth's environment and achieving sustainable development.

If the environmental costs are properly reflected in the prices paid for goods and services then companies and ultimately the consumer would adjust market behaviour in a way that would reduce damage to environment, pollution and waste production. Price signal will also influence behaviour to avoid exploitation or excessive utilization of natural resources. Such measures would facilitate the approach of "Polluter Pays Principle". Removing subsidies that encourage environmental damage is another measure.

Question 9

Answer whether the statement is correct or incorrect with brief reason:

'Business does not sub-serve environmental ethics'.

Answer

Incorrect: Previously the business concerns were mainly concerned with only good business in economic sense. The conservation of natural resources was a motive of more economic gains. But now due to awareness of social responsibility and ethical norms the motive of business is not only concerned with business interest of the shareholders but also a general concern for the community. Now the business houses have realized that environmental ethics make good business sense if quality, ethics and environmental standards are maintained.

Question 10

State with reason whether the following statement is correct or incorrect:

'A good environmental practice improves corporate performance'

Answer

Environmental consideration have become a part of corporate strategy, which means incorporating environmental issues in the process of developing a product, in new investments and in the organisational set up. A good environmental practice improves corporate performance. In many industries it has been found that environmental friendly practices have resulted in more saving; for example the process of recycling the waste. Thus environmental considerations play a key role in corporate strategy. Markets of new millennium will be able to create wealth if they respond to the challenges of sustainable development, as unsustainable products will become obsolete.

Question 11

State with reason whether the following statement is correct or incorrect.

'Business and industry are closely linked with environment and resource utilization'.

Answer

Correct: Business and industry are closely linked with environment and resource utilization. Production process and strategy for eco-friendly technologies throughout the product life cycle and minimization of waste play a major role in the protection of the environment and conservation of resources. Business, industry and multinational corporations have to recognize environmental management as the priority area and a key determinant to sustainable development.

Question 12

What do you understand by the term "Acid Rain"? How does it adversely affect the environment?

Answer

Like a Global Warming, "Acid Rain" is a threat to the environment that is closely related to the combustion of fossil fuels (oil, coal and natural gases) which are heavily used by utilities to

produce electricity. Burning fossil fuels, particularly coal containing high levels of sulphur, releases large quantities of sulphur oxides and nitrogen oxides into the atmosphere. When these gases are carried into the air, they combine with water vapour in clouds to form nitric acid and sulphuric acid. These acids are then carried down in rain, which often falls hundreds of miles away from the original sources of the oxides raising the acidity of the water sources. It also soaks into soils and falls directly on trees and other vegetations.

Numerous studies have shown that many fish populations and other aquatic organisms are unable to survive in lakes and rivers that have become highly acidic due to acid rain. Other studies have shown that acid rain directly damages forests and indirectly destroys the wildlife and species that depend on forests for food and breeding. Acidic rain water can also contaminate drinking water. Acid rain can corrode and damage buildings, statues and other objects, particularly those made of iron, lime stone and marble thereby causing great threat to life and property over a long period of time.

Question 13

Discuss different environmental phenomena of ethical concern?

Answer

Different environmental phenomena of ethical concern: An ecological system is an interrelated and interdependent set of organisms and environments, such as a lake, in which the fish depend on small aquatic organisms, which in turn live off decaying plant and fish waste products. Since the various parts of an ecological system are interrelated, the activities of one of its parts will affect all the other parts. Business firms (and all other social institutions) are parts of a larger ecological system. Business firms depend on the natural environment for their energy, material resources, and waste disposal, and that environment in turn is affected by the commercial activities of business firms.

The issue of environmental ethics goes beyond the problems relating to protection of environment or nature in terms of pollution, resource utilization or waste disposal. It is the issues of exploitive human nature and attitudes that should be addressed in a rational way. Problems like Global warming, Ozone depletion and disposal of hazardous wastes that concern the entire world. They require International cooperation and have to be tackled at the global level.

Few decades ago, the corporate world, the industry or others engaged in the use of natural resources or environmental services were mainly concerned with good business in economic sense. There is now a growing concern for Social responsibility and ethical norms in all spheres of human activities; be it public behaviour, business or environment and there are ethical concerns to look after not only the interest of stakeholders but also that of community; as the regulatory / mandatory requirements have also become more stringent. This translates into providing safety for the workers at workplace, concern for their health, reducing pollution and incorporating environmental values in governance.

Exercise

1. *Write short note on 'Business and Environment Ethics'.*

   [**Hints**: Environmental ethics is a larger issue that concerns ethical behaviour of all types of organisations ranging from International bodies, national governments, opinion makers, media, intelligentsia, public and private enterprises and NGOs. In India many companies have come to realize that ethical practices make good business sense especially the organizations engaged in exports as these organisations have to satisfy the importer in regard to the quality, ethics and environmental standards.]

2. *Short Note on:*

   (i) Global Warming

   (ii) Ozone Depletion

   [**Hints**:

   (i) Greenhouse gases - carbon dioxide, nitrous oxide, methane, and chloro-fluorocarbons, occur naturally in the atmosphere to absorb and hold heat from the sun, preventing it from escaping back into space.

   (ii) A layer of ozone in the lower stratosphere screens all life on earth from harmful ultraviolet radiation. This ozone layer, however, is destroyed by CFC gases]

11 Ethics in Marketing and Consumer Protection

Question 1

Explain the extent to which it is possible to observe ethical behaviour in marketing. Also explain in brief the merits and demerits of the above.

Answer

Ethical behaviour in Marketing; Merits and Demerits: Market is flooded with duplicate goods having fake labels for selling drugs, food stuffs, consumables like agarbathis, suparis etc. followed by misleading advertisements. This results in disrepute for the products of good companies even though such fake goods are small in quantities. Setting high ethical standard and enforcing them reverses the position. If government notices such depletion of ethical standard, rigid regulations are brought in and are never withdrawn. Marketing executives enjoy great amount of social power in influencing the society. They also are the emblems for the organization. Once the virtues are lost it is difficult to regain the social power, influence and image.

Question 2

*Answer 'yes' **or** 'no' with brief reason:*

Ethics are necessary in marketing to build Brand image only.

Answer

No, the ethics are necessary in marketing not only to build image, but ethics are necessary for sustainable development of business, and ultimately for transparency and good corporate governance in the country.

Question 3

Answer whether the statement is correct or incorrect with brief reason:

Ethical behaviour in marketing is necessary to avoid Government intervention/ regulation.

Answer

Correct: Business apathy, resistance or token responses to unethical behaviour simply increase the probability of more Governmental regulation. Indeed, most of the Governmental limitations on marketing are the results of management's failure to live up to its ethical responsibilities at one time or other. However, once some form of government control has

been introduced, it is rarely removed. So, business enterprises in their own interest must behave ethically in marketing.

Question 4

Explain the pragmatic reasons for maintaining ethical behaviour in marketing through marketing executives.

OR

What reasons force a marketing executive to adopt ethical practices in marketing? Explain.

Answer

Pragmatic reasons for maintaining ethical behaviour: Marketing executives should practice ethical bahaviour because it is morally correct. To maintain ethical behaviour in marketing, the following positive reasons may be useful to the marketing executives:

1. **To reverse declining public confidence in marketing:** Sometime misleading package labels, false claim in advertisement, phony list prices, infringement of trademarks pervert the market trends and such behaviour damages the marketers' reputation. To reverse this situation, business leaders must demonstrate convincingly that they are aware of their ethical responsibility and will fulfill it. Companies must set high ethical standards and enforce them. Moreover, it is in management's interest to be concerned with the well being of consumers, since they are the lifeblood of a business.
2. **To avoid increase in government regulation:** Business apathy, resistance, or token responses to unethical behaviour increase the probability of more governmental regulation. The governmental limitations may also result from management's failure to live up to its ethical responsibilities. Moreover, once the government control is introduced, it is rarely removed.
3. **To retain power granted by society:** Marketing executives wield a great deal of social power as they influence markets and speak out on economic issues. However, there is a responsibility tied to that power. If marketers do not use their power in a socially acceptable manner, that power will be lost in the long run.
4. **To protect the image of the organisation:** Buyers often form an impression of an entire organisation based on their contact with one person. That person represents the marketing function. Some times a single sales clerk may pervert the market opinion in relation to that company which he represents.

Therefore, the ethical behaviour in marketing may be strengthened only through the behaviour of the marketing executives.

Question 5

*Answer 'yes' **or** 'no' with brief reason:*

Consumer purchases goods and health services for personal purposes only.

Answer

No. The consumer does not purchase goods and health services for personal purposes only, because on certain occasions various items are purchased for public welfare and development of the society as a whole. Further, under the Competition Act, 2002, a consumer is also one who may purchase goods for commercial purposes also.

Question 6

Answer whether the statement is correct or incorrect with brief reason:

'Competition Act, 2002 protects the interest of consumers'.

Answer

Correct: The Competition Act, 2002 intends to protect the interests of consumers by establishing a commission to prevent practices having adverse effect on competition and to promote and sustain competition in markets. The commission is empowered to prohibit certain agreements which are considered as anti-competitive in nature, abuse of dominant position and regulation of combinations likely to cause appreciable adverse effect on competition.

Question 7

A retailer was purchasing goods regularly from XYZ Ltd. for the purpose of resale. There were defects in the goods in one of the purchase lot and as a result the retailer suffered loss of his share in competition. The retailer sued the said company for this reason. The company contended that the goods were purchased for the purpose of resale and therefore, not bound. Is it a valid contention? Explain clearly the provisions of the Competition Act, 2002 in this regard

Answer

The problem as asked in the question is based on the provisions of Section 2(f) of the Competition Act, 2002. The Section provides that "consumer" means any person who buys any goods for a consideration which has been paid or promised or partly paid or partly promised or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised or under any system of deferred payment when such use is made with the approval of such person whether such purchase of goods is for resale or for any commercial purpose or for personal use.

Hence Section 2(f) of the Competition Act, 2002 provides that whether purchase of goods is for resale or for any commercial purpose or for personal use, the purchaser is a consumer. Thus consumer will also include a person who purchases goods for re-sale. Therefore the contention of XYZ Ltd. is not valid and not tenable.

Question 8

Answer whether the statement is correct or incorrect with brief reason:

'Consumer for personal use and consumer for commercial use are synonymous'.

Answer

Incorrect: It seems that the definitions of "consumer" under Competition Act, 2002 and under Consumer Protection Act, 1986 are substantially the same. But there is difference between the two and that difference is that under clause (1) of Section 2(f) in Competition Act, the words used are "whether such purchase of goods is for the resale of for any commercial purpose or for personal use" in place of the words "but does not include a person who obtains such goods for resale of for any commercial purpose" as in the Consumer Protection Act. Likewise in clause (ii) the words used in the Competition Act are "Whether such hiring or availing of services is for any commercial purpose or for personal use" in place of the words "but does not include a person who avails of such services for any commercial purpose" as in the Consumer Protection Act. Thus in case of Competition Act the word consumer includes both consumer for personal use and for commercial use but it is not so in the case of the Consumer Protection Act.

Question 9

Answer whether the statement is correct or incorrect with brief reason.

'Consumer interest' and 'Public interest' are synonymous'.

Or

Differentiate between 'consumer interest' and 'public interest'.

Answer

Incorrect: Apparently it seems that public interest and consumer interest are synonymous, but it is not so. They may be differentiated as under:

(i) In the name of public interest, many Governmental policies are formulated which manifest themselves in anti-competitive behaviour. If the consumer is at the fulcrum, consumer interest and welfare should have primacy in all governmental policy formulations.

(ii) Consumer is a member of a broad class of people who purchase, use, maintain and dispose of products and services. They are being affected by pricing policy, financing practice, quality of goods, services and trade practices. They are clearly distinguished from manufacturers who produce goods for wholesalers, retailers who sell goods in public interest.

Public interest is something in which the society as a whole has some interest, and is seen as an externality to competitive markets. There is also a justifiable apprehension that in the name of public interest, Governmental policies may be fashioned and

introduced which may not be in the ultimate interest of the consumers. In fact in such situations, there is the possibility that a conflict could arise between public interest and consumer interest.

Question 10

What are the United Nations' guidelines themes on consumer protection? Enumerate also the consumer rights enshrined therein.

Answer

The UN Guidelines call upon governments to develop, strengthen and maintain a strong consumer policy, and provide for enhanced protection of consumers by enunciating various steps and measures around eight themes (UNCTAD, 2001). These eight themes are:

1. Physical safety
2. Economic interests
3. Standards
4. Essential goods and services
5. Redress
6. Education and information
7. Specific areas concerning health
8. Sustainable consumption

The Guidelines have implicitly recognised eight consumer rights, which were made explicit in the Charter of Consumer International as follows:

- Right to basic needs
- Right to safety
- Right to choice
- Right to redress
- Right to information
- Right to consumer education
- Right to representation
- Right to healthy environment

These eight consumer rights can be used as the touchstones for assessing the consumer welfare implications of competition policy and law, and to see how they help or hinder the promotion of these rights.

Question 11

Examine the following hypothetical situation and give a brief analytical note on it.

ABC Ltd. has been the leading scientific equipment manufacturing company in South India. But it suddenly finds that certain companies from North India that do not have anywhere near its own kind of clout in their own turfs, are trying to enter the south Indian market. But because of its superior clout, ABC Ltd coerces them to enter into agreement with itself such that they do not sell at prices above that of its own products. Please comment on the legality of such agreements. Conversely, if ABC Ltd were to enter into agreements with distributors such that the distributors are prevented from marketing the products of the North Indian companies, would that be illegal?

Answer

The Competition Act, 2002 intends to provide, keeping in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in India, and for matters connected therewith or incidental thereto.

The Act deals with the following:

- **Prohibition of certain agreements**, which are considered to be anti-competitive in nature. Such agreements [namely tie in arrangements, exclusive dealings (supply and distribution), refusal to deal and resale price maintenance] shall be presumed as anti-competitive if they cause or are likely to cause an appreciable adverse effect on competition within India.
- **Abuse of dominant position** by imposing unfair or discriminatory conditions or limiting and restricting production of goods or services or indulging in practices resulting in denial of market access or through in any other mode are prohibited.
- **Regulation of combinations** which cause or likely to cause an appreciable adverse effect on competition within the relevant market in India.

In light of the above points, any agreement that ABC Ltd. may enter into with its competitors from North India to tie-up the price at a certain level is prohibited. Such agreements would also amount to abuse of dominant position.

Conversely, agreements with distributors preventing the latter from distributing the goods of its competitors would also be illegal since they would restrict market access and can be deemed anti-competitive.

Question 12

State the objectives of the Central Consumer Protection Council in India.

Or

What are the objects of the "Central Consumer Protection Council" in relation to protection of rights of the consumers?

Answer

The objectives of the Central Consumer Protection Council in India are to promote and protect the rights of the consumers such as:-

(i) the right to be protected against the marketing of goods and services which are hazardous to life and property;

(ii) the right to be informed about the quality, quantity, potency, purity, standard and price of goods/services so as to protect the consumer against unfair trade practices;

(iii) the right to be assured, whichever possible, access to a variety of goods and services at competitive prices;

(iv) the right to be heard and to be assured that consumers interest will receive due consideration at appropriate terms;

(v) the right to seek redressal against unfair trade practices;

(vi) the right to consumer education.

Question 13

Which parameters are applicable in relation to Competition Law in India?

Answer

Parameter under Competition Law in India:

- Prohibition of certain agreements, which are considered to be anti-competitive in nature. Such agreements namely tie in arrangements, exclusive dealings (supply and distribution), refusal to deal and resale price maintenance shall be presumed as anti-competitive if they cause or likely to cause an appreciable adverse effect on competition within India.
- Abuse of dominant position by imposing unfair or discriminatory conditions or limiting and restricting production of goods or services or indulging in practices resulting in denial of market excess or through in any other mode are prohibited.
- Regulation of combinations which cause or likely to cause an appreciable adverse affect on competition within the relevant market in India is also considered to be void.

Exercise

1. *Mark the correct answer:*

   Ethics are necessary in marketing because

   (a) To avoid intervention by the Government

   (b) To get recognition from the society

(c) To build brand image

(d) (a) & (b) only

[**Hints**: The Correct option is (d)]

2. *What is the object behind the enactment of the Competition of Act, 2002?*

[**Hints:** The Competition Act, 2002 intends to provide, keeping in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in India, and for matters connected therewith or incidental thereto]

12 Ethics in accounting and Finance

Question 1

Answer whether the statement is correct or incorrect with brief reason:

'Window-dressing of financial statements will not be useful in the long run'.

Answer

Correct: In window-dressing, efforts are made to show a 'good balance sheet' by manipulating accounting entries. This can help companies to boost their market image and obtain further capital from the market for some time. Window dressing is on the assumption that next year performance will be better and accounts will be regularised next year. Window dressing can go on for 2 or 3 years but not more. It will lead to the downfall of the company in a few years.

Question 2

Answer whether the statement is correct or incorrect with brief reason:

'Ensuring fair treatment to whistle blowers will help in creating good ethical accounting environment in a business enterprise'.

Answer

Correct: A whistle blower is an employee/person who reports fraud, mismanagement or unethical practices to the appropriate levels of management. Fair treatment and appreciation of whistle blowers is necessary to check fraud. This will help in creating good accounting environment in a business enterprise.

Question 3

State, how far a sound ethical environment in a company may be created and corporate scandals may be avoided.

Answer

Creating an ethical environment in company: A sound ethical environment in a company may be created and corporate scandals may be avoided by adopting the following methods:

(i) Ensuring that employees are aware of their legal and ethical responsibilities.

Some ethical organisations are having policies to train and motivate employees towards ethical behaviour. To start with, such initiation should be from the top. A number of companies in India

and abroad are being known for their quality and soundness of their ethics programmes. Companies like Raytheon, Texas Instruments, Wipro are pioneers in establishing ethical environment among the employees enabling them to take ethical decisions.

(ii) Providing a communication system between the management and employees so that anyone in the company can report fraud and mismanagement with out the fear of being reprimanded.

In India, Wipro has introduced a helpline comprising of senior members of the company, who are available for guidance on any moral, legal or ethical issues that an employee of the company may face.

(iii) Ensuring fair treatment to those who act as whistle blowers :

This is perhaps the most important and sensitive issue. Fair treatment to whistle blowers is a basic necessity to check fraud. Some acts must be appreciated and that appreciation should be extended from within the company rather than outside.

Question 4

Explain the reasons for unethical behaviour among finance and accounting professionals.

Answer

The reasons which lead to unethical behaviour are as follows:

(i) Emphasis on short term results.

This is one of the primary reasons which has led to the downfall of many companies like Enron and Worldcom.

(ii) Ignoring small unethical issues.

It is a known fact that most of the compromises we make are small but however they lead us into committing large infractions. And ignoring minor lapses, lead to bigger and more huge mistakes.

(iii) Economic cycles.

In good times, companies are relaxed in their accounting procedures or disclosures, as there is a pervasive feel-good effect. But when times of hardship follow, then the hit taken by them is almost fatal, as was proved in the Enron case. So companies need to watch out for economic cycles and be vigilant in good times as well as bad.

(iv) Accounting rules.

In the era of globalization and massive cross border flow of capital, accounting rules are changing faster than ever before. The rules have become more complex and it is difficult to identify deviations from these complex set of requirements. The complexity of these principles and rules and the difficulty associated with identifying abuse are reasons which may promote unethical behaviour.

Question 5

Self interest threats may occur as a result of financial or other interests of finance and accounting professional. Give three examples each of such threats when the accounting professional is working as-

(i) An auditor or consultant

(ii) An employee in a company.

Answer

Self Interest Threats: Auditors: Employees:

(i) Self interest threats for finance and accounting professionals working as consultants or auditors are given below:

(a) A financial interest in a client or jointly holding a financial interest with a client.

(b) Undue dependence on total fees from a client,

(c) Having a close business relationship with a client.

(d) Concern about the possibility of losing a client,

(e) Potential employment with a client.

(f) Contingent fees relating to an assurance engagement.

(ii) Self interest threats for finance and accounting professionals working as an employee are given below:

(a) Financial interests, loans and guarantees in the company in which the professional is working.

(b) Incentive compensation arrangements.

(c) Inappropriate personal use of corporate assets.

(d) Concern over employment security.

(e) Commercial pressure from outside the employing organization.

Question 6

Finance and accounting professionals working as employees in an organisation have to face various threats which make it difficult for them to comply with fundamental principles relating to ethics. Explain the safeguards in the work environment which may be created by a business enterprise to overcome such threats.

Answer

Safeguards in the work environment: Safeguards against threats faced by professional shall be to (i) Ensure an ethical environment, (ii) Increase the likelihood of identifying or deterring unethical behaviour and (iii) Eliminate or reduce threats to acceptable level.

The following safeguards may be created by a business enterprise in the work environment:

(i) The employing organisations' systems or corporate oversight or other oversight structures.

(ii) The employing organisation's ethics and conduct programmes.

(iii) Recruitment procedures in the employing organisation emphasizing the importance of employing high caliber competent staff

(iv) Strong internal controls

(v) Appropriate disciplinary process

(vi) Leadership that stresses the importance of ethical behaviour and expectation that employees will act in an ethical manner.

(vii) Policies and procedures to implement and monitor the quality of employee performance.

(viii) Timely communication of the employing organisation's policies and procedures, including any changes to them, to all employees and appropriate training and education on such policies and procedures.

Question 7

What are the fundamental principles of ethics applicable to the persons of finance and accounting profession?

Answer

Principles of Ethics

The fundamental principles relating to ethics as applicable to accounting and finance professionals are as follows:

(i) The principle of integrity: Integrity means veracity. The principle requires all accounting and finance personnel to be honest and straight-forward in discharging their respective professional duties.

(ii) The principle of objectivity: The principle requires accounting and financial professionals to stick to their professional and financial judgement without bias, conflicting interests, or under influence of others.

(iii) The principle of confidentiality: The principle requires accounting and financial professionals to refrain from disclosing confidential information related to their work.

(iv) The principle of professional competence and due care: The financial and accounting professional need to update their professional skill in the modern competitive environment.

(v) The principle of professional behavior: The principle requires accounting and financial professional to comply with relevant laws and regulations and avoid such action which may result into discrediting the profession.

Question 8

State the pressures which are faced by the finance and accounting professionals' in an organization in the compliance of fundamental principles of ethics.

Answer

Pressures faced by finance and accounting professionals: The finance and accounting professionals are supposed to support the legitimate and ethical objectives established by the employer. As they are having responsibilities to an employing organization, may be under pressure to act or behave in ways that could directly or indirectly threaten compliance with the fundamental principles. Such pressures may be explicit or implicit which may come from supervisor, manager, director or another individuals. Such pressures which are being faced by finance and accounting professionals may be stated as follows:

(a) To act contrary to Law or Regulation

(b) To act contrary to technical a professional standards.

(c) To facilitate unethical or illegal earnings management strategies.

(d) Lie to, or otherwise intentionally mislead other, in particular the auditors of the employing organization or Regulators.

(e) To issue or otherwise be associated with, a financial or non financial report that materially misrepresents the facts, including statements, in connection with. For example:

  (i) The financial statements

  (ii) Tax compliance

  (iii) Legal compliance, or

  (iv) Reports required by securities regulators.

Question 9

Describe the safeguards which may be created by finance and accounting profession and legislation to eliminate or reduce the threats to an acceptable level to ensure an ethical environment in an organization.

Answer

Safeguards created by the profession, legislation or regulation are as follows:

i. Educational, training and experience requirements for entry into the profession.

ii. Continuing professional development requirements

iii. Corporate governance regulations

iv. Professional standards

v. Professional or regulatory monitoring and disciplinary procedures.

vi. External review by a legally empowered third party of the reports, returns, communications or information produced by concerned professionals.

Question 10

Which threats are existing in environment which adversely affect the fundamental principles of ethics?

OR

Explain the 'threats faced by an accounting and finance professional adhering to ethical principles' at the time of performing his professional duties.

Answer

The dynamic environment in which businesses operate today may usher a broad range of circumstances because of which compliance with the fundamental principles may potentially be threatened. Such threats may be classified as follows :-

(i) Self-interest threats, which may occur as a result of the financial or other interests of a finance and accounting professional or of an immediate or close family member:

(ii) Self-review threats, which may occur when a previous judgement needs to be reevaluated by the finance and accounting professional responsible for that judgement:

(iii) Advocacy threats occur when a professional promotes a position or opinion to the point that subsequent objectivity may be compromised :

(iv) Familiarity threats occur when finance and accounting professional has close relationship in the work environment and such relationship impair his selfless attitude towards work.

(v) Intimidation threats occur when a professional may be prohibited from acting objectively by threats, actual or perceived.

Question 11

Explain briefly the matters to be considered and the steps that may be taken by a Finance and Accounting professional when he is required to resolve an ethical conflict in the application of Fundamental principles.

Answer

Conflict Resolution: While evaluating compliance with the fundamental principles, a finance and accounting professional may be required to resolve a conflict on the application of fundamental principles. The following need to be considered, either individually or together with others, during a conflict resolution process:

(a) Relevant facts

(b) Ethical issues involved

(c) Fundamental principles related to the matter in question

(d) Established internal proceedings and

(e) Alternative course of action

Having considered these issues, the professional should determine the appropriate course of action that is consistent with the fundamental principles identified. The professional should weigh the consequences of each possible course of action. If the matter remains unresolved, the professional should consult other appropriate persons within the firm or employing organization for help in obtaining resolution. During times where a matter involves a conflict with or within an organization, the finance and accounting professional should also consider consulting those charged with governance of the oganisation, such as the Board of Directors.

It may be in the best interests of the professional to document the substance of the issues and details of any discussions held or decisions taken, concerning that issue.

If a significant conflict cannot be resolved, a professional may also obtain professional advice from the relevant professional body or legal advisors and thereby obtain guidance on ethical issues without breaching confidentiality.

If, after adopting all strategies, the ethical conflict still remains unresolved, a professional should try to disassociate from the matter causing the conflict or even from the organization, if need be.

Question 12

Explain the importance of 'Ethics' for finance and accounting professionals.

Answer

Finance and Accounts is perhaps the only business function which accepts responsibility to act in public interest. Hence, a finance and accounting professional's responsibility is not restricted to satisfy the needs of any particular individual or organization. While acting in public interest, it becomes imperative that the finance and accounting professional adheres to certain basic ethics in order to achieve his objectives.

Until recently, various surveys conducted globally had ranked finance and accounting professionals very high in terms of professional ethics. However, various accounting scandals witnessed during the past few years have put a serious question mark on the role of the finance and accounting professional in providing the right information for decision making both within and outside their respective organizations. As these finance and accounting professionals are in public practice, they should take reasonable steps to identify circumstances that could pose the conflict of interest and thus leading to follow unethical behavior.

Exercise

1. *State the fundamental principles relating to ethics for behaving in an ethical manner.*

   [**Hints**: The principle of Integrity, the principle of objectivity, the principle of confidentiality, the principle of professional competence and due care, and the principle of professional behavior]

2. *Explain the importance of ethics for a finance and accounting professional.*

   [**Hints**: Finance and Accounts is perhaps the only business function which accepts responsibility to act in public interest. Hence, a finance and accounting professional's responsibility is not restricted to satisfy the needs of any particular individual or organisation While acting in public interest, it becomes imperative that the finance and accounting professional adheres to certain basic ethics in order to achieve his objective]

13 Essentials of Communication

Question 1

Explain the factors which are responsible for the growing importance of communication of an organization.

Answer

The importance of communication in the industrial organization has increased immensely in these days. The following factors are responsible for the growing importance of communication:

(a) **Growth in the size and multiple locations of organizations:** Most of the organizations are growing larger and larger in size. The people are working in the country and abroad, of these organizations. Keeping in touch, sending directions across and getting feedback is possible only when communication lines are kept working effectively.

(b) **Growth of trade unions:** Over the last so many decades, trade unions have been growing strong. No management can be successful without taking the trade unions into confidence. Effective communication will create relationship between the management and the workers.

(c) **Growing importance of human relations:** Workers in an organization are not like machines. They have their own hopes and aspirations. Management has to recognize them and should work with the spirit of integration so that human relations may be maintained. This may only be achieved though effective communication.

(d) **Public relations:** Every organization has a social responsibility towards customers, government, suppliers and the public at large. Communication is the only way an organization can project a positive image of itself.

(e) **Advances in behavioral sciences:** Modern management is deeply influenced by exciting discoveries made in behavioral sciences like psychology, sociology, transactional analysis etc. All of them throw light on suitable aspects of human nature and help in developing a positive attitude towards life and building up meaningful relationship. This is possible only through communication.

(f) **Technological advancement:** The world is changing very fast, owing to scientific and technological advancements. These advancements deeply affect not only the methods of

work but also the compositions of groups. In such a situation, proper communication between superiors and subordinates becomes very necessary.

Question 2

Explain clearly the process of Communication.

Answer

Process of Communication: Communication is a two-way process in which there is an exchange of ideas or thoughts linking the sender and receiver towards a mutually accepted direction or goal consisting of 7 elements which are as under:

1. **Sender:** The process of communication begins with a sender, the person who has an idea and desires to exchange it.
2. **Encoding:** The sender puts his/her ideas or facts into words, symbols, pictures or gestures that the receiver can understand.
3. **Message:** A message refers to what is being communicated. It may be verbal or non-verbal.
4. **Channel:** Channel is the medium through which message is transmitted to the sender. Channel may be in oral or written forms.
5. **Receiver:** It is any person who notices and attaches some meaning to a message.
6. **Decoding:** The receiver translates the words and symbols used in the message into ideas and interpret it to attain its meaning.
7. **Feedback:** Ultimately receiver reacts or responds to the communication sent by the sender. It could be based on clear interpretation of the symbols sent or misunderstanding or misinterpretation of the symbols sent.

Question 3

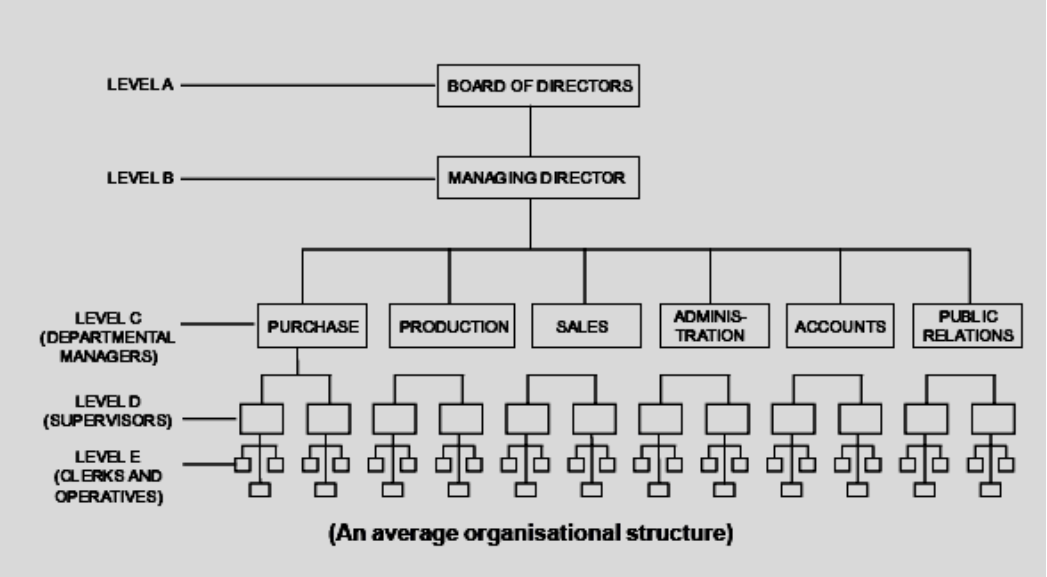
What is formal communication? Explain in brief its major advantages.

Or

Explain clearly the advantages of a formal communication.

Answer

Formal Communication: A formal communication flows along prescribed channels which all organizational members desirous of communicating with one another are obliged to follow. Every organisation has a built-in hierarchical system that can be compared to a pyramid. It can, therefore, be understood that communication normally flows from top- downwards. But it is not always so. Communication in an organisation is multidimensional or multidirectional.



(An average organisational structure)

Following are the directions in which communications are sent:

(a) Downward

(b) Upward

(c) Horizontal or Lateral

(d) Diagonal or Crosswise

Advantages of Formal Communication:

(a) The formal channels account for most of the effectiveness of communication. As has been said earlier, great care has to be taken in sending across any letter or report through the 'proper' formal channel.

(b) Formal channels cover an ever – widening distance as organizations grow. Through them, it is easier to reach out to the branches of an organisation spread far and wide.

(c) The formal channels, because of their tendency to filter information, keep the higher level managers from getting bogged down.

(d) Formal channels of communication consolidate the organisation and satisfy the people in managerial position.

Question 4

Explain the various forms of formal communication.

Answer

A formal communication flows along prescribed channels which all organizational members desirous of communicating with one another are obliged to follow. Every organization has

built-in hierarchical system, communication in an organization is multidirectional. On the basis of various directions in which communications are sent, we can classify formal communication in these forms:

(i) Downward Communication

(ii) Upward Communication

(iii) Horizontal or Lateral Communication

(iv) Diagonal or Crosswise Communication

Communication generally flows from top to bottom. Downward communication means communication from superior to subordinate in the hierarchical system of the organization. It includes orders and instructions. In upward communication, message flows from the subordinate to superior in the form of request, reports, instructions complaints and suggestions. Communication between co-workers with different areas of responsibility is called horizontal (lateral) communication. Communication among the functional managers of a company is the best example of horizontal communication. Diagonal communication means communication among the various Department/employees of the organization without any hierarchical system in case of emergency.

Question 5

What are the factors that lead to grapevine communication?

Answer

The grapevine becomes active when the following factors are present:

(a) Feeling of uncertainty or lack of sense of direction when the organisation is passing through a difficult period.

(b) Feeling of inadequacy or lack of self confidence on the part of the employee, leading to the formation of groups.

(c) Formation of a coterie or favoured group by the manager, giving other employees a feeling of insecurity or isolation. People operating in such circumstances will be filled with all sorts of ideas and will share them with like minded companions, at whatever level they may be. Mostly they find them at their own level, but other levels are not barred. This type of communication is being seriously studied by psychologists and management experts.

Question 6

Explain clearly the meaning of the term "Grapevine' as applicable to Communication.

Answer

Grapevine: Applicable to Communication: Communication may be oral or written for direct contact. It may be informal also. The "Grapevine" is one of the recognized channels of

informal communication. According to human psychology, a person likes to form and move in groups. They interact on serious and non- serious issues and they spread it fast whether the information is correct or not. This process is known as rumour mill. The larger the organization, the more active is the rumour mill. The phenomenon of grapevine is based on generally three factors, namely: (1) formation of favoured group (2) lack of self confidence and, (3) feeling of uncertainty due to lack of directions. Four kinds of the grapevine chains have been identified and they are:

(a) Single Strand Chain, which is the least accurate in passing on the information or message.

(b) Gossip Chain, which is often used when information or a message regarding 'not-on-job' nature is being conveyed.

(c) Probability Chain is used when information is somewhat interesting but not really significant.

(d) Cluster Chain, which acts as liaison and spreads information with the greatest speed.

Question 7

What are the merits and demerits of grape-vine form of Communication?

Answer

Merits of the grapevine phenomenon:

(a) Speedy transmission: It transmits information very speedily. A rumour spreads like wild fire.

(b) Feedback value: The managers or top bosses of an organisation get the feedback regarding their policies, decisions, memos etc.

(c) Support to other channels: It is a supplementary or parallel channel of communication.

(d) Psychological satisfaction: It gives immense psychological satisfaction to the workers and strengthens their solidarity.

Demerits of the grapevine phenomenon:

(a) It is less credible. It cannot always be taken seriously.

(b) It does not always carry the complete information.

(c) It often distorts the picture or often misinforms.

Question 8

Explain clearly the different types of grapevine chains in an informal communication.

OR

Briefly explain the "Grapevine Chains" propounded by the experts in relation to informal way of communication.

Answer

Grapevine Chains: Specialists in this field have identified four types of grapevine chains in an informal communication:-

(1) **Single Strand Chain:** In this type of chain, 'A' tells something to 'B' who tells it to 'C' and so on. This type of chain is least accurate in passing on the information or message.

(2) **Gossip Chain:** In it, a person seeks out and tells everyone the information he has obtained. This chain is often used when information or a message regarding a 'not-on-job' nature is being conveyed.

(3) **Probability Chain:** In it, individuals are indifferent to the persons, to whom they are passing some information. This chain is found when the information is somewhat interesting but not really significant.

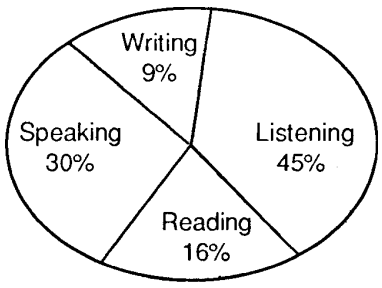
(4) **Cluster Chain:** In this type of chain, 'A' tells something to a few selected individuals and then some of these individuals inform a few other selected individuals. In fact, cluster chain is the dominant grapevine pattern in an organisation. Only few persons are 'liaison individuals' who pass on the information they have obtained and then they are likely to share it with the people they trust. Most informal communication flows through this chain.

Question 9

Elaborate merits and limitations of oral communication.

Answer

Oral Communication: According to a research, an average manager in general spends only 9% of his/her time in writing, 16% in reading, 30% in speaking and 45% in listening, as shown in the following figure



Oral communication is characterized by seven Cs – Candidness, Clarity, Completeness, Conciseness, Concreteness, Correctness, and Courtesy. These act as principles for choosing the form (style) and content (matter) of oral communication. Oral communication should provide a platform for fair and candid exchange of ideas.

Oral communication, which is face-to-face communication with others, has its own benefits. When people communicate orally, they are able to interact; they can ask questions and even test their understanding of the message. In addition, people can also relate and comprehend

the non-verbal, which serves far more than words. By observing facial expressions, eye contact, tone of voice, gestures, postures, etc., one can understand the message better.

The only shortcoming of oral communication is that more often than not it is spontaneous and if one communicates incorrectly, the message will not get understood. It is primarily due to this reason, one need to develop effective oral communication skills as a message; if not understood at appropriate time, can lead to disaster

Question 10

What principles you would keep in mind in oral communication?

Answer

The communicator should follow the following –

(a) Consider the objective.

(b) Think about the interest level of the receiver.

(c) Be sincere.

(d) Use simple language, familiar words.

(e) Be brief and precise.

(f) Avoid vagueness and generalities.

(g) Give full facts.

(h) Assume nothing.

(i) Use polite words and tone.

(j) Cut out insulting message.

(k) Say something interesting and pleasing to the recipient.

(l) Allow time to respond.

Question 11

What important factors should be considered to make oral communication effective?

Answer

Factors to be considered for oral effective communication: Oral communication, which is face-to-face communication with others, has its own benefits. The only shortcoming of oral communication is that it is spontaneous and if one communicates incorrectly, the message will not get understood. It is primarily due to this reason one needs to develop effective oral communication skills as a message, if not understood at appropriate time, can lead to disaster.

In order to provide a fair and candid exchange of ideas, the following factors to be considered to make the oral communication effective:

- Consider the objective
- Think about the interest level of the receiver
- Be sincere
- Use simple language, familiar words
- Be brief and precise
- Avoid vagueness and generalities
- Give full facts
- Assume nothing
- Use polite words and tone
- Cut out insulting message
- Say something interesting and pleasing to the recipient
- Allow time to respond
- To make the oral communication effective, the speaker should converse slowly with proper semantic pauses to enable the listener receive and register in mind whatever is said by the speaker and there should be a due correlation between the pace of speaking and the rate of listening.

Question 12

Elaborate advantages and limitations of oral and written communication.

Answer

Advantages and limitations of oral and written communication:

Oral Communication	Written Communication
Advantages	**Advantages**
More personal and informal	Better for complex and difficult subjects, facts and opinions
Makes immediate impact	Better for keeping records of messages exchanged
Provides opportunity for interaction and feedback	Provides opportunity to refer back
Helps us to correct ourselves (our messages according to the feedback and non-verbal cues received from the listener)	Can be read at receiver's convenience or pleasure
Better for conveying feelings and emotions	Can be revised before transmitting
	Can be circulated

Limitations	Limitations
Demands ability to think coherently as you speak	Never know if the message is ever read
A word once uttered cannot be taken back	Impersonal and remote
Hard to control voice pitch and tone, especially under stress, excitement or anger	Immediate feedback is not available for correction on the spot
Very difficult to be conscious of our body language	Reader is not helped by non-verbal cues that contribute to the total message

Question 13

State reasons for selecting the oral mode of communication instead of the written mode of communication.

Answer

Oral Communication is a face to face communication with others. Oral communication is characterized by seven Cs – Candidness, Clarity, Completeness, Conciseness, Concreteness, Correctness, and Courtesy. These act as principles for selecting the mode of oral communication. In addition to above seven principles it has its own benefits as under:

(i) More personal and informal.

(ii) Make immediate and impact.

(iii) Provides opportunity for interaction and feedback.

(iv) Helps us to correct ourselves (our message according to the feedback and non-verbal cues received from the listener).

(v) Better for conveying feelings and emotions.

(vi) More effective because one can understand the message better by observing facial expressions, eye contact, tone of voice, gestures, postures etc of the sender.

It is said that it does not matter what you say, what matters is how you say it. Your way of saying includes your choice of words, your confidence and sincerity.

Question 14

Explain the merits and limitations of oral communication.

Answer

Oral Communication – its merits and limitations - Communication through the spoken word is known as oral communication. Some of the merits of oral communication are as under:

(i) saves time and money;

(ii) immediate feed back;

(iii) saves paper work;

(iv) an effective tool for exhortation;

(v) builds a healthy climate;

(vi) best tool during emergency.

Some of the limitations of Oral Communication are:

(i) Greater chances of misunderstanding;

(ii) Bad speaker;

(iii) Ineffective for lengthy communication;

(iv) Lower retention rate;

(v) No legal validity;

(vi) Difficult to fix responsibility.

Question 15

"*Importance of communication is increasing day-by-day in the business organizations". State the reasons for this increasing importance.*

Answer

Reasons for increasing importance of communication: It is true that importance of communication is increasing day by day in the business organizations. The reasons for this growth may be stated as follows:

(a) Growth in the size and multiple locations of organization: Most of the organizations are growing larger and large in size. The people working in these organizations may be spread over different states of a country or over different countries. Keeping in touch, sending directions across and getting feedback is possible only when communication lines are kept working effectively.

(b) Growth of trade unions: Over the last so many decades trade unions have been growing strong. No management can be successful without taking the trade unions in confidence. Only through effective communication can a meaningful relationship be built between the management and workers.

(c) Growing importance of human relations: Workers in an organization are not like machines. They have their own hopes and aspirations. Management has to recognize them above all as sensitive human beings and work towards a spirit of integration with them which effective communication helps to achieve.

(d) Public Relations: Every organization has a social responsibility, towards customers, government, suppliers and the public at large. Communication with them is the only way an organization can project a positive image of itself.

(e) Advance in Behavioural Sciences: Modern management is deeply influenced by exciting discoveries made in behavioural sciences like psychology, sociology, transactional

analysis etc. All of them throw light on subtle aspects of human nature and help in developing a positive attitude towards life and building up meaningful relationships. And this is possible only through communication.

(f) Technological advancement: The world is changing very fast, owing to scientific and technological advancements. These advancements deeply affect not only methods of work but also the composition of groups. In such a situation proper communication between superiors and subordinates becomes very necessary.

Question 16

What is Chronemics?

Answer

Chronemics is the study of how we use time to communicate. The meaning of time differs around the world. While some are preoccupied with time, others waste it regularly. While some people function better in the morning, others perform better at night. Punctuality is an important factor in time communication. Misunderstandings or disagreements involving time can create communication and relationship problems.

Question 17

Explain the main barriers to communication.

Answer

A communication of the message is successful only when both the sender and the receiver perceive it in the same manner. Quite often, there is miscommunication due to one barrier or the other. Barriers or problems can arise at any stage of the communication process. It is very important to understand the causes of communication breakdown.

Following are the main barriers to communication:

(a) *Noise:* Noise refers to the distracting element that breaks the concentration of the sender or receiver and prevents him/her from paying attention to the content of the message. Distraction (noise) can be either physical or psychological. Noise can lead to miscommunication and measures must be taken to overcome it.

(b) *Semantic Barriers:* Semantic refers to the study of meanings of words and signs. Semantic barrier occurs due to:

  (i) Sender and receiver interpret same words in different manner.

  (ii) Words carry different nuances, shades and flavours to the sender and receiver.

  (iii) Faulty translation.

  (iv) Poor expression power or ability.

(c) *Cultural Barrier:* We live in a globalised world and may encounter individuals of different races, religions and nationalities. The same category of words, phrases, symbols, actions, colours mean different things to people of different cultural background e.g. in

the United States of America, people like to be called by their first name, while in Britain and to a large extent also in India, people like to be addressed by their surname.

(d) *Emotions:* Emotions play a very vital role in our life. Both encoding and decoding of messages are influenced by our emotions. A message received when we are emotionally charged up will have a different meaning for us than when we are calm and composed.

(e) *Status Consciousness:* Subordinates are either too conscious of their low status or too afraid of being snubbed. At the same time, many executives keep distance from their juniors thinking that consulting subordinates is something below their dignity.

(f) *Poor Listening:* Poor listening may lead to serious communication problems. Too many people are interested in talking and mostly talking about themselves. Poor listening accounts for incomplete information and also for poor retention.

Question 18

What do you understand by the "Semantic Barriers" to the communication?

OR

Explain the term "Semantic Problems" as the source contributing towards noise factor.

Answer

Semantic Barriers to the communication: Semantics is the systematic study of meaning. That is why the problems arising from expression or transmission of meaning in communication are called semantic problems. Oral or written communication is based on words. And words, limited in number, may be used in unlimited ways. The meaning is in the mind of the sender and also in that of the receiver. But it is not always necessary for the meaning in the mind of the sender to be the same as in the mind of receiver. Much, therefore, depends on how the sender encodes his message. The sender has to take care that the receiver does not misconstrue his message, and gets the intended meaning. Quite often it does not happen in this way. That leads to semantic problems. It can be ensured only if we aim at clarity, simplicity and brevity so that the receiver gets the intended meaning.

Question 19

How is "noise" a barrier to effective communication?

Answer

Noise as barrier to communication: Noise is the first and foremost barrier to communication. It means "interference that occurs in a signal and prevents you from hearing sounds properly. In a factory the continuous noise made by machines makes oral communication difficult. In the same way, same technical problems in a public address system or a static in a telephone or television cable will distort the sound signal and affect communication. Adverse weather conditions or some fault in the ultramodern telecommunications systems may also spoil the effect.

Further, the sender may resort to ambiguous or confusing signals. The receiver may mess up the message owing to inattention or may spoil decoding because of wrong or unexpected interpretation. The receiver's prejudices may also come in the way of his understanding the message in the right spirit. Thus the communication is always likely to affected by 'noise' that stands for so many things. Some of the factors contributing towards noise factors are as follows:

(a) Poor Listening: A last moment communication with deadline may put too much pressure on the receiver and may result in resentment.

(b) In appropriate Channel: Poor choice of channel of communication can also be contributory to them in understanding of the message.

(c) Network breakdown: Some time staff may forget to forward a letter or there may be professional jealousy resulting in closed channel.

Question 20

What are "Socio-psychological Barriers" to effective communication? Explain.

Answer

Socio-psychological barriers- The attitudes and opinions, place in society and status consciousness arising from one's position in the hierarchical structure of the organization, one's relations with peers, seniors, juniors and family background – all these deeply affect one's ability to communicate both as a sender and receiver. Status consciousness is widely known to be a serious communication barrier in organizations. It leads to psychological distancing which further leads to breakdown of communication or miscommunication. Often it is seen that a man high up in an organization builds up a wall around himself. This restricts participation of the less powerful in decision making. In the same way one's family background formulates one's attitude and communication skills.

Frame of reference is another barrier to clear communication. Every individual has a unique frame of reference formed by a combination of his experiences, education, culture, attitude and many other elements, resulting in biases and different experiences in a communication situation.

Planning Business Messages

Question 21

You have been assigned the job of composing business messages. What check-list would you prepare for organising the message?

OR

Prepare the detailed checklist for composing business message in an organization.

OR

Prepare a check list for organizing the messages in a business firm as a job of composing business messages being assigned to you.

Answer

Check-list for organising the message:

Organisation:

1. *Recognise good organisation*
   (a) Subject and purpose are clear
   (b) Information is directly related to subject and purpose.
   (c) Ideas are grouped and presented logically
   (d) All necessary information is included
2. *Achieve good organization through outlining-*
   (a) Decide what to say
      (i) Main idea
      (ii) Major points
      (iii) Evidence
   (b) Organise the message to respond the audience is probable reaction-
      (i) use the direct approach when audience will be neutral, pleased, interested, or eager.
      (ii) use the indecent approach when audience will be displeased, interested, or unwilling.
3. *Choose the appropriate organisation plan-*
   (a) Short Messages -
      (i) Direct request
      (ii) Routine, good news and good message
      (iii) Bad news message
      (iv) Persuasive Message
   (b) Longer message -
      (i) Information pattern
      (ii) Analytical pattern.

Question 22

Draft a business letter, presuming your facts that you have received the goods from the company and you are sending payments.

Answer

Business Letter – acknowledging receipt of goods:

MEHTA CHEMICALS LIMITED

Regd. Office : 15, Okhla Estate, New Delhi - 110016

Phone : 6132757, Fax : 6132767

E-mail: mehtachem@rediffmail.com , website: www.mehtachem.org

Messrs. Shippers & Perfect Delivers Dated:

16, Nariman Point

Mumbai

Sir

Subject: Acknowledging the receipt of Consignment No _____

Reference: Our request 24/FD/55 – dated 1st June, 2011

We acknowledge with thanks the receipt of above consignment in our godown and we are arranging the payment of proceeds towards the said consignment by way of crossed cheque in favour of your company within a period of next 15 days.

We solicit your relationship in our future dealings.

Thanking you

Yours faithfully

For on behalf of Mehta Chemicals Ltd.

Question 23

Write short notes on the following:

(I) Proxemics

(II) Haptics

Answer

(I) Proxemics: It is form of a non-verbal communication which refers to the space that exists between us when we talk or relate to each other as well the way we organize space around us. We can also call it 'space language" as the following four space zones indicate the type of communication and the relationship of the source and receiver:

Intimate – Physical contact to 18 inches.

Personal – 18 inches to 4 feet.

Social – 4 to 12 feet

Public-12 feet to as far as we can see or hear.

(II) Haptics: It is communication through touch. How we use touch sends important messages about us. It reveals our perceptions of status, our attitudes and even our needs. The amount of touching we do or find acceptable is at least in part culturally conditioned.

Exercise

1. *Define the term paralanguage.*

   [Hint: Paralanguage: The term paralanguage is used to describe a wide range of vocal characteristics like tone, pitch, and speed etc – vocal cues that accompany spoken language which help to express and reflect the speaker's attitude. Adept communicators know how to use these cues effectively to help their listeners appreciate and understand content and mood. Through it one can convey enthusiasm, confidence, anxiety, and urgency. Paralanguage describes a wide range of vocal characteristics, which help to express and reflect the speaker's attitude.

2. *Explain poor listening as a barrier to communication.*

   [Hint: Poor listening may lead to serious communication problems. Too many people are interested in talking, and mostly talking about themselves. They are so much involved with themselves that they do not have patience to listen. The result is that they are not interested in the speaker whose words go waste. Everybody knows about the importance of listening, but very few actually practice patient, active and empathic listening. That is why, so many communication problems crop up. Poor listening accounts for incomplete information and also poor retention. One may simply not get the desired result if this keeps on happening.]

14 Interpersonal Communication Skills

Question 1

What are the principles of inter-personal communication?

Answer

The following principles are key to interpersonal communication:

Interpersonal communication is inescapable: We cannot keep ourselves away from communication. The very attempt not to communicate, communicates something. Not only through words but also through the tone of voice and gestures, postures, facial expressions etc, we constantly communicate to others.

Interpersonal communication is irreversible: It is rightly said that a word uttered once can not be taken back.

Interpersonal communication is complicated: No form of communication is simple due to the number of variables involved; even simple requests can be extremely complex.

Interpersonal communication is contextual: Communication does not take place in isolation. They are context specific:

Psychological context: It refers to who the communicators are and what they bring to the interaction? Their needs, desires, values, personality etc all form the psychological context.

Relational context: This is concerning the nature of interaction and reactions and the way it all affects the communication process.

Situational context: Refers to social concept of communication viz. an interaction that takes place in a classroom will be very different from one that takes place in a board room.

Environmental context: It is all about the surroundings in which communication takes place e.g. Furniture location, noise level, temperature, season, time of day etc. are all examples of elements in the environmental context.

Cultural context: Includes all the learned behaviours and rules that affect the interaction. If one comes from a culture where it is considered rude to establish long, direct eye contact, one will out of politeness avoid eye contact. If the other person comes from a culture where long direct eye contact signals trustworthiness, then we have a basis for misunderstanding.

Question 2

What are the tips for improving inter-personal skills in a business organization?

Answer

Tips for improving interpersonal skills: Lines of communication must be open between people who rely on one another to get work done. Poor interpersonal communication skills, which include active listening, result in low productivity simply because one does not have the tools needed to influence, persuade and negotiate which are necessary for workplace success. To get this success the following tips are suggested:

(i) Congruency in communication elements: If the words used are incongruent with the other interpersonal communication dynamics interpersonal communication is adversely affected. Since communication is shared meaning, words must send the same message as the other interpersonal communication dynamics – body language, facial expression, posture, movement, tone of voice to help emphasize the truth, sincerity and reliability of the communication. A consistent message ensures effective communication.

(ii) Listening effectively: Effective or active listening is very important skill to enhance interpersonal communication. Listening helps to build strong personal relationships. The process of communication completes when the message as intended by the sender is understood by the receiver. Most of the persons assume that listening is natural trait, but practically very few of us listen properly. One needs to give the communicator of the message sufficient attention and make an effort to understand his view point.

Question 3

Explain the functions of interpersonal communication.

Answer

Functions of Interpersonal Communication: Interpersonal communication is important because of the following functions it achieves:

Gaining Information: One reason, we engage in interpersonal communication, is to gain knowledge about another individual. We attempt to gain information about others so that we can interact with them more effectively.

Building Understanding: Interpersonal communication helps us to understand better what someone says in a given context. Words can mean very different things depending on how they are said or in what context. **Content Messages** refer to the surface level meaning of a message. **Relationship Messages** refer to how a message is said. The two are sent simultaneously, but each affects the meaning assigned to the communication and helps us understand each other better.

Establishing Identity: We also engage in interpersonal communication to establish an identity based on our relationships and the image we present to others.

Interpersonal Needs: We also engage in interpersonal communication to express interpersonal needs. William Schutz has identified three such needs: inclusion, control, and affection.

- Inclusion is the need to establish identity with others.
- Control is the need to exercise leadership and prove one's abilities.
- Affection is the need to develop relationships with people. Groups are an excellent way to make friends and establish relationships.

Question 4

What is meant by "Active listening"? State the importance of 'Active listening' in the business communication skills.

Answer

Active Listening: - Most of us assume that listening is a natural trait, but practically very few of us listen properly. What we regularly do is-"we hear but do not listen". Hearing is through ears and listening is by mind. Listening happens when we understand and message as intended by sender. Many managers are so used to helping people solve problems that their first cause of action is transforming solutions and giving advice instead of listening with full attention directed towards understanding what the co-worker or staff member needs. Therefore, every employer and worker needs a listening ear.

If one does not learn how to listen, a great deal of what people are trying to tell you would be missed. In addition, appropriate response would not be possible. Active listening is important for several reasons.

(i) It aids the organization in carrying out its missions.

(ii) It helps individuals to advance in their careers.

(iii) It provides information that helps them to learn about important happenings in the organization, as well as assisting them in doing their own jobs well.

(iv) It also helps in building strong personal relationships.

Question 5

Explain the significance of 'active listening' in inter-personal communication skills.

Answer

Significance of active listening: If one does not learn how to listen, a great deal of what people are trying to tell you would be missed. In addition, appropriate response would not be possible. Active listening is important for several reasons. First, it aids the organization in carrying out its mission. In addition, it helps individuals to advance in their careers. It provides information that helps them to learn about important happenings in the organization,

as well as assisting them in doing their own jobs well. It also helps build strong personal relationships.

Question 6

What are the guidelines for "Active Listening"?

Answer

Guidelines for Active Listening

- Look at the person and suspend other things you are doing in order to understand the other person's concerns, intentions.
- Be interested in what the other person is saying. If you just can't make yourself interested, you will lose important information, so try taking notes. Doing so will keep your body and mind active.
- Listen to the tone of voice and inflection; look at gestures and body language – these may carry an unspoken message.
- Restate what the person said. Restating their meaning is a way for you to make sure you understand the person clearly.
- Ask questions once in a while to clarify the meaning. Doing so will keep you alert and let the other person know that you have been listening and are interested in getting all the facts and ramifications.
- Be aware of your own feelings and opinions.

Question 7

What is meant by 'Critical thinking'? How shall you develop critical thinking?

Or

Discuss the qualities of a critical thinker.

Answer

Critical Thinking: Critical thinking is the discipline of rigorously and skillfully using information, experience, observation and reasoning to guide one's decisions, actions and beliefs. Critical thinking refers to the act of question of every step of the thinking process e.g. (i) Have you considered all the facts? Have you tested your assumptions? Is your reasoning sound? Can you be sure your judgment is unbiased? Is your thinking process logical, rational and complete?

Developing Critical thinking: To develop as a critical thinker, one must be motivated to develop the following attributes:

1. **Open-minded:** Readiness to accept and explore alternative approaches and ideas.
2. **Well informed:** Knowledge of the facts and what is happening on all fronts.

3. **Experimental:** Thinking through 'what if scenarios to create probable options and then test the theories to determine what will work and what will not be acceptable.
4. **Contextual:** Keeping in mind the appropriate context in the course of analyses. Apply factors of analysis is that are relevant or appropriate.
5. **Reserved in making conclusion:** Knowledge of when, a conclusion is a 'fact' and when it is not only true conclusions support decisions.

Question 8

Why is the 'critical thinking' important part of success and wisdom? What steps are required to make it effective in a business organisation?

Answer

Critical thinking is the discipline of rigorously and skillfully using information, experience, observation and reasoning to guide our decisions, actions and beliefs. By developing the skills of critical thinking and bringing rigour and discipline to the thinking processes, a person stands at a better chance of being "right" and likely to make good judgments, choices and decisions in all areas of the life. This kind of questioning is called Socratic questions based upon logic, originated by Greek Philosopher Socrates, founder of Critical Thinking. Thus, this forms an important part of "success" and "wisdom".

Steps required to make it effective: To do critical thinking effectively, following skills need to be developed:-

1. Analyze Cause and Effect: One must be able to separate the motive or reason for an action or even (the cause) from the result or outcome (the effect).
2. Classify and Sequence: One must be able to group items or sort them according to similar characteristics.
3. Compare and Contrast: One must be able to determine how things are similar and how they are different.
4. Infer: One must be skilled in reasoning and extending logic to come up with plausible options or outcomes.
5. Evaluate: One must be able to determine sound criteria for making choices and decisions.
6. Observe: One must be skilled in attending to the details of what actually happened.
7. Predict: One must be able to find and analyze trends, and extend these to make sensible predictions about the future.
8. Rationalize: One must be able to apply the laws of reason (induction, deduction, analogy) to judge an argument and determine its merits.
9. Prioritize: One must be able to determine the importance of an event or situation and put it in the correct perspective.
10. Summarize: One must be able to distill a brief report of what happened or what has been learnt.

11. Synthesize: One must be able to identify new possible outcome by using pieces of information that is already known.

Question 9

What is meant by 'Emotional Intelligence' and 'Emotional Quotient'? State any six social competencies associated with Emotional Intelligence.

OR

Discuss personal competencies that are associated with Emotional Intelligence.

OR

What is meant by 'Emotional Intelligence'? Explain the 'Self-Awareness and Self-Management Personal Competencies' associated with emotional intelligence.

Answer

Emotional Intelligence: Emotional intelligence refers to the capacity to recognizing your own feelings and those of others, for motivating yourself, and for managing emotions well in yourself and in your relationships.

Emotional quotient: inventory is designed to measure a nature of constructs related to emotional intelligence. EQ is the ability to make and deeper connections at three levels: with ourselves (personal mastery), with another person (one-to-one) and within groups/teams. Our EQ or emotional intelligence is the capacity for effectively recognizing and managing our own emotions and those of others.

Social competencies associated with emotional intelligence are as follows:

Social Awareness:

1. Empathy: Sensing others emotions, understanding their perspective and taking active interest in their concerns.
2. Organizational awareness: Leading the currents decision, networks and politics at the organizational level.
3. Service: Recognizing and meeting follower, client or customer needs.

Relationship Management:

4. Inspirational leadership: Guiding and motivating with a compelling vision.
5. Influence: wielding a range of tactics for persuasions
6. Developing others: Bolstering others' abilities through coaching, feedback and guidance.

Question 10

What is meant by 'Critical thinking'? Suggest the measures to develop critical thinking.

Answer

Critical Thinking: Critical thinking is the discipline of rigorously and skillfully using information, experience, observation and reasoning to guide one's decisions, actions and beliefs. Critical thinking refers to the act of question of every step of the thinking process e.g. Have you considered all the facts? Have you tested your assumptions? Is your reasoning sound? Can you be sure your judgment is unbiased? Is your thinking process logical, rational and complete?

Developing Critical thinking: To develop as a critical thinker, one must be motivated to develop the following attributes:

1. ***Open-minded: Readiness to accept and explore alternative approaches and ideas.***
2. ***Well informed: Knowledge of the facts and what is happening on all fronts.***
3. ***Experimental: Thinking through 'what if scenarios to create probable options and then test the theories to determine what will work and what will not be acceptable.***
4. ***Contextual: Keeping in mind the appropriate context in the course of analyses. Apply factors of analysis is that are relevant or appropriate.***
5. ***Reserved in making conclusion: Knowledge of when, a conclusion is a 'fact' and when it is not only true conclusions support decisions.***

Question 11

What are the basic principles of inter-personal communication?

Answer

Principle of Interpersonal Communication: The following principles are key to interpersonal communication -

Interpersonal communication is inescapable: We cannot keep ourselves away from communication. The very attempt not to communicate, communicates something. Not only through words but also through the tone of voice and gestures, postures, facial expressions etc, we constantly communicate to others.

Interpersonal communication is irreversible: It is rightly said that a word uttered once cannot be taken back.

Interpersonal communication is complicated: No form of communication is simple due to the number of variables involved; even simple requests can be extremely complex.

Interpersonal communication is contextual: Communication does not take place in isolation. They are context specific:

Psychological context: It refers to who the communicators are and what they bring to the interaction? Their needs, desires, values, personality etc all form the psychological context.

Relational context: This is concerning the nature of interaction and reactions and the way it all affects the communication process.

Situational context: Refers to social concept of communication viz. an interaction that takes place in a classroom will be very different from one that takes place in a board room.

Environmental context: It is all about the surroundings in which communication takes place e.g. Furniture location, noise level, temperature, season, time of day etc. are all examples of elements in the environmental context.

Cultural context: Includes all the learned behaviours and rules that affect the interaction. If one comes from a culture where it is considered rude to establish long, direct eye contact, one will out of politeness avoid eye contact. If the other person comes from a culture where long direct eye contact signals trustworthiness, then we have a basis for misunderstanding.

Exercise

1. *How listening is helpful in interpersonal communication skills?*

   [Hint :Effective or active listening is a very important skill to enhance interpersonal communication. Listening helps to build strong personal relationships. The process of communication completes when the message as intended by the sender is understood by the receiver. Most assume that listening is natural trait, but practically very few of us listen properly. One needs to give the communicator of the message sufficient attention and make an effort to understand his viewpoint**]**

2. *Elaborate guidelines for active listening.*

   [Hint: Guidelines for Active Listening

   - Look at the person and suspend other things you are doing. Otherwise, your brain will be distracted from its main goal - understanding the other person's concerns, intentions.
   - Be interested in what the person is saying. If you just can't make yourself interested, you will lose important information, so try taking notes.
   - Listen to the tone of voice and inflections; look at gestures and body language - these may carry an unspoken message.
   - Restate what the person said. Restating their meaning is a way for you to make sure you understand the person clearly.
   - Ask questions once in a while to clarify meaning. Doing so will keep you alert and let the other person know you have been listening and are interested in getting all the facts and ramifications.
   - Be aware of your own feelings and opinions. They may cloud your perception of what is being said. Being aware of your own preconceptions is a type of critical thinking that prevents biasing your judgment about the other person.]

15 Group Dynamics

Question 1

What are features of 'groups' in an organization?

Answer

Following are the salient characteristics of groups in an organization:

(a) Group Goal: Every group establishes its own group goals that provide motivation for their existence.

(b) Group Structure: It is based on the roles to be performed.

(c) Group Patterns of Communication: It is the pattern of message flow in a group.

(d) Group Climate: It is the emotional environment of a group based on:

  (i) Bonding and trust among members

  (ii) Participative spirit

  (iii) Openness and

  (iv) High performance goals

Question 2

What do you understand by Group Dynamics?

Answer

Groups are the basic building blocks of organizations. It is now very common for groups of employers to make decisions to solve difficult problems that were once the domain of authoritarian incentives. Given below are the characteristics of group personality:

1. spirit of conformity
2. respect for group values
3. resistance to change
4. group prejudice
5. collective power

Question 3

Describe types of groups in organization.

Or

State the types of groups in an organisation which play an important role in solving the difficult problems in an organisation.

Answer

Types of Groups in Organization:

1. **Self directed teams** – autonomous and self regulated groups of employees empowered to make decisions.
2. **Quality Circles** – Quality Circle has been defined "as a group of workers from the same area who usually meet for an hour each week to discuss their quality problems, investigate causes, recommend solutions and take corrective actions when authority is in their purview. In other words, Quality Circle is a small group to perform voluntarily quality control activities within their work area.
3. **Committees** – are of various types (a) Standing Committee which are permanent in nature and highly empowered. (b) An advisory Committee comprises of experts in particular fields (c) An adhoc committee is setup for a particular purpose and after the goal is achieved, it is dissolved
4. **Task Force** – Task force is like Committee but it is usually temporary. Task force has wide power to take action and properly fix responsibility for investigation, results and proper implementation of decisions

Question 4

What do you understand by 'Group conflicts'? How shall these be managed effectively? Explain.

Answer

Group conflict: Group conflict is an 'express struggle' between two inter-dependent parties who perceive incompatible goals, scarce resources and interference from the other party in achieving their goals. There are two aspects in relation to conflict

1. **Expression:** The two sides must communicate/express about the problem for there to be conflict.
2. **Perception:** Conflict evolves perceptions in the two sides may only perceive that their goals, resources, and interference are incompatible with each other's.

   Managing conflicts: The climate in which conflict is managed is important. It is essential to plan communications to foster a supportive climate, marked by emphasis on

   (i) Presenting ideas or options

   (ii) Problem orientation- focusing attention the task

   (iii) Spontaneity - Communicating openly and honestly

(iv) Empathy - understanding another person's thoughts.

(v) Equality- asking for opinion s

(vi) Willing to listen to the ideas of others.

Successfully managed conflicts can be constructive and can strengthen relationships in an organisation.

Question 5

Explain Consensus Building.

Answer

Consensus Building: Consensus means overwhelming agreement. Most consensus building efforts set out to achieve unanimity. The key indicator of whether or not a consensus has been reached is that everyone agrees with the final proposal and it is important that consensus be the product of a good-faith effort to meet the interests of all stakeholders. Thus, consensus requires that someone frame a proposal after listening carefully to everyone's interests. Before the parties in a consensus building process come together, mediators (or facilitators) can play an important part in helping to identify the right participants, assist them in setting an agenda and clarifying the ground rules by which they will operate, and persuading noncompliant parties to participate.

- *Problem-Solving Orientation*- It is important to be constructive and maintain a problem-solving orientation, even in the face of strong differences and personal antagonism. It is in every participant's best interest to behave in a fashion they would like others to follow. Concerns or disagreement should be expressed in an unconditionally constructive manner.
- *Engage in Active Lis*tening-Participants in every consensus building process should be encouraged (indeed, instructed, if necessary) to engage in what is known as active listening a procedure for checking to be sure that communications are being heard as intended.
- *Disagree Without Being Disagreeable*-Participants in every consensus building process should be instructed to "disagree without being disagreeable." This dictum should probably be included in the group's written ground rules.
- *Strive for the Greatest Degree of Transparency Possible*-To the greatest extent possible, consensus building processes should be transparent. That is, the group's mandate, its agenda and ground rules, the list of participants and the groups or interests they are representing, the proposals they are considering, the decision rules they have adopted, their finances, and their final report should, at an appropriate time, be open to scrutiny by anyone affected by the group's recommendations.
- *Strive to Invent Options for Mutual Gain*-The goal of a consensus building process ought to be to create as much value as possible and to ensure that whatever value is created

be divided in ways that take account of all relevant considerations. The key to creating value is to invent options for mutual gain.

Question 6

"Once the process of consensus building has begun, mediators try to assist the parties in their efforts to generate a creative resolution of differences". Examine this statement and also state in brief the process which should be followed by mediators to resolve the differences between the parties.

Answer

Process which should be followed by mediators to resolve the differences between the parties- Efforts which help to generate a creative resolution are:

(i) Problem – solving orientation – it is important to be constructive and maintain a problem solving orientation, even in the face of strong differences and personal antagonism. It is in every participant's best interest to behave in a fashion, they would like others to follow. Concerns or disagreement should be expressed in an unconditionally constructive manner.

(ii) Engage in active listening – Participants in every consensus building process should be encouraged (indeed, instructed, if necessary) to engage in what is known as active listening.

(iii) Disagree without being disagreeable – Participants in every consensus building process should be instructed to 'disagree without being disagreeable'.

(iv) Strive for the greatest degree of transparency possible – To the greatest extent possible, consensus building process should be transparent. That is, the group's mandate, its agenda and ground rules, the list of participants and the groups or interests they are representing, the proposals they are considering, the decision rules they have adopted, their finances and their final report should, at an appropriate time, be open to scrutiny by anyone affected by the group's recommendations.

(v) Strive to invent options for mutual gain – The goals of a consensus building process ought to be to create as much value as possible and to ensure that whatever value is created be divided in ways that take account of all relevant considerations. The key to creating value is to invent options for mutual gain.

Question 7

What is meant by "Negotiation"? Name the various steps which can be identified in the process of negotiation from start to the completion of the process.

Answer

When two or more persons meet together and talk/ discuss on any business or non business matter, it is known as negotiation. When same persons discuss specific proposals in order to

come to a mutually accepted solutions; whether it is with an employer, family member or business partner. It can be said that negotiation is a common way of settling things in business.

Steps in the negotiation process

1. Preparing
2. Arguing
3. Signaling
4. Packaging
5. Bargaining
6. Closing and arguing

Question 8

Explain the concept of "Negotiation". What are its techniques?

Answer

Negotiation: Negotiation occurs when two or more parties either individuals or groups discuss specific proposals in order to find a mutually acceptable agreement. Whether it is with an employer, family member or business associate, we all negotiate for things each day like higher salary, letter service or solving a dispute with a co worker or family member Negotiation is a common way of settling conflicts in business. When handled skillfully, negotiation can improve the position of one or even both but when poorly handled; it can leave a problem still unsolved and perhaps worse than before.

Techniques for Negotiation:

(a) Spiraling agreements: Begin by reaching a minimums agreement even though it is not related to the objectives and build, hit by hit, on this first agreement.

(b) Changing of position: Formulate the proposals in a different way, without changing the final result.

(c) Gathering information: Ask for information from the other party to clarify their position

(d) Making the cake bigger: Offer alternatives that may be agreeable to the other party, without changing the terms.

(e) Commitments: Formalize agreements orally and in writing before ending the negotiation.

Question 9

List out the characteristics of group personality under Group Dynamics.

Answer

Characteristics of Group Personality: Following are the characteristics of group personality:

(a) Spirit of Conformity: Individual members soon come to realize that in order to gain recognition, admiration and respect from others they have to achieve a spirit of conformity. Our beliefs, opinions, and actions are influenced more by group opinion than by an individual's opinion, even if it is an expert's opinion.

(b) Respect for group values: Any working group is likely to maintain certain values and ideals which make it different from others. In order to deal effectively with a group we must understand its values which will guide us in foreseeing its programmes and actions.

(c) Resistance to change: It has been observed that a group generally does not take kindly to social changes. On the other hand the group may bring about its own changes, whether by dictation of its leader or by consensus. The degree to which a group resists change serves as an important index of its personality. It helps us in dealing with it efficiently.

(d) Group prejudice: Just as hardly any individual is free from prejudice, groups have their own clearly evident prejudices. It is a different matter that the individual members may not admit their prejudiced attitude to other's race, religion, nationality etc. But the fact is that the individual's prejudices get further intensified while coming in contact with other members of the group holding similar prejudices.

(e) Collective power: It need not be said that groups are always more powerful than individuals, how so ever influential the individual may be. That is why individuals may find it difficult to speak out their minds in groups. There is always the risk of the one-against-many situation cropping up.

Exercise

1. *Define in brief formal and informal groups.*

   [Hint: Mainly two types of groups are present in organizations: **Formal Groups** created by deliberate sanction of management to meet certain official requirement and **Informal Group**s that are created because of the operation of the social and psychological factors at the work place**]**

2. *Explain the term group thinking.*

   [Hint: Groupthink is the tendency of group members to seek agreement solely for agreement's sake. A group gripped by groupthink fails to be creative, explore alternative solutions, problems, or concerns in an effort to present a united or cohesive front to outsiders. Group members must question themselves and their actions to ensure high-quality decision making.**]**

16 Communication Ethics

Question 1

What do you understand by "ethical communication"? What are its elements.

Answer

According to the National communication Association, ethical communication is fundamental to responsible thinking, decision making and the development of relationship and communities within and across contexts, cultures, channels and media. Ethical communication enhances human worth and dignity by fostering, truthfulness, fairness, responsibility, personal integrity and respect for self and others'. While unethical communication threatens the quality of all communication and consequently the well-being of individuals and the society in which we live. In nutshell ethical communicators have a 'well developed sense of social responsibility'.

An ethical communication is one which:

- includes all relevant information
- is true in every sense and is not deceptive in any way.
- is accurate and sincere. Avoids language that manipulates, discriminates or exaggerates.
- does not hide negative information behind an optimistic attitude.
- does not state opinions as facts.
- portrays graphic data fairly.

Question 2

Write Short Notes On:

(a) Advantages of Ethical Communication

(b) Organization Values

Answer

(a) Advantages of Ethical Communication: Ethical communication promotes long-term business success and profit. However, improving profits isn't reason enough to be ethical, as soon as the cost of being ethical outweighed the benefits, ethical choices would no longer be possible. One advantage of ethics long-term integrity. Surveys report

that all employees want to work for organizations with high ethical standards. Competent people are likely to search for organizations that maintain high ethical standards. When competent people migrate toward ethical firms, everyone benefits because both competence and ethics are perpetuated.

(b) Organization Values: Values are the principles and ideas that people or organizations strongly believe in and consider important. When people are in doubt about decisions, they frequently rely on deep-seated values to help them make the right choice. In organizations, reliance on shared values makes setting goals easier in the face of the competing ideas, desires, and objectives of individual employees.

One can get a good idea about the values of an organization by examining its vision and mission statement. These statements are short descriptions of the purpose of organizations and the directions they try to take to achieve success. Many organizations post their vision and mission statements in several places so that employees know what the organization values are.

Question 3

Suggest guidelines to handle communication ethics dilemmas.

Answer

Guidelines to handle communication ethics dilemmas:

(a) Maintain candour: Candour refers to truthfulness, honesty, frankness and one should stick to these elements while communicating with others.

(b) Keep message accurate: At the time of relaying information from one source to another, communicate the original message as accurately as possible.

(c) Secrecy: One has to maintain secrecy and confidence in communication. So one should not divulge such information to others

(d) Ensure timeliness of communication: The timing of messages can be critical. Delay in sending messages can be assumed unethical.

(e) Avoid deception: Ethical communicators are always vigilant in their quest to avoid deception, fabrication, intentional distortion or withholding of information in their communication.

(f) Confront unethical behaviour: One must confront an unethical behaviour in order to ensure a consistent ethical view point.

Question 4

State with reasons whether following statements are correct or incorrect.

(i) Rumours and gossips are synonymous.

(ii) Lying breaks down the trust between individuals.

Answer

(i) The given statement "Rumour and gossip are synonymous" is INCORRECT.

Rumours and gossip seem to be an inevitable part of everyday corporate life. Even though rumours and gossip often travel through the same network, there is a distinction between the terms. Rumours tend to focus on events and information, whereas gossip focuses on people. Even though managers usually treat the information as "yet to be confirmed", it may cloud judgments about the employee. The information has a way of creeping into performance evaluations and promotion decisions, even if unintended.

(ii) The given statement "Lying breaks down the trust between individuals" is CORRECT.

A lie is a false statement intended to deceive. Of all the ethical dilemmas, lying would appear to be the least morally perplexing. Most would agree that "one ought not to lie". Yet lies in business are more common that many would care to admit. Lying break down the trust between individuals, shaking the foundation of ethical communication.

Exercise

1. *What is an ethical communication?*

Hints

An ethical communication:

- includes all relevant information,
- is true in every sense and is not deceptive in any way.
- accurate and sincere. Avoids language that manipulates, discriminates or exaggerates.
- does not hide negative information behind an optimistic attitude.
- does not state opinions as facts,
- portrays graphic data fairly.

In a nutshell ethical communicators have a "well developed sense of social responsibility".

2. *Discuss whistle blowing.*

Answer

Any employee who goes public with information about corporate abuses or negligence is known as a whistle-blower. Corporations and managers legitimately expect employee loyalty. Greed, jealousy, and revenge motivate some whistle-blowers. Some are simply misinformed. Some confuse public interest with private interest. Certainly the community has a right to know about corporate practices that are potentially hazardous, yet courting the whistle-blower too aggressively can be problematic.

17 Communication Corporate Culture, Change and Innovative Spirits

Question 1

Write short notes on:

(a) Corporate Culture

(b) Elements of Culture

(c) Resistance to change

Answer

(a) Corporate Culture: Corporate Culture is described as the personality of an organization, or simply as "how things are done around here." It guides how employees think, act, and feel. Corporate culture is a broad term used to define the unique personality or character of an organization, and includes such elements as core values and beliefs, corporate ethics, and rules of behavioral norms that are shared by people and groups in an organization and that control the way they interact with each other and with stakeholders outside the organization.

Organizational values are beliefs and ideas about what kinds of goals members of an organization should pursue and ideas about the appropriate principles of behaviour, organizational members should use to achieve these goals. From organizational values develop organizational norms, guidelines or expectations that prescribe appropriate kinds of behaviour by employees in particular towards one another.

(b) Elements of Culture: A number of elements that can be used to describe or influence Organizational Culture:

- **The Paradigm:** What the organization is about; what it does; its mission and values.
- **Control Systems**: The processes in place to monitor what is going on.
- **Organizational Structures**: Reporting lines, hierarchies, and the way that work flows through the business.
- **Power Structures**: Who makes the decisions and how power is distributed across the organization.

- **Symbols:** These include the logos and designs, but would extend to symbols of power, such as car parking spaces and executive washrooms.
- **Rituals and Routines:** Management meetings, board reports and so on may become more habitual than necessary.
- **Stories and Myths:** build up about people and events, and convey a message about what is valued within the organization.

(c) Resistance to change: No matter whether a change is of major proportions or is objectively rather small, the change manager must anticipate that people in the organization are going to find reasons to resist changes. It is a basic tenet of human behaviour that any belief or value that has been previously successful in meeting needs will resist change.

Question 2

Explain those elements which can be used to influence an "Organizational Culture".

Answer

A number of elements that can be used to describe or influence Organizational Culture and they are :-

- The Paradigm: What the organization is about; what it does; its mission; its values.
- Control Systems: The processes in place to monitor what is going on
- Organizational Structures: Reporting lines, hierarchies, and the way that work flows through the business.
- Power Structures: Who makes the decisions and how power is distributed across the organization.
- Symbols: These include the logos and designs, but would extend to symbols of power, such as car parking spaces and executive washrooms.
- Rituals and Routines: Management meetings, board reports and so on may become more habitual than necessary.
- Stories and Myths: build up about people and events, and convey a message about what is valued within the organization.

Communicating the corporate culture effectively is paramount. For example, at General Electric (GE), corporate values are so important to the company that Jack Welch, the former legendary CEO of the company, had them inscribed and distributed to all GE employees at every level of the Company.

Question 3

State the reasons for acceptance of change in an organization.

Or

State the reasons for accepting the change in the present management set-up of the corporate culture in a business organisation.

Answer

Generally, people resist change in an organization. Even after there are some people who accept or welcome change due to the following reasons:

1. **Personal Gain:** People will be more likely to accept change when they see the possibility that they will gain in some of the following areas:-
   - Increased security
   - Money
   - More authority
   - Status/Prestige
   - Better Working Conditions
   - Self-Satisfaction
   - Better Personal Contracts
   - Less time and efforts
2. **Other factors:**
   - Provide a new challenge
   - Respects/like the source
   - Likes the way change is being communicated
   - Reduces boredom
   - Provides opportunity for input
   - Improve future

   Perception, that the change is necessary.

Question 4

What qualities should a sustainable innovation organization possess?

Answer

A sustainable innovation organisation should have:

(a) Vision and strategy for innovation

(b) Culture supporting innovation

(c) Processes, practices and systems supporting innovation

(d) Top management team leading to innovation.

(e) Effective cross-financial teams.

(f) Empowered employees driving innovation.

(g) Finding the right balance between bureaucracy and chaos.

Question 5

Explain the key elements involved in the innovation frame work of an organisation.

Answer

The **key elements in the innovation framework** are:

(i) Accessibility: The major organizational challenge is to make everyone, particularly the workers as active participants in the work process. The innovative enterprise ensures everyone is accessible to each other at all levels within the organization.

(ii) Recognize and reward innovation: One of the more radical steps an organization or manager can take is to make innovation a requirement of the job.

(iii) Develop company programs that encourage innovation: Some companies allow their employees to take sabbaticals to work in a new environment or teach in a college. By placing employees in different environments, they can meet new people, come across new ideas and hopefully generate their own novel approaches.

(iv) Foster informal communication: The paperwork involved in proposing or even pursuing a project can be a major roadblock to innovation. Employees often feel stifled when asked to fully justify ideas; they may be working on a hunch.

(v) Information: The right kind of information is called innoinformation. This type of information is critical to the vitality of the enterprises. Innoinformation consists of the plans, vision, goals and all the new ideas affecting the enterprises. The innovative enterprise is looking forward continuously changing and adapting to the needs of the customer.

(vi) Framework: The innovative enterprise must constantly adapt, create and innovate. Information and communication are the wind that sails the innovative enterprise towards its destination. Information and communication pose difficult challenges for most businesses. The difficulty lies in balancing the flow of information between providing too much or too little information.

Question 6

State the reasons for 'resistance to change' in an organization.

Answer

Resistance to Change: No matter whether a change is of major proportions or is objectively rather small, the change manager must anticipate that people in the

organization are going to find reasons to resist changes. It is a basic tenet of human behavior that any belief or value that has been previously successful in meeting needs will resist change.

Reasons why people resent or resist change:

1. *One major reason why people resist change is the potential for loss on a personal level. Objectively, there may be little threat, but people may act as if there is one. Some of the things people feel are at risk during change processes are:*
   - *Security*
   - *Friends and contacts*
   - *Money*
   - *Freedom*
   - *Pride and satisfaction*
   - *Responsibility*
   - *Authority*
   - *Good working conditions*
   - *Status*
2. *While a feeling of threat is a primary reason why people resist change, there are other factors that can mobilize people into resisting any change from a status quo. These include:*
   - *Change not needed – status quo is working fine*
   - *Proposed change does more harm than good*
   - *Lack of respect for person responsible for the change*
   - *Objectionable way of implementing the change*
   - *Negative attitude towards the organization before change*
   - *No opportunity to have input into change*
   - *Change perceived as implying personal criticism*
   - *Change simply adds more work and confusion*
   - *Change requires more effort to keep status quo*
   - *Bad timing of the change*
   - *A desire to challenge authority*
   - *Hearing about the change secondhand*

3. The uncertainty principle: This states that when people are faced with ambiguous or uncertain situations, where they feel they do not know what to expect, they will resist moving into those situations.

Exercise

1. *What is strong/weak culture?*

   Hints: A strong culture is said to exist where the staff's response to change and innovation is high because of their alignment to organizational values- people do things because they believe it is the right thing to do. Conversely, there is Weak Culture where there is little alignment with organizational values, and control must be exercised through extensive procedures and bureaucracy.

2. *Why is organization-wide change difficult to accomplish?*

   Hints: Typically, there are strong resistances to change. People are afraid of the unknown. Many people think things are fine and don't understand the need for change. Many are inherently cynical about change. Many doubt there are effective means to accomplish major organizational change. Often, there are conflicting goals in the organization, e.g., to increase resources to accomplish the change yet concurrently cut costs to remain viable. Organization-wide change often goes against the very values held dear by members in the organization, that is, the change may go against how members believe things should be done.

18 Communication in Business Environment

Question 1

Draft a notice for ABC's Annual General Meeting with four ordinary business.

Answer

Notice is hereby given that the 15th Annual General Meeting of the members of ABC will be held on Monday the 15th day of September 2006 at the registered office of the Company ……. at 10 a.m. to present the following business:

Ordinary Business:

To

1. Receive, consider and adopt the Audited Balance sheet of the company as on 31st March, 2006 and the Profit and Loss account for the year ended on that date and Audit's and director's response thereon.
2. To declare dividend for the year ended 31st March, 2006
3. To appoint a director in place of Mr……..
4. To appoint Statutory Auditors of the Company.

NOTE: A member entitled to attend and vote is entitled to appoint a proxy to attend and vote instead of himself and proxy need not be a member of the company.

For and on behalf of the Board of Directors…….

Registered Office……

Question 2

Board of Directors of Prakash Traders Private Limited proposes to convene an Extraordinary General Meeting for changing the name of the company to Prakash International Private Limited. Draft the notice for calling the Extraordinary General Meeting of the Members.

Answer

Notice for Extraordinary General Meeting of the Members

Notice is hereby given that extraordinary General Meeting of the members of Prakash Traders Private Limited will be held on Monday , the .....day of 2008, at the registered office of the company at…….Mumbai at……..P.M. to transact the following business.

Special Business

To consider and if thought fit, to pass with or without modification the following resolution as special resolution.

"Resolved that, subject to the approval of the Central Government under section 21 of the Companies Act,1956, the name of the company be and is changed from Prakash Traders Private Limited to Prakash International Private Limited and that consequent to this change clause I of the Memorandum and Articles of Association of the company be altered accordingly.

By order of the Board of Directors of Prakash Traders Private Limited.

Secretary……

Place:……

Date:……

Question 3

MNP Limited was incorporated in September, 2010. Now the company wants to hold its first meeting of the Board of Directors. Draft a notice of the said meeting along with agenda.

Answer

Notice of the First Meeting of the Board of Directors

MNP Limited

To, Date

(Director)

Dear Sir/Madam,

This is to inform you that the first meeting of the Board of Directors will be held at the Registered Office of the company on 15th September, 2010 at 3 p.m. to transact the business as per the enclosed agenda.

You are requested to please attend the meeting.

Yours faithfully,

Secretary

For and on behalf of the

Board of Directors

Place : .....

Date ……

Agenda:

(i) Election of the Chairman of the Meeting.

(ii) To produce the Certificate of Incorporation, the Memorandum and the Articles of Association.

(iii) Election of the Chairman of the Company.

(iv) Appointment of Managing Director.

(v) Appointment of Secretary.

(vi) Appointment of Auditors.

(vii) Appointment of Bankers and approval of the opening of a Bank Account and its operation.

(viii) Adoption of the company's seal.

(ix) Approval of the statement of preliminary expenses by the promoters and adoption of the preliminary contracts and underwriting contracts.

(x) Any other business with the permission of the chairman.

Question 4

Fifth Annual General Meeting of the shareholders of Devrishi Limited was held on 20 August, 2009 at its registered office at Mumbai. 55 shareholders attended the meeting in person and 6 shareholders in proxy. Several ordinary businesses regarding adoption of audited balance sheet, declaration of dividend, appointment and re-appointment of directors and auditors were transacted at the meeting. Draft the minutes of the fifth Annual General Meeting of the shareholders of Devrishi Limited.

Answer

Minutes of the 5th Annual General Meeting

Fifth Annual General Meeting held at

Place: 25th Devrishi Apartment, Andheri East, Mumbai

Date: 20th August, 2009

Time: At 11 A. M.

Present

1. Shri Devrishi M. D. in the chair
2. Shri X Director.
3. Shri Y Director.
4. Shri Z Director.
5. Shri T Director.

6. Shri R Director.
7. Shri Alok, representative of Alok and Co. Chartered Accountants.
8. Shri S., Secretary of the company.

55 shareholders attended the meeting in person and 6 shareholders in proxy.

1. **Notice:** The notice convening the meeting was read by the Secretary of the company.
2. **Directors' Report and Accounts:** With the consent of the members present, the Director's Report and Accounts having already been circulated to the members were taken as read.
3. **Auditors' Report:** The Auditors' Report was read
4. **Adoption of Directors' Report, etc.:**

   The Chairman then invited queries from the members present on Directors' report, Accounts and Auditors' and auditor's Report, but there was no query. Thereafter, the Chairman proposed the following resolution which was seconded by some of the members namely……..

   "Resolved that the Directors' Report, audited Balance Sheet as on 31st March, 2009 and Profit and Loss Account for the year ended 31st March, 2009 and Auditors' Report thereon be and the same are hereby received, considered and adopted."

   Carried unanimously.
5. **Dividend:**

   Proposed by Shri Devrishi M.D

   Seconded by Shri X and Y Directors

   "Resolved that the Dividend as recommended by the Board of Directors for the year ended 31st March, 2009 at the rate of Rs. 5/- per share on the equity share capital of the company, subject to deduction of tax at source be and is hereby declared for payment to those shareholders whose names appeared on the Register of Members as on …… 2009."

   Carried unanimously
6. **Directors:**

   Proposed by ……..

   Seconded by …….

   "Resolved that Shri Y who retires by rotation and is eligible for re-appointment to and is hereby re-appointed a director of the company."

   Carried unanimously.

7. Auditors:

Proposed by X Director of the Company.

Seconded by A, B Shareholders of the Company.

"Resolved that M/s Alok and Company Chartered Accountants, be and are hereby appointed Auditors of the Company to hold office from the conclusion of this meeting until the conclusion of the next Annual General Meeting at a remuneration of Rs. 50,000/-"

Carried unanimously.

The meeting closed with a vote of thanks to the Chair.

Dated: 2nd Sepember,2009 Sd/-

Chairman

Question 5

The statutory meeting of PQR Limited was held on 20th January, 2010 at its registered office at Kolkata. As a secretary of the company, draft the minutes of the statutory meeting of the shareholders of the company.

Answer

Minutes of the Statutory Meeting

Minutes of the proceeding of the statutory meeting of PQR Limited held on 20th January 2010 at 11.00 a.m. at the Registered Office of the company at Bada bazaar Kolkata.

Mr. A	Chairman
Mr. B	Director
Mr. C	Director
Mr. C	Director
Mr. D	Secretary

and 120 members and 30 proxies.

The secretary read the notice convening the meeting.

The Chairman welcomed the members and reviewed the activities of the company since its incorporation.

The chairman informed the members that a list of members of the company has been placed on the table for the inspection of members.

With the permission of the members, the chairman took as read the Statutory Report. It was moved that the Statutory Report sent to the members with the notice of the meeting be approved. Accordingly, it was resolved that the Statutory Report be and is hereby approved.

All the pre-incorporation and provisional contracts were approved by the members of the company.

The meeting was ended with a vote of thanks by the members and chairman declared the meeting closed.

Date Secretary Chairman

Question 6

Third Annual General Meeting of ABC Limited was held on 28th September, 2007.Several business was transacted at the meeting including the adoption of annual accounts for the year ended 31st March, 2007. The meeting was attended by 30 members in person and 5 members in proxy. Draft the minutes of the Annual General meeting indicating how shall the adoption of accounts being one of the business transacted at' the meeting, be recorded.

Answer

Minutes of 3rd Annual General Meeting of the shareholders of ABC Ltd held at …..... p.m. on 28th September, 2007.

Present

1. 30 members in proxy.
2. ..... Director
3. .....Chartered Accountant
4. .....Secretary.

Mr. ....., Chairman took the chair, in accordance with articles of the company. The quorum being present, chairman called the meeting to order. The notice convening the meeting was read by the Secretary. The auditors report was read by the Secretary.

Adoption of Accounts

The Chairman then invited queries from the members present on Directors report, accounts and auditor and auditors, report, but there was no query. Thereafter, the Chairmen proposed the following resolution which was recoded by .....

"Resolved that the Directors' Report audited balance sheet as on 31st March, 2007 and profit and loss account for the year ended 31st March, 2007 and auditors report thereon be the same are hereby received, considered and adopted.

Carried unanimously_____

The meeting conducted ended with a vote of thanks to the Chair.

Sd/-

Dated ……..2007 Chairman

Question 7

ABC Ltd. wants to hold its Annual General Meeting on 15th December, 2008 to discuss the matters relating to ordinary business. Draft a notice along with notes in brief for calling annual general meeting of its shareholders.

Answer

Draft of notice for calling annual general meeting:

Notice

Notice is hereby given that the 3rd annual general meeting of the ABC Ltd. will be held on Friday, the 15th of December, 2008, at the registered office of the company at 123, tower complex, Lucknow Distt. Lucknow (U.P.) at 11.00 a.m. to transact the following ordinary business:

1. To receive, consider and adopt the audited balance sheet of the company as on 31st march 2008 and the profit and loss account for the year ended on the date auditor's and director's reports there on.
2. To declare dividend for the year ending 31st March 2008.
3. To appoint a director in place of Mr. A.V. Kamath, Who retires by rotation and being eligible, offers himself for re-appointment.
4. To appoint a director in place of Mr. J.K. Smith, Who retires by rotation and being eligible, offers himself for reappointment.
5. To appoint statutory auditors of the company and fix their remuneration.

Regd. Office — For and on behalf of Board of Directors.

123, Tower complex

Distt. Lucknow (U.P.) — Sd/-

Dated: Oct. 15, 2008 — Chairman of the meeting

Notes:

- A members entitled to attend and vote is entitled to appoint a proxy to attend and vote instead of himself and the proxy need not be a member of the company.
- The register of members and the shares transfer banks of the company will remain closed from 7th day of December 2008 to 15th day of December 2008, both days inclusive.
- Members are requested to notify immediately change of address, if any, to the company's registered office. While communicating to the company, please quote folio number.
- Shareholders desirous of answering any information concerning the accounts the accounts and operations of the company are requested to address their questions to the company's head office, so as to reach at least 5 day before the date of the meeting so that information may be made available at the meeting to the best extent possible.

Question 8

Draft a notice for calling the Board of Directors meeting of M/s. MN Limited where Mr. RS is co-opted as an Additional Director and also to consider buy-back of company's equity shares to an extent of 10%, of issued share capital.

OR

Draft a notice for calling the meeting of the Board of Directors of a company. In this meeting, following transactions have to be proposed:-

(i) Mr. X to be co-opted as an Additional Director

(ii) Decision to be taken to buy-back company's equity shares

Answer

Notice: Meeting of Board of Directors:

Notice

Notice is hereby given that meeting of the Board of Directors of the company will be held at the registered office on…….at……a.m./p.m. to transact the following:

Agenda

1. Confirmation of the minutes of the previous Board Meeting held on……to…….
2. Discussion of the progress in business.
3. Co-option of Mr. RS/ X as an Additional Director of the company.
4. Buy back of 10% of the equity shares of the company.
5. Any other matter with the permission of the chair.

Place:…… By Order of the Board of Directors

Date:……..

Question 9

As a Secretary of AB forgings Ltd., draft a notice of a Board of Directors meeting to consider any five items as agenda of the meeting, to be held on November 15, 2008 at the registered office of the Company at Mysore.

Answer

Notice of a Board Meeting

AB forgings Limited,

Ph. No- Saiyaji Road

Fax - Mysore – 32

Ref. No. October 10, 2008

Dear sir/ Madam

This is to inform you that a meeting of the board of director will be held on November 15, 2008 at the registered office of the company, 281 Saiyaji Road, Mysore- 32 at 11. 30 AM to consider the following:

1. To approve the minutes of the last meeting.
2. To consider matters arising out of the minutes.
3. To consider and pass the statement of accounts for payment.
4. To approve transfer of shares.
5. To sanction an interim dividend @ 10% (tax free) on the equity shares of Rs 10/- each. Rs 8/- per shares paid up.
6. To consider any other matter with the permission of the chair and.
7. To fix the date and time of the next meeting.

To …… Yours faithfully

(Ajay Garg)

Question 10

TKR Limited wants to hold its statutory meeting on 20 December, 2009 to discuss the matters relating to information of the company and incidental matters thereto. Draft a notice alongwith notes in brief for calling statutory meeting of the company.

Answer

Notice of Statutory Meeting

TKR Limited

Registered Office:……

Notice is hereby given that the statutory meeting of the company will be held at the registered office of the company at----------on-------20-------at A.M./P.M. for considering the statutory report and for considering any other business which ought to be considered at the that meeting.

Please find enclosed a copy of the statutory report.

Date: By order of the Board

Place: For TKR Ltd.

Sd/-

Company Secretary

Note:
A member entitled to attend and vote at the meeting is entitled one or more proxies to attend and vote instead of himself and a proxy need not be a member. The instrument, appointing a proxy should be deposited at the registered office of the company not less than 48 hours of the commencement of the meeting.

Question 11

Draft a circular for employees insisting on punctuality.

Answer

Jaipee Electronics Ltd.

Civil Lines, Kanpur.

Circular No: Date……..

To all employees

Recent surprise checks have revealed that there is considerable late coming and in some cases, even the standard instructions for ensuring punctual attendance are not followed. All employees are requested to strictly adhere to the arrival, departure and lunch timing of the office. Tendency to move around in the corridors and canteen would also be viewed seriously.

Cooperation of all employees is solicited.

Sd/-
J.P.Dutta
Manager – H.R

Question 12

Write Short notes on:

(a) Guidelines for drafting a Pres Release

(b) The Press Communiqué

(c) ***The Press Notes***

Answer

(a) Guidelines for drafting a Press Release: The term press release in its narrower sense is used for releases covering news. The press release contains worthwhile material which has some news value.

The press release should be written in a journalistic style. It should provide facts or information of interest to the readers and should attempt to cover all aspects of a specific subject. There should not be any loose ends. It should be on a subject which is recent or in news. The release should not be generally lengthy. It should be concise and to the point. It has not much place for subsidiary or background material.

The introduction or lead should be in a summary format as it is a news story.

The releases should have a consistent format. Generally, the name of the organization from where the release emanates is given on the top. The date and place are indicated on the top right side. The release should have a title and a sub-title also, if necessary. It should have a suitable introductory paragraph. In the case of releases from non-official organization, it is desirable also to mention the designation of the person issuing the release and his telephone number.

(b) The Press Communiqué: The press communiqués are issued when some important government decisions or announcements are made such as cabinet appointments, conclusion of the foreign dignitaries' visits, international agreement, etc. The press communiqué is formal in character. It carries the name of the ministry or department and the place the date at the bottom left-hand corner of the release. Generally, the press is expected to reproduce the press communiqué without any substantial change. No heading or subheading is given on press communiqués.

(c) The Press Note: The press notes are less formal in character. They are issued on important matters, e.g. raising or lowering of tariff rates etc. The press note also carries the name of the ministry or department concerned and the place and date at the bottom left-hand corner. Heading or sub-heading are given in the press notes.

Exercise

1. *Define the term press release.*

   Answer: The term press release in its narrower sense is used for releases covering news. The press release contains worthwhile material which has some news value. It is not only unnecessary expenditure but also damages the reputation of the concerned publicity / information department if the release is on a very trivial matter.

2. *Explain press notes.*

   Answer: Press notes are less formal in character. They are issued on important matters, e.g., raising or lowering of tariff rates, etc. The press note also carries the name of the ministry/department and the place and date at the bottom left-hand corner. Heading or sub-heading are given in press notes.

19 Basic Understanding of Legal Deeds and Documents

Question 1

State the various components which are required to draft a partnership deed.

Answer

Components of the Partnership Deed: A Partnership Deed is divided into different paragraphs. Each paragraph deals with relevant and related information in simple and intelligible language. If a particular part is not applicable in a particular case that part is omitted from the document. The important components in general are as following:-

- Heading of the document
- Date and place of execution of the document
- Names & description of Parties
- Recitals
- Terms and condition
- Special rules
- Jurisdiction
- Signature of the parties
- Signature of the witnesses

The Deed must be executed on a stamp paper of prescribed value. The copy of the deed must be sent to the Registrar of Partnership Firms along with the prescribed form duly completed for issue of acknowledgement by the Registrar of Firms. All subsequent changes must be notified to the Registrar.

Question 2

Draft a 'Power of Attorney' by subscribers of Memorandum of Association of the Company authorising a Chartered Accountant to appear before the Registrar of Companies to do the needful for the purpose of incorporation of the company.

Answer

Before Registrar of Companies: We the subscribers of the Memorandum and Article of Association of the Proposed Company, hereby authorize to present the memorandum of Article of Association and other connected documents for the registration of the said company before the registrar of companies, Karnataka, Bangalore and to make such corrections/Alterations/deletions/Additions as may be required to be done by the Registrar in the documents and also to receive the certificate of incorporation.

General Power of Attorney: Know we all men by their present we do hereby appoint and constitute……son of……(hereinafter called "chartered Accountant" who has subscribed his signature hereunder in token of identification) presently residing……to my lawful Chartered Accountant in our name and on our behalf do it any one or all the following acts, deeds, things namely

1. to give all particulars necessary for incorporation of company.
2. to give affidavit to the Registrar of Company for the purpose of incorporation.
3. to do needful acts necessary for incorporation of the company
4. he is authorized to include promissory notes letter of declaration and indemnity for the purpose of incorporation.
5. to receive documents on behalf of the members of the company.
6. to sign forms, documents and papers required for the purpose of incorporation of the company.

Dated …….at this the …… day of ……..

(address)

Specimen signature of the Chartered Accountant above named

Notary Public

Question 3

Draft a 'Power of Attorney' by an assessee authorizing a professional to appear before the Income Tax Authorities in respect of the pending taxation matter.

Answer

Power of Attorney to appear before Income Tax Authorities

I, …….S/o……., R/o……..and partner of the firm M/s……..with registered office at……., do hereby appoint Mr……., S/o……., R/o……as attorney of the firm above named and authorize him for the purpose hereinafter mentioned :

1. That the said attorney shall appoint an advocate of his choice and hand him over the judgement of the tribunal of Income Tax and instruct him to file the appeal against the order, for the Assessment Year …..

2. That the said attorney shall execute Vakalatnama to the Advocate appointed by him and shall sign all the related papers under the supervision of the advocate.
3. That specimen signature of the said attorney is given below of this deed.
4. The said attorney shall generally do all other lawful acts necessary for the conduct of the said case.

I hereby declare that the acts done by the said attorney in connection with the work given to him shall be deemed to have been done by me and shall be binding on the firm and its partners.

IN WITNESS WHEREOF I have signed this power of attorney in the presence of the following witnesses:

Signature

(Holder of Power of Attorney)

WITNESSES:

1.....

2.....

Question 4

M/s. Assure Investments, a firm of partners A and B, appoint and authorize Mr. X giving powers to sell and sign transfer deeds for transfer of shares and debentures by executing an instrument of the "Power of Attorney". Draft such instrument of the "Power of Attorney" of the firm.

Answer

Power of Attorney to execute a deed for the transfer of shares & debentures:-

BY THIS POWER OF ATTORNEY, M/s. Assure Investments (full details), the firm hereby appoints Mr. X (full details) as Attorney of the firm, to act in his name and on his behalf and to do or execute all or any of the acts or things relating to transfer of shares and debentures, that is to say:

1. To receive from.....(Full details), the transferee the sum of ₹.....(Rupees..... only) being the price agreed to be paid to the firm by the said transferee for the purchase of (full description of shares and debentures) under an agreement dated.....and to give proper receipt and discharge for the same.
2. To execute a transfer deed of the said shares and debentures
3. To present the said transfer deed for registration before the proper registration authority, to admit the execution thereof, to do all acts, deeds and things which may be necessary for registering the said transfer deed.

4. To execute or to do all acts, things or deeds or assurance for the completion of the transfer of the said shares and debentures.

AND, the firm DO HEREBY AGREE to ratify all acts, things, deeds or proceedings lawfully done by the said Attorney on behalf of the firm and in the name of the firm by virtue of this power of attorney and the same shall be binding on firm in full force or effect.

IN WITNESS WHEREOF the firm have executed this power at ……..this……..day of……..20…….

Witness: 1 _____ Signature

2 _____ (Executant)

Question 5

Explain lease deed.

Answer

A lease is defined under Section 105 of the transfer of enjoyment of immovable property by the lesser to the lessee in consideration of a premium that means a price paid or promised on rent that may be periodical payment of money, share of crops or rendering of services. In order to constitute the valid lease, there must be a transfer of right to enjoyment of immovable property though delivery of possession of the property. However, this is not a condition preceded for operation of a lease. The term of lease including the period of lease, amount of rent etc. are contained in a leased agreement or deed duly executed and signed by both the lesser and lessee.

Question 6

The Board of Directors of RSP Limited agrees with X to hire his (X's) flat at NOIDA on lease for ten years @ ₹ 20,000 per month for marketing office of the company. You are a senior executive of the Board and the board asks you to prepare the lease deed for the agreement. Draft a lease deed.

Answer

Lease Deed: This Lease is made on this the day of 01 March 2010, between, X s/o Y, aged about 45 years, residing at Noida (hereinafter called the LESSOR); which expression shall, whenever the context so requires or admits mean and include his heirs, executors, Administrators and permitted assignees of the one part;

And RSP Limited, Noida and herein after called the LESSEE Whereas, the lessor is the absolute owner of the property Noida (more fully described in the schedule hereunder and hereinafter referred to as 'Schedule Property') and Whereas, the Lesssee is desirous of taking on lease the Schedule property for a period of 10 years and , whereas, the Lessor is agreeable for the same.

Now therefore this deed witnessed that in pursuance of aforesaid agreement and in consideration of the rent hereinafter contained, the Lessor hereby demises by way of lease who Lessee the Schedule Property for a period of from today, on the following terms and conditions:

1. That the lessee has undertaken to pay the lessor a monthly rent of ₹ 20,000/- (Rupees twenty thousand only) for the Scheduled Property on or before the 10 day of the following calendar month, and 10 months rent of ₹ 2.00 lac only deposit by the lessee on the date of execution of this lease; the receipt where of the lessor hereby acknowledges and agrees to repay the same without interest at the time of vacating the Scheduled Property, after deducting for damages, if any.
2. The lease shall commence from the 1st April 2010 and shall be in force for a period of 10 years.
3. The lessee shall use the Scheduled Property only for official purpose and shall not assign or sublease or use the Scheduled Premises for any unlawful purposes or alter the Scheduled Property without the consent of the lessor in writing.
4. During the lease period, the lessee shall pay the electricity and water charges to the respective departments promptly and obviate disconnection at any time.
5. The lessee shall permit the lessor or his agents, to enter the Scheduled Property at all reasonable times for the purpose of periodical inspection.

Schedule:

1500 Squares of house bearing No. 56 at Noida measuring East to West 50 eter North to South 30 eter and bounded on: East by: Road, West by: Road, North by: Plot No. 55, South by: Plot No. 57.

In witness whereof the parties hereto have their respective hands and seals to this Agreement on the day, month, year first written above.

Witness

1. LESSOR
2. LESSEE

Question 7

Explain Affidavit and its model format.

Answer

Affidavit

An affidavit is a written statement used mainly to support certain applications and in some circumstances as evidence in court proceedings. A person who makes the affidavit is called the Deponent and must swear or affirm that the contents are true before a person who has the

authority to administer oaths in respects of the particular kind of affidavit. The model form of affidavit is given below:

I..... son of ..... aged .....
years, residing at .....,
hereby declare an oath as follows:
"..... ...."..... .....”Sworn on this .....the day of
……

Date:…… Signature

Place:……

Question 8

What is an Indemnity Bond? Supply a format for Indemnity Bond.

Answer

Indemnity Bond

A contract of indemnity as defined under Section 124 of the Indian Contract Act, 1872 is a contract by which one party promises to save the other from laws cost to him by the contract of the promissory himself or by the contract of any other person. A person who gives the indemnity is called indemnifier and a person for whom protection is given is called the indemnity holder. The model form of indemnity bond is given below:

Name of the Assessee:

P.A.N. No. Assessment Year:

I. ..... son/ wife/ daughter of ..... Resident of ..... do hereby agree to indemnify the Government of India for any loss that may occur on giving credit for the Certified Photostat copies of the TDS Certificates/ ...../...../ ..... for a sum of Rs..... being ... % of my share in the total TDS of ₹ .....

of ..... I further declare that the credit for consolidated TDS Certificate was not claimed in the hands of the Association of

Persons,.....

Date: Signature:

Place:

Question 9

Mr. A has not received a dividend warrant of ₹ 1,500 for 150 shares of XYZ Ltd. Draft an indemnity bond, to be given to the company for seeing release of Dividend.

Answer

Indemnity Bond

Mr. A S/o …….. resident …… do hereby agree to indemnify the XYZ Ltd. for any loss that may occur for seeking release of dividend for 150 shares of ₹ 1500.

I further declare that personally I have not received the dividend warrant in question.

Mr. A

Date: Signature

Place:

Question 10

SVA Limited dispatched Bonus Share Certificate to Mr.R.R did not receive the Bonus Share Certificate as it was lost in the transit. R applied to the company to issue the Bonus share certificate in duplicate. SVA Limited asked Mr. R to submit an Indemnity Bond so that Bonus Share Certificate in duplicate may be issued to him. Draft an Indemnity Bond to be given by R to the company for seeking release of Bonus Share Certificate in duplicate.

Answer

Indemnity Bond

Mr. R S/o X resident of Mumbai do hereby agree to indemnify the SVA Limited for any loss that may occur for seeking release of Bonus Share Certificate in duplicate of 50 equity shares of Rs.10 each fully paid. I further declare that personally I have not received the Bonus Share Certificate issued by the company for which the company is claiming that it has already been despatched.

Date……

Place: Mumbai Signature

(Mr. R)

Question 11

Write a short note on: Gift deed

Answer

Gift deed: The law relating to gifts is provided for in the Transfer of Property Act, 1882 and Indian Succession Act, 1925. Gift is defined as the transfer of certain movable or immovable

property made voluntarily and without consideration by one person called the donor to another called the donee and accepted by or on behalf of the donee. A gift to be valid must be accepted by the donee during the life time of the donor. Registration of a gift often immovable property is must and that of movable property is optional.

Question 12

Draft a 'Gift Deed' assuming your own facts regarding parties and subject matter relating to gift.

Answer

Gift Deed

THIS DEED OF GIFT made on this 15th day of May 2014 BETWEEN 'X' an Indian aged about 70 years, son of 'A' resident of .....(hereinafter called "the Donor") of the one part AND 'Y' an Indian aged about 30 years, son of 'B', resident of .....(hereinafter called "the Donee") of the other part :

WHEREAS the Donor has no issue and the donee is the nephew of the Donor and has been living with him since childhood in the house owned by Donor.

AND WHEREAS the Donor out of natural love and affection for his said nephew, is desirous of making a gift of the said house to the donee.

NOW THEREFORE THIS DEED WITNESSETH as follows :-

1. That in consideration of natural love and affection of Donor for the Donee, the donor hereby voluntarily transfers to the Donee free from all encumbrances whatsoever of the said house with all rights of easements, privileges appurtenant thereto and to hold the same unto the donee absolutely forever.
2. That the Donor or his heirs shall have no interest in the said house hereafter.
3. That the Donee hereby accepts the said transfer made by the Donor.
4. That the value of the said house is Rs. 5,00,000/- (Rupees Five Lakhs only).

IN WITNESS WHEREOF the parties hereto have signed this deed at .....in presence of the witnesses on the day and year first hereinabove written.

SIGNED AND DELIVERED

By the within named "Donor"

In the presence of.....

1).....

2).....

SIGNED AND DELIVERED

By the within named "Donee"

In the presence of……..

1)…….

2)…….

Question 13

J desires to gift out her flat in Mumbai in City Cooperative Society registered under the Maharashtra Cooperative Societies Act, 1960, to her brother A. Stating the legal requirements to be complied with, draft a Gift Deed. Take your own data regarding date, flat no., floor area etc.

Answer

Drafting of Gift Deed:

This Deed of gift is made of……..…..on this……day of……..2007. Between…….. an Indian……..inhabitant residing at flat No., Cooperative Housing Society Ltd…….(city), hereinafter called 'The Doner' of the one part and , also an Indian inhabitant of (City)…….Residing at ……..... at…….(city) herein after called there 'Donee of the other part. Whereas the Donee ……..is the…… of donor……..and whereas the Doner is the member of …… society which is duly registered under Maharashtra Cooperative Societies Act, 1960. The donor has 5 fully paid shares of the said society. The donor has acquired a flat No. ……... on the ……floor and measuring:……sqr. mtr. In the building situated at…….. (city)

Whereas the Donor has full right title and in last in their said shares/flat more particularly described in this schedule.

And whereas the donor desired to gift his right, title and interest in the said share/flat in the said building of the said society described in the schedule hereunder written to the Donee hereto.

The Donor out of natural love and affection for the donee hereby transfer by way of gift his right title and interest in the said shares and the flat absolutely forever.

The Donee accept the gift and agrees to hold that right title and interest of the Donor in said shares/flat of the societies.In the interest whose of the parties hereto have here under set and subscribed their respective hands on the day and the year.

Signed and Delivered

In the presence of……

1. .....

2. .....

Signed and Delivered:

By the named Donee.

In the presence of.....

1 .....

2. .....

Question 14

X desires to gift his flat to Y. Draft a gift deed.

Answer

This Deed of Gift is made at----- (city) on this ------ day of ----- 2010 between X and Y an Indian inhabitant residing at flat No. ------ Floor, -------- Coop. Housing Society Ltd. ----(city) hereinafter called "THE DONOR" of the ONE PART and ------ also an Indian inhabitant of------ (city), residing at flat no. ------- floor --------- Coop. Housing Society Ltd. -------(city), hereinafter called" THE DONEE" of the OTHER PART.

WHEREAS the Donee Y is the ------- (Relative) of Donor X .

AND WHEREAS the Donor is the member of ------- society which is duly registered under the Maharashtra Coop. Societies Act 1960, (hereinafter referred to as “the said society”). The donor has five fully paid up shares of the said society. The donor has acquired a flat No. ------ on the ----- floor and measuring ------ sq. meters. In the building known as "----” (hereinafter referred to as the "said building") situate at ------ (City), (hereinafter referred to as "the said flat") more particularly described in the Schedule hereunder written "said society").

WHEREAS the Donor has full right title and interest in the said shares/flat more particularly described in the Schedule hereunder written.

AND WHEREAS the Donor desires to gift his right, title and interest in the said shares/flat in the said building of the said society more particularly described in the Schedule hereunder written to the Donee hereto.

NOW THIS DEED OF GIFT WITNESSETH AS FOLLOWS:

The donor out of natural love and affection for the Donee, hereby transfers by way of gift his right, title and interest in the said shares and the said flat more particularly described in the Schedule hereunder written to the Donee absolutely for ever.

The Donee accepts the gift and agrees to hold the right, title and interest of the donor in the said shares/flat in the said building of the said society more particularly described in the Schedule hereunder written of the said flat from the Donor.

Schedule of property above referred to:

IN WITNESS WHEREOF the parties hereto have hereunder set and subscribed their respective hands on the day and the year first herein above written.

SIGNED AND DELIVERED

By the within named "Donor"

In the presence of ---------

1) ----------

2) ----------

SIGNED AND DELIVERED

By the within named "Donee"

In the presence of

1) ----------

2) ----------

Question 15

State the contents that are required for drafting an Annual Report of a Company.

Answer

The following are the main contents are required for drafting an annual report of a company.

1. Leadership team : including top Management.
2. Directors report
3. Financial Statements - Balance Sheet and Profit and Loss Account including Auditors report
4. Corporate social responsibility
5. Graphs

Exercise

1. *What is a deed?*

   Answer Deed: The Legal Glossary defined 'deed' instrument in writing (or other legible representation or words on parchment or paper) purporting to effect some legal disposition. Simply stated deeds are instruments though all instruments may not be deeds. However, in India no distinction seems to be made between instruments and deeds.

2. *Explain partnership deed.*

   Answer: A partnership firm may be constituted either by oral agreement or a written agreement. A written agreement of partnership or partnership deed is preferred as it minimizes the challenges of disputes and ambiguities in future. The model form of partnership is given below:

In form, deed can be seen as comprising of the following components:

1. Date
2. Names of Partners
3. Preamble
4. Recitals
5. Attestation
6. Custody
7. Special Rules

The Deed must be executed on a stamp paper of prescribed value. The copy of the deed must be sent to the Registrar of Partnership Firms along with the prescribed form duly completed for issue of acknowledgement of firm. All subsequent changes must be notified to the Registrar.