Intermediate

Business Laws and Ethics

Paper 5

The Institute of Cost Accountants of India
Statutory Body under an Act of Parliament
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About the Institute

The Institute of Cost Accountants of India is a Statutory Body set up under an Act of Parliament in the year 1959. The Institute as a part of its obligation, regulates the profession of Cost and Management Accountancy, enrols students for its courses, provides coaching facilities to the students, organizes professional development programmes for the members and undertakes research programmes in the field of Cost and Management Accountancy. The Institute pursues the vision of cost competitiveness, cost management, efficient use of resources and structured approach to cost accounting as the key drivers of the profession.

With the current emphasis on management of resources, the specialized knowledge of evaluating operating efficiency and strategic management the professionals are known as ''Cost and Management Accountants (CMAs)''. The Institute is the 2nd largest Cost & Management Accounting body in the world and the largest in Asia, having more than 5,00,000 students and 90,000 members all over the globe. The Institute operates through four regional councils at Kolkata, Delhi, Mumbai and Chennai and 113 Chapters situated at important cities in the country as well as 11 Overseas Centres, headquartered at Kolkata. It is under the administrative control of the Ministry of Corporate Affairs, Government of India.

Vision Statement

"The Institute of Cost Accountants of India would be the preferred source of resources and professionals for the financial leadership of enterprises globally."

Mission Statement

"The Cost and Management Accountant professionals would ethically drive enterprises globally by creating value to stakeholders in the socio-economic context through competencies drawn from the integration of strategy, management and accounting."

Motto

असतोमा सद्गमय	From ignorance, lead me to truth
तमसोमा ज्योतिर् गमय	From darkness, lead me to light
मृत्योर्मामृत गमय	From death, lead me to immortality
ॐ शान्ति शान्ति शान्तिः	Peace, Peace, Peace

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Behind Every Successful Business Decision, there is always a CMA

INTERMEDIATE
Paper 5

BUSINESS LAWS AND ETHICS

Study Notes
SYLLABUS 2022

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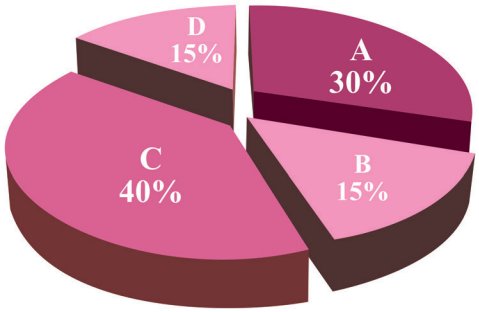
PAPER 5: BUSINESS LAWS AND ETHICS

Syllabus Structure:

The syllabus in this paper comprises the following topics and study weightage:

Module No.	Module Description	Weight
	Section A: Commercial Laws	**30%**
1	Introduction to Law and Legal System in India	5%
2	Indian Contracts Act, 1872	10%
3	Sale of Goods Act, 1930	5%
4	Negotiable Instruments Act, 1881	5%
5	Indian Partnership Act, 1932	5%
6	Limited Liability Partnership Act, 2008	
	Section B: Industrial Laws	**15%**
7	Factories Act, 1948	10%
8	Payment of Gratuity Act, 1972	
9	Employees Provident Fund and Miscellaneous Provisions Act, 1952	
10	Employees State Insurance Act, 1948	
11	The Code on Wages, 2019	5%
	Section C: Corporate Laws	**40%**
12	Companies Act, 2013	40%
	Section D: Business Ethics	**15%**
13	Business Ethics and Emotional Intelligence	15%



Learning Environment

Subject Title	**BUSINESS LAWS & ETHICS**
Subject Code	**BLE**
Paper No.	**05**
Course Description	The subject deals with four core components namely business laws, industrial laws, corporate laws and ethics. Accordingly, it covers various commercial laws that govern business transactions and settlement procedures in entities and internal management in partnership organisations. It provides a wholistic view of various industrial laws having significant impact on business operations and decisions on employee compensation and work environment. The subject also offers a detailed understanding of legislation governing formation of a company, role of directors, operation and financial control as well as shareholders' rights. Finally, it introduces the concept of ethics and emotional intelligence and explains how they can complement laws in ensuring legitimate as well as responsible business dealings.
CMA Course Learning Objectives (CMLOs)	1. Interpret and appreciate emerging national and global concerns affecting organizations and be in a state of readiness for business management. a. Identify emerging national and global forces responsible for enhanced/varied business challenges. b. Assess how far these forces pose threats to the status-quo and creating new opportunities. c. Find out ways and means to convert challenges into opportunities 2. Acquire skill sets for critical thinking, analyses and evaluations, comprehension, syntheses, and applications for optimization of sustainable goals. a. Be equipped with the appropriate tools for analyses of business risks and hurdles. b. Learn to apply tools and systems for evaluation of decision alternatives with a 360-degree approach. c. Develop solutions through critical thinking to optimize sustainable goals. 3. Develop an understanding of strategic, financial, cost and risk-enabled performance management in a dynamic business environment. a. Study the impacts of dynamic business environment on existing business strategies. b. Learn to adopt, adapt and innovate financial, cost and operating strategies to cope up with the dynamic business environment. c. Come up with strategies and tactics that create sustainable competitive advantages. 4. Learn to design the optimal approach for management of legal, institutional, regulatory and ESG frameworks, stakeholders' dynamics; monitoring, control, and reporting with application-oriented knowledge. a. Develop an understanding of the legal, institutional and regulatory and ESG frameworks within which a firm operates. b. Learn to articulate optimal responses to the changes in the above frameworks. c. Appreciate stakeholders' dynamics and expectations, and develop appropriate reporting mechanisms to address their concerns.

	5. Prepare to adopt an integrated cross functional approach for decision management and execution with cost leadership, optimized value creations and deliveries. a. Acquire knowledge of cross functional tools for decision management. b. Take an industry specific approach towards cost optimization, and control to achieve sustainable cost leadership. c. Attain exclusive knowledge of data science and engineering to analyze and create value.
Subject Learning Objectives [SLOB(s)]	1. To obtain application-oriented knowledge of certain commercial laws that define and design business transactions, guides the settlement procedure through negotiable instruments. (CMLO 4 a, b) 2. To gain detail knowledge of formation and management of partnership organisations including LLPs. (CMLO 4 a, c) 3. To gain an insight into various industrial laws that have significant bearing on an organisation's effort to ensure a fair compensation and work environment to the employees. (CMLO 4 a, b) 4. To obtain in-depth knowledge about corporate legislations governing operational and financial considerations and the role and responsibilities of directors in this context. (CMLO 4 a, c) 5. To comprehend the dynamic complementary role of ethics in business decisions taken in a regulated environment. (CMLO 2c and 4c)
Subject Learning Outcome [SLOC(s)] and Application Skill [APS]	1. To obtain application-oriented knowledge of certain commercial laws that define and design business transactions, guides the settlement procedure through negotiable instruments. (CMLO 4 a, b) 2. To gain detail knowledge of formation and management of partnership organisations including LLPs. (CMLO 4 a, c) 3. To gain an insight into various industrial laws that have significant bearing on an organisation's effort to ensure a fair compensation and work environment to the employees. (CMLO 4 a, b) 4. To obtain in-depth knowledge about corporate legislations governing operational and financial considerations and the role and responsibilities of directors in this context. (CMLO 4 a, c) 5. To comprehend the dynamic complementary role of ethics in business decisions taken in a regulated environment. (CMLO 2c and 4c)
Subject Learning Outcome [SLOC(s)] and Application Skill [APS]	**SLOCs:** 1. Students will be able to ensure adherence to legal requirements relating to business transactions including settlements. 2. They will be able to identify the requirements of compliance with the maintainable work standards and minimum compensation norms. 3. They will become competent enough to comply with corporate legislations relating to operational and financial control. 4. They will be able to guide management in identifying the ethical issues that may emerge in response to a business decision. **APS** 1. Students will develop necessary skills to independently identify requirements for compliance, assist management in conducting legally sustainable operations and prepare various compliance reports to identify lapses in adhering to various statutes.

Subject Learning Outcome (SLOC) and Application Skill (APS)	**SLOCs:** 1) Students will gain understanding about special contracts and their validity under Indian Contract Act, 1872 2) Students will be able to identify valid contracts and apply laws to fact situations for dispute settlement

Module wise Mapping of SLOB(s)

Module No.	Topics and Sub-topics	Additional Resources (Research articles, case studies, blogs)	SLOB Mapped
	Section A: Commercial Laws		
1	Introduction to Law and Legal System in India	http://www.barcouncilofindia.org/about/about-the-legal-profession/legal-education-in-the-united-kingdom/	To obtain an in-depth understanding of various commercial laws that define and design business transactions, guides the settlement procedure through negotiable instruments.
2	Indian Contracts Act, 1872	https://legislative.gov.in/sites/default/files/A1872-09.pdf	
3	Sale of Goods Act, 1930	https://legislative.gov.in/sites/default/files/A1930-3_0.pdf	
4	Negotiable Instruments Act, 1881	https://legislative.gov.in/sites/default/files/A1881-26.pdf	
5	Indian Partnership Act, 1932	https://www.mca.gov.in/Ministry/actsbills/pdf/Partnership_Act_1932.pdf	To gain detail knowledge of formation and management of partnership organisations including LLPs
6	Limited Liability Partnership Act, 2008	https://www.mca.gov.in/content/mca/global/en/acts-rules/llp-act-2008.html	
	Section B: Industrial Laws		
7	Factories Act, 1948	https://labour.gov.in/sites/default/files/Factories_Act_1948.pdf	To gain an insight into various industrial laws that have significant bearing on an organisation's effort to ensure a fair compensation and work environment to the employees.
8	Payment of Gratuity Act, 1972	https://clc.gov.in/clc/sites/default/files/PaymentofGratuityAct.pdf	
9	Employees Provident Fund and Miscellaneous Provisions Act, 1952	https://www.epfindia.gov.in/site_docs/PDFs/Downloads_PDFs/EPFScheme.pdf	
10	Employees State Insurance Act, 1948	https://labour.gov.in/sites/default/files/TheEmployeesAct1948_0.pdf	
11	The Code on Wages, 2019	https://www.indiacode.nic.in/handle/123456789/15793?view_type=browse&sam_handle=123456789/1362	

Section C: Corporate Laws			
12	Companies Act, 2013	https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks.html	To obtain in-depth knowledge about corporate legislations governing operational and financial considerations and the role and responsibilities of directors in this context.
Section D: Business Ethics			
13	Business Ethics and Emotional Intelligence	https://link.springer.com/article/10.1007/s10551-011-1158-5	To comprehend the dynamic complementary role of ethics in business decisions taken in a regulated environment.

Contents as per Syllabus

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SECTION - A

COMMERCIAL LAWS

Introduction to Law and Legal System in India

1

This Module includes -

Introduction to Law and Legal System in India

SLOB Mapped against the Module

To develop an understanding about the different legal maxims and terminologies, constitution of India and its related features.

Module Learning Objectives:

After studying this module, the students will be able to -

- To acquire knowledge of the various provisions dealing with fundamental rights, sources of law, legislative process in India and legal methods of dispute resolution.
- To develop an understanding about the different legal maxims and terminologies, constitution of India and its related features.

Introduction to The Constitution of India

1.1

The Indian Constitution is the lengthiest written Constitution which has a blend of rigidity and flexibility and has a federal system with unitary features. It mentions about the parliamentary form of Government and lays down that India shall have an independent judiciary. The constitution further provides for emergency provision structure and has many features that help in governance of our country.

Preamble:- The preamble to the constitution was adopted by constituent assembly and it reads as follows:

WE, THE PEOPLE OF INDIA, having solemnly resolved to constitute India into a SOVEREIGN SOCIALIST SECULAR DEMOCRATIC REPUBLIC and to secure to all its citizens:

JUSTICE, social, economic and political;

LIBERTY of thought, expression, belief, faith and worship;

EQUALITY of status and of opportunity; and to promote among them all

FRATERNITY assuring the dignity of the individual and the unity and integrity of the Nation;

IN OUR CONSTITUENT ASSEMBLY this twenty-sixth day of November, 1949, do HEREBY ADOPT, ENACT AND GIVE TO OURSELVES THIS CONSTITUTION.

Purpose of the Preamble:- The preamble to the constitution is a key to open the minds of the makers and shows the general purpose for which they made the several provisions in the constitution. Preamble serves the following purposes:

1. It discloses the source of the constitution.
2. It lays down the date of the commencement of the constitution.
3. It set out the rights and freedoms which the people of India wished to secure for themselves. 4. It declares the nature of the government

In the case of Kesavananda Bharti vs. State of Kerala, the Supreme Court has held that preamble is part of the constitution. Preamble is of extreme importance and the constitution should be read and interpreted in the light of grand and noble vision expressed in the preamble. However, the preamble is neither a source of power to legislature nor creates a prohibition upon the powers of legislature. It is not enforceable in courts of law.

Fundamental Rights

1.2

The aim of Fundamental Rights is that certain elementary rights such as right to life, liberty, freedom of speech and freedom of faith and so on should be regarded as inviolable under all circumstances and that the shifting majority in legislatures of the country should not have a free hand in interfering with fundamental rights. Fundamental right is called the Magna Carta of India.

In E. P. Royappa v. State of Tamil Nadu the new concept of equality in the following words – "Equality is a dynamic concept with many aspects and dimensions and it cannot be described, Cabined and confined" within traditional limits from a positivistic point of view, equality is antithesis to arbitrariness.

In fact equality and arbitrariness are sworn enemies, one belongs to the rule of law in a republic while the other, to the whim and caprice of an absolute monarch. Where an act is arbitrary, it is implicit in it that it is unequal both according to political logic and constitutional law and is therefore violated of Article14. Exceptions to the equality before law- Article 361 of the Constitution permits the following exceptions to this rule –

- The President or the Governor of a State shall not be answerable to any court.
- No criminal proceeding whatsoever shall be instituted or continued against the President or a Governor in any court during his term of office.
- No Civil Proceeding in which relief is claimed against the President or the Governor of a state shall be instituted during his term of office in any Court in respect of any act done or purporting to be done by him in his personal capacity.

Prohibition of discrimination on certain grounds

Article 15(1) provides that the state shall not discriminate against any citizen on grounds only of:-

- Religion
- Race
- Caste
- Sex
- Place of birth or
- Any of them

Article 15 (2) provides that:- No citizen shall be on above grounds, subject to any disability, liability, restriction or condition with regard to:

a) access to shops, public restaurants, hotels and places of public entertainment; or

b) the use of wells, tanks, bathing ghats, roads and places of public resort maintained wholly or partly out of State funds or dedicated to the use of the general public.

Exceptions:- Article 15 (3), (4) and (5) contain exceptions to the general principal laid down under Article 15 (1) and (2):-

Nothing in this article shall prevent the State from making any special provision for women and children.

Nothing in this article shall prevent the State from making any special provision for the advancement of any socially and educationally backward classes of citizens or for the Scheduled Castes.

Nothing in this article shall prevent the State from making any special provision, by law, for the advancement of any socially and educationally backward classes of citizens or for the Scheduled Castes or the Scheduled Tribes in so far as such special provisions relate to their admission to educational institutions including private educational institutions, whether aided or unaided by the State, other than the minority educational institution.

Article-16: Equality of opportunity in matters of public employment :-

- There shall be equality of opportunity for all citizens in matters relating to employment or appointment to any office under the State.
- No citizen shall, on grounds only of: religion, race, caste, sex, descent, place of birth, residence, or any of them, be ineligible for, or discriminated against in respect of, any employment or office under the State. Exceptions:-
- Nothing in this article shall prevent Parliament from making any law prescribing, in regard to a class or classes of employment or appointment to an office under the Government of, or any local or other authority within, a State or Union territory, any requirement as to residence within that State or Union territory prior to such employment or appointment.
- Nothing in this article shall prevent the State from making any provision for the reservation of appointments or posts in favour of any backward class of citizens which, in the opinion of the State, is not adequately represented in the services under the State.
- Nothing in this article shall prevent the State from making any provision for reservation in matters of promotion, with consequential seniority, to any class or classes of posts in the services under the State in favour of the Scheduled Castes and the Scheduled Tribes which, in the opinion of the State, are not adequately represented in the services under the State.
- Nothing in this article shall affect the operation of any law which provides that the incumbent of an office in connection with the affairs of any religious or denominational institution or any member of the governing body thereof shall be a person professing a particular religion or belonging to a particular denomination.

Abolition of Untouchability "Untouchability" is abolished and its practice in any form is forbidden. The enforcement of any disability arising out of "Untouchability" shall be an offence punishable in accordance with law. The term "Untouchability" is not defined under the Constitution. However, it refers to the social disabilities imposed on certain class of person by reason of their birth in certain caste. However, it does not cover social boycott of a few individuals.

Abolition of Titles:

- No title, not being a military or academic distinction, shall be conferred by the State.
- No citizen of India shall accept any title from any foreign State.

- No person who is not a citizen of India shall, while he holds any office of profit or trust under the State, accept without the consent of the President any title from any foreign State.
- No person holding any office of profit or trust under the State shall, without the consent of the President, accept any present, emolument, or office of any kind from or under any foreign State.

Right to Freedom Article 19 (1) defines six freedoms:-

a) Freedom of speech and expression

b) Freedom of Assembly

c) Freedom to from Association

d) Freedom of Movement

e) Freedom to reside and to settle

f) Freedom of Profession, occupation, trade or business.

These six freedom are however not absolute, and subject to reasonable restrictions which are as follows:-

i. Security of the State

ii. Friendly relations with foreign states

iii. Public order

iv. Decency and Morality

v. Contempt of Court

vi. Defamation

vii. Incitement to an offence

viii. Sovereignty and Integrity of India

Meaning: 19 (1) (a)

- In Prabhu Dutt vs. Union of India: Supreme Court held that right to know news and information about the functioning of the Govt., is included in the freedom of Press.
- In Union of India vs. Association for Democratic Reforms: Supreme Court held that people have right to know about the candidate before voting. Thus, the law preventing the Election Commission from asking for a candidate's wealth, Assets, liabilities education and other such information is invalid.
- In Tata Press Ltd. vs. M.T.N.L. the Supreme Court held that commercial speech (Advertisement) is a part of freedom of speech and expression as per Article 19(1) (a).
- In Union of India vs. Naveen Jindal, the Court held that "Flying National Flag" is fundamental Right under Article 19(1) (a)
- Freedom of Silence – Right not to speak
- In Bijoy Emmanuel vs. State of Kerala: Freedom not to sing the national anthem, but not to disrespect it. Students belonging to the Apostle's creed Christians did not sing the national anthem as their religion prohibits glorification of anything else other than their God.

Article 20 lays down Protection in respect of conviction for offences:

Ex-post facto law:

No person shall be convicted of any offence except for violation of a law in force at the time of the commission of the Act charged as an offence, nor be subjected to a penalty greater 8 than that which might have been inflicted under the law in force at the time of the commission of the offence.

Double jeopardy:

No person shall be prosecuted and punished for the same offence more than once. The protection under this clause is available only in proceedings before a court of law or a judicial tribunal. In other words, it is not available in proceedings before departmental or administrative authorities.

Self -Incrimination:

No person accused of any offence shall be compelled to be a witness against himself.

It extends to both oral and documentary evidence.

Therefore, where a person is accused of an offence, if compelled to be a witness, then such compulsion should not result in his giving evidence against himself.

Article 21 lays down Right to Life & Personal Liberty "No person shall be deprived of his life or personal liberty except according to Procedure established by law."

In Maneka Gandhi v. Union of India. The Court has given the widest possible interpretation of personal liberty.

Right to life includes within its ambit the right to live with human dignity. The Supreme Court held that the right to life defines not only physical existence but the "quality of life." This right is an inclusive right including the following:

- Right to Travel abroad. (Satwant Singh v. Assistant Passport officer)
- Right to livelihood. (D.K.Yadav v. J.M.A Industries)
- Right to Shelter. (Chameli Singh v. State of U.P.)
- Right to Privacy. (R.Raja Gopal v. State of T.N.)
- In PUCL Vs. Union of India, the S.C. held that telephone tapping is a serious invasion of an individual's right to Privacy which is part of the right to life and personal liberty.
- Right to Health & Medical Assistance.
- Protection of Ecology and Environmental Pollution
- Right to education under Art. 21A
- Prisoner's Right: The Court held that if the Prisoner died due to beating by Police Officer, his family is entitled to compensation.
- Right to free Legal Aid
- Right to speedy Trial
- Right Against Handcuffing
- Right against Delayed Execution

- Right to food
- Right to Marriage. (Lata Singh v. State of U.P.)
- Right to Reputation
- Right to Education-21A Article 21A declares that state shall provide free and compulsory education to all children of the age of six to fourteen years in such a manner as the state may decide. Thus, this provision makes only elementary education a fundamental right and not higher or professional education.

Right against exploitation: Prohibition of traffic in human beings and forced labour:- Article 23 prohibits traffic in human beings and other similar forms of forced labour. This right is available to both citizens and non-citizens. It protects the individual not only against state but also against the private person. However, state may impose compulsory service for public purposes, which are: military service or social service.

Prohibition of employment of children in factories etc.:- Article 24 prohibits the employment of children below the age of 14 years in any factory, mine or other hazardous activities. But it does not prohibit their employment in any harmless innocent work.

Article 25 says that all persons are equally entitled to freedom of conscience and the right to freely profess, practice and propagate religion. The implications of these are as follows:

- Freedom of conscience
- Right to profess
- Right to propagate
- Right to practice

Article 25 covers not only religious belief but also religious practices. This right is available to all person citizen as well as noncitizen.

As per **Article 26,** every religious denomination or any of its section shall have the following right:-

- to establish and maintain institutions for religious and charitable purposes;
- to manage its own affairs in matters of religion.
- to own and acquire movable and immovable property; and
- to administer such property in accordance with law.

Article 27 lays down that no person shall be compelled to pay any taxes for the promotion or maintenance of any particular religion or religious denomination. In other words, the state should not spend the public money collected by way of tax for the promotion or maintenance of any particular religion. This provision prohibits only levy of tax and not a fees.

Article 28 provides that no religious instruction shall be provided in any educational institution wholly maintained out of state funds. However, this provision shall not apply to an educational institution administered by the state but established under any endowment or trust requiring imparting of religious institution in such institution.

Article 29 says any section of the citizens residing in the territory of India or any part thereof having a distinct language, script or culture of its own shall have the right to conserve the same. No citizen shall be denied admission into any educational institution maintained by the State or receiving aid out of State funds on grounds

only of religion, race, caste, language or any of them.

Article 30 mentions about the Right of minorities to establish and administer educational institutions:

1. All minorities, whether based on religion or language, shall have the right to establish and administer educational institutions of their choice

1A. In making any law providing for the compulsory acquisition of any property of an educational institution established and administered by a minority, referred to in clause (1), the State shall ensure that the amount fixed by or determined under such law for the acquisition of such property is such as would not restrict or abrogate the right guaranteed under that clause.

2. The state shall not, in granting aid to educational institutions, discriminate against any educational institution on the ground that it is under the management of a minority, whether based on religion or language

Article 32 mentions about the Right to Constitutional Remedies:

1. The right to move the Supreme Court by appropriate proceedings for the enforcement of the rights conferred by this Part is guaranteed
2. The Supreme Court shall have power to issue directions or orders or writs, including writs in the nature of habeas corpus, mandamus, prohibition, quo warranto and certiorari, whichever may be appropriate, for the enforcement of any of the rights conferred by this Part
3. Without prejudice to the powers conferred on the Supreme Court by clauses (1) and (2), Parliament may by law empower any other court to exercise within the local limits of its jurisdiction all or any of the powers exercisable by the Supreme Court under clause (2)
4. The right guaranteed by this article shall not be suspended except as otherwise provided for by this Constitution.

Sources of Law

1.3

In some of the legal systems, court decisions are binding as law. On the basis of the above discussion, three major sources of law can be identified in any modern society are as follows:

- Custom
- Judicial precedent
- Legislation

Customs

A custom, to be valid, must be observed continuously for a very long time without any interruption. Further, a practice must be supported not only for a very long time, but it must also be supported by the opinion of the general public and morality. However, every custom need not become law.

For example, the Hindu Marriage Act, 1955 prohibits marriages which are within the prohibited degrees of relationship. However, the Act still permits marriages within the prohibited degree of relationship if there is a proven custom within a certain community. Custom can simply be explained as those long established practices or unwritten rules which have acquired binding or obligatory character. In ancient societies, custom was considered as one of the most important sources of law; In fact it was considered as the real source of law. With the passage of time and the advent of modern civilization, the importance of custom as a source of law diminished and other sources such as judicial precedents and legislation gained importance.

Legal custom may be further classified into the following two types:

Kinds of Customs:

- **General Customs:** These types of customs prevail throughout the territory of the State.
- **Local Customs:** Local customs are applicable to a part of the State, or a particular region of the country.
- **Conventional Customs:** Conventional customs are binding on the parties to an agreement. When two or more persons enter into an agreement related to a trade, it is presumed in law that they make the contract in accordance with established convention or usage of that trade. All customs cannot be accepted as sources of law, nor can all customs be recognized and enforced by the courts. The jurists and courts have laid down some essential tests for customs to be recognized as valid sources of law.

These tests are summarized as follows:

- **Antiquity:** In order to be legally valid customs should have been in existence for a long time, even beyond human memory. However, in India there is no such time limit for deciding the antiquity of the customs. The only condition is that those should have been in practice since time immemorial.
- **Continuous:** A custom to be valid should have been in continuous practice. It must have been enjoyed without any kind of interruption. Long intervals and disrupted practice of a custom raise doubts about

the validity of the same. Exercised as a matter of right: Custom must be enjoyed openly and with the knowledge of the community. It should not have been practiced secretly. A custom must be proved to be a matter of right. A mere doubtful exercise of a right is not sufficient to a claim as a valid custom.

- **Reasonableness:** A custom must conform to the norms of justice and public utility. A custom, to be valid, should be based on rationality and reason. If a custom is likely to cause more inconvenience and mischief than convenience, such a custom will not be valid.
- **Morality:** A custom which is immoral or opposed to public policy cannot be a valid custom. Courts have declared many customs as invalid as they were practiced for immoral purpose.

Bombay High Court in the case of Mathura Naikon vs. Esu Naekin, (1880) ILR 4 Bom 545) held that, the custom of adopting a girl for immoral purposes is illegal. It is imperative that a custom must not be opposed or contrary to legislation. Many customs have been abrogated by laws enacted by the legislative bodies in India.

For instance, the customary practice of child marriage has been declared as an offence. Similarly, adoption laws have been changed by legislation in India. Custom was the most important source of law in ancient India. Even the British initially adopted the policy of non-intervention in personal matters of Hindus and Muslims.

At the same time, it is important to note that customs were not uniform or universal throughout the country. Some regions of the country had their own customs and usages. After independence, the importance of custom has definitely diminished as a source of law and judicial precedent, and legislation has gained a more significant place. A large part of Indian law, especially personal laws, however, are still governed by the customs.

Judicial Precedent as a Source of Law:

In simple words, judicial precedent refers to previously decided judgments of the superior courts, such as the High Courts and the Supreme Court, which judges are bound to follow. This binding character of the previously decided cases is important, considering the hierarchy of the courts established by the legal systems of a particular country. In the case of India, this hierarchy has been established by the Constitution of India.

Judicial precedent is an important source of law, but it is neither as modern as legislation nor is it as old as custom. It is an important feature of the English legal system as well as of other common law countries which follow the English legal system. In most of the developed legal systems, judiciary is considered to be an important organ of the State. In modern societies, rights are generally conferred on the citizens by legislation and the main function of the judiciary is to adjudicate upon these rights. The judges decide those matters on the basis of the legislation and prevailing custom but while doing so, they also play a creative role by interpreting the law. By this exercise, they lay down new principles and rules which are generally binding on lower courts within a legal system.

1. **Supreme Court (SC):** became the supreme judicial authority and a streamlined system of courts was established. Supreme Court: Binding on all courts in India, not bound by its own decisions, or decisions of Privy Council or Federal Court - AIR 1991 SC 2176
2. **High Courts:** Binding on all courts within its own jurisdiction Only persuasive value for courts outside its own jurisdiction. In case of conflict with decision of same court and bench of equal strength, referred to a higher bench. Decisions of Privy Council and federal court are binding as long as they do not conflict with decisions of SC.
3. **Lower Courts:** Bound to follow decisions of higher courts in its own state, in preference to High Courts of other states.

Judicial decisions can be divided into following two parts:

1. **Ratio decidendi:** 'Ratio decidendi' refers to the binding part of a judgment. 'Ratio decidendi' literally

means reasons for the decision. It is considered as the general principle which is deduced by the courts from the facts of a particular case. It becomes generally binding on the lower courts in future cases involving similar questions of law.

2. **Obiter dicta:** An 'obiter dictum' refers to parts of judicial decisions which are general observations of the judge and do not have any binding authority. However, obiter of a higher judiciary is given due consideration by lower courts and has persuasive value. Having considered the various aspects of the precedent i.e. ratio and obiter, it is clear that the system of precedent is based on the hierarchy of courts.

Legislation as a Source of Law:

In modern times, legislation is considered as the most important source of law. The term 'legislation' is derived from the Latin word legis which means 'law' and latum which means "to make" or "set". Therefore, the word 'legislation' means the 'making of law'. The importance of legislation as a source of law can be measured from the fact that it is backed by the authority of the sovereign, and it is directly enacted and recognised by the State. The expression 'legislation' has been used in various senses. It includes every method of law-making. In the strict sense it means laws enacted by the sovereign or any other person or institution authorised by him. The chart below explains the types of legislation: The kinds of legislation can be explained as follows:

i) **Primary Legislation:** When the laws are directly enacted by the sovereign, it is considered as supreme legislation. One of the features of Supreme legislation is that, no other authority except the sovereign itself can control or check it. The laws enacted by the British Parliament fall in this category, as the British Parliament is considered as sovereign. The law enacted by the Indian Parliament also falls in the same category. However in India, powers of the Parliament are regulated and controlled by the Constitution, through the laws enacted by it are not under the control of any other legislative body.

ii) **Subordinate Legislation:** Subordinate legislation is a legislation which is made by any authority which is subordinate to the supreme or sovereign authority. It is enacted under the delegated authority of the sovereign. The origin, validity, existence and continuance of such legislation totally depends on the will of the sovereign authority. Subordinate legislation further can be classified into the following types:-

   a) **Local laws:** In some countries, local bodies are recognized and conferred with the law-making powers. They are entitled to make bye-laws in their respective jurisdictions. In India, local bodies like Panchayats and Municipal Corporations have been recognized by the Constitution through the 73rd and 74th Constitutional amendments. The rules and bye-laws enacted by them are examples of local laws.

   b) **Laws made by the Executive:** Laws are supposed to be enacted by the sovereign and the sovereignty may be vested in one authority or it may be distributed among the various organs of the State. In most of the modern States, sovereignty is generally divided among the three organs of the State.

The three organs of the State namely legislature, executive and judiciary are vested with three different functions. The prime responsibility of law-making vests with the legislature, while the executive is vested with the responsibility to implement the laws enacted by the legislature. However, the legislature delegates some of its law-making powers to executive organs which are also termed delegated legislation. Delegated legislation is also a class of subordinate legislation. In welfare and modern states, the amount of legislation has increased manifold and it is not possible for legislative bodies to go through all the details of law. Therefore, it deals with only a fundamental part of the legislation and wide discretion has been given to the executive to fill the gaps. This increasing tendency of delegated legislation has been criticized. However, delegated legislation is resorted to, on account of reasons like paucity of time, technicalities of law and emergencies. Therefore, delegated legislation is sometimes considered as a necessary evil.

Primary and Subordinate Legislations

1.4

Primary legislation is an act that has been passed by the Parliament. Whereas, subordinate legislation is the legislation made by an authority subordinate to the legislature. Subordinate legislation is that which is made under the authority other than the sovereign power and is, therefore, dependent for its continued existence and validity on some superior or supreme authority. Most of the enactments provide for the powers for making rules, regulations, bye-laws or other statutory instruments which are exercised by the specified subordinate authorities. Such legislation is to be made within the framework of the powers so delegated by the legislature and is, therefore, known as delegated or subordinate legislation.

The need and importance of subordinate legislation have been underlined by the Supreme Court in the Gwalior Rayon Mills Mfg. (Wing.) Co. Ltd. vs. Asstt. Commissioner of Sales Tax and Others (All India Reporter 1974 SC 1660 (1667) as:

Most of the modern socio-economic legislations passed by the legislature lay down the guiding principles and the legislative policy. The legislatures because of limitation imposed upon by the time factor hardly go into matters of detail. Provision is, therefore, made for delegated legislation to obtain flexibility, elasticity, expedition and opportunity for experimentation. The practice of empowering the executive to make subordinate legislation within a prescribed sphere has evolved out of practical necessity and pragmatic needs of a modern welfare State.

The legislature lays down the policy and purpose of the legislation and leaves it to the executive, experts and technocrats to provide for working details within the framework of the enactment by way of rules, regulations, bye-laws or other statutory instruments. That is why, delegated legislation is increasingly assuming an important role in the process of law-making, comprising an important component of legislation. Powers have also been conferred under various provisions of the Constitution of India on the different functionaries to frame rules, regulations or schemes dealing with various aspects.

Delegated legislation under such delegated powers is ancillary and cannot, by its very nature, replace or modify the parent law. Indian democracy is said to rest on the acclaimed four pillars and these are the legislature, the executive, the judiciary, and the press. These pillars are empowered by the constitution not to interfere in the matters of others. As per the Constitution, the legislative has legislative powers and the Executive has the power to execute the laws. Similarly, the Judiciary has the power to resolve dispute. There are multifarious functions that have to be performed by the Legislature in welfare states and therefore there is a need to delegate rule-making power to other authorities. They have limited themselves to policy matters and have left a large volume of area to the Executive to make rules to carry out the purposes of the Legislature. In such types of situations, the system of delegated legislation comes to our mind. Therefore, the need for delegation is necessary and is sought to be justified on the ground of flexibility, adaptability and speed.

Legislatives Processes in India

1.5

Every country is governed by a set of rules and laws. The importance of laws and ancillary rules is to maintain a semblance of order in the society so as to regulate the behaviour of various entities within it. Every decision relating to citizenship to voting age, to how a country will be run in various aspects is all done through various laws, be it central or state laws. Law serves many purposes, such as, maintaining order, resolving disputes, ensuring safety and guaranteeing enforcement of rights of citizens. Laws are binding on all people residing in a country in addition to the organizations and Government alike. The primary source of law is our constitution and every law either central act or state act or any other local act is made according to this important source of law. No law in the country can be inconsistent with the Constitution of India. The constitution lays down the framework for procedures, powers, and duties of government institutions and sets out fundamental rights and duties of citizens along with directive principles of state policy. The constitution mentions that India is a secular, sovereign, socialist and democratic republic and ensures its citizens justice, liberty, equality among other things. The Constitution can never be overridden by any institution in India.

The Government of India has many ministries that cater to various sectors that are in charge of putting forth proposals involving major policies that is of national importance. These major policy proposals are usually in line with the goals of the Government that gets elected to power. Therefore, before a bill is produced at the Parliament, detailed study and survey is undertaken by the relevant ministry and its ancillary departments. The study relates to social and financial cost, benefit and the key challenges that are required to be settled before and after the legislation comes into force.

There are different stages that a law goes through before it gets passed and acquires binding effect.

In pre-drafting stages, first comes the formulation of legislative proposal. The concerned ministry makes the legislative proposal only after consulting with interested and effective stakeholders from financial and administrative point of view. Concerned ministry also mentions the necessity of the legislation in the proposal and all other incidental matters. The pre-legislative consultation policy was adopted pursuant to the decision by a committee headed by the Cabinet Secretary on 10th January 2014. In this the concerned Ministry/department will have to publish the proposed legislation with explanatory note either on the internet or through other means. Such details will then be kept in the public domain for at least 30 days. If a piece of legislation affects a particular group of people, it has to be published in a manner so it reaches the concerned affected people. The feedback from the stakeholders shall then be taken into consideration while drafting the bill.

The concerned ministry then refers the matter to Ministry of Law and Justice for advice as to its practicability from legal and constitutional point of view. The Ministry of Law and Justice at this point only advice about the necessity and desirability of such legislation in the light of existing law and also constitutional validity of the proposal without going into the merits.

After the aforementioned consultation, the concerned ministry sends all relevant documents to Ministry of

Law & Justice with office memorandum.

The Ministry of Law & Justice (Legislative Department) then prepares the draft bill on receipt of the proposal after getting clearance from the department of the legal affairs.

Once the draft is prepared by the Ministry of Law & Justice and is accepted after scrutiny done by the concerned ministry, a note to the cabinet secretary is sent for placing the draft bill before the cabinet for its consideration and subsequent approval.

After the approval of the draft, the concerned ministry examines the decision of the cabinet for any necessary changes suggested which would then be sent to the Ministry of Law and Justice with the comment of the cabinet for making the said changes. After the approval of the draft, if no suggestion is given by the cabinet then the concerned ministry makes the statement of object and reason relating to the bill, to be signed by the Ministry of Law and Justice.

To enable the ministry of parliamentary affair to draw up the legislative programme of the session, complete details of the bill proposed to be introduced during a session will be sent at least one month before the commencement of the session.

Under Articles 109 read with 110 (1) & 117 (1) of the Indian Constitution, a money bill is to be introduced first in the House of People. In case of other type of bill, the house in which they have to be introduced will be decided by in consultation with ministry of parliamentary affairs.

Article 107: Provisions as to introduction and passing of Bills-

1. Subject to the provisions of articles 109 and 117 with respect to Money Bills and other financial Bills, a Bill may originate in either House of Parliament.
2. Subject to the provisions of articles 108 and 109, a Bill shall not be deemed to have been passed by the Houses of Parliament unless it has been agreed to by both Houses, either without amendment or with such amendments only as are agreed to by both Houses.
3. A Bill pending in Parliament shall not lapse by reason of the prorogation of the Houses.
4. A Bill pending in the Council of States which has not been passed by the House of the People shall not lapse on a dissolution of the House of the People.
5. A Bill which is pending in the House of the People, or which having been passed by the House of the People is pending in the Council of States, shall, subject to the provisions of article 108, lapse on a dissolution of the House of the People.

Article 108: Joint sitting of both Houses in certain cases-

1. If after a Bill has been passed by one House and transmitted to the other House-
   a) the Bill is rejected by the other House; or
   b) the Houses have finally disagreed as to the amendments to be made in the Bill; or
   c) more than six months elapse from the date of the reception of the Bill by the other House without the Bill being passed by it, the President may, unless the Bill has elapsed by reason of a dissolution of the House of the People, notify to the Houses by message if they are sitting or by public notification if they are not sitting, his intention to summon them to meet in a joint sitting for the purpose of deliberating and voting on the Bill:

Provided that nothing in this clause shall apply to a Money Bill.

2. In reckoning any such period of six months as is referred to in clause (1), no account shall be taken of any period during which the House referred to in sub-clause (c) of that clause is prorogued or adjourned for more than four consecutive days.
3. Where the President has under clause (1) notified his intention of summoning the Houses to meet in a joint sitting, neither House shall proceed further with the Bill, but the President may at any time after the date of his notification summon the Houses to meet in a joint sitting for the purpose specified in the notification and, if he does so, the Houses shall meet accordingly.
4. If at the joint sitting of the two Houses the Bill, with such amendments, if any, as are agreed to in joint sitting, is passed by a majority of the total number of members of both Houses present and voting, it shall be deemed for the purposes of this Constitution to have been passed by both Houses:

   Provided that at a joint sitting-

   a) if the Bill, having been passed by one House, has not been passed by the other House with amendments and returned to the House in which it originated, no amendment shall be proposed to the Bill other than such amendments (if any) as are made necessary by the delay in the passage of the Bill;

   b) if the Bill has been so passed and returned, only such amendments as aforesaid shall be proposed to the Bill and such other amendments as are relevant to the matters with respect to which the Houses have not agreed;

   and the decision of the person presiding as to the amendments which are admissible under this clause shall be final.

5. A joint sitting may be held under this article and a Bill passed thereat, notwithstanding that a dissolution of the House of the People has intervened since the President notified his intention to summon the Houses to meet therein.

Article 109: Special procedure in respect of Money Bills-

1. A Money Bill shall not be introduced in the Council of States.
2. After a Money Bill has been passed by the House of the People it shall be transmitted to the Council of States for its recommendations and the Council of States shall within a period of fourteen days from the date of its receipt of the Bill return the Bill to the House of the People with its recommendations and the House of the People may thereupon either accept or reject all or any of the recommendations of the Council of States.
3. If the House of the People accepts any of the recommendations of the Council of States, the Money Bill shall be deemed to have been passed by both Houses with the amendments recommended by the Council of States and accepted by the House of the People.
4. If the House of the People does not accept any of the recommendations of the Council of States, the Money Bill shall be deemed to have been passed by both Houses in the form in which it was passed by the House of the People without any of the amendments recommended by the Council of States.
5. If a Money Bill passed by the House of the People and transmitted to the Council of States for its recommendations is not returned to the House of the People within the said period of fourteen days, it shall be deemed to have been passed by both Houses at the expiration of the said period in the form in which it was passed by the House of the People.

Article 111: Assent to Bills-

When a Bill has been passed by the Houses of Parliament, it shall be presented to the President, and the President shall declare either that he assents to the Bill, or that he withholds assent therefrom:

Provided that the President may, as soon as possible after the presentation to him of a Bill for assent, return the Bill if it is not a Money Bill to the Houses with a message requesting that they will reconsider the Bill or any specified provisions thereof and, in particular, will consider the desirability of introducing any such amendments as he may recommend in his message, and when a Bill is so returned, the Houses shall reconsider the Bill accordingly, and if the Bill is passed again by the Houses with or without amendment and presented to the President for assent, the President shall not withhold assent therefrom.

After the assent of the President, the Ministry of Law & Justice publishes the Act in Gazette of India Extraordinary, forwards the copies to the all-state government for publication in their official gazette, get copies of the act in printed form for sale to the General Public.

Legal Methods including Judicial Alternative Dispute Resolution (ADR) Process in India

1.6

There are many ways in which disputes can be resolved and grievances redressed. Whenever there is a lawful agreement between parties that bind both of them with certain duties and obligations, in cases they get breached, a dispute resolution body, either a court or a tribunal can be approached. However, the law has also provided for resolving disputes through mechanisms that do not involve courts or litigations. These methods may include arbitration, mediation, conciliation, negotiation and others. In older times nations used to resolve disputes through warfare, but as nations got more civilized and various conventions and treaties came into effect, different means of resolution of disputes came into emergence. These aforementioned procedures of dispute resolution can be categorized into two broad heads, such as, adjudicative processes and consensual processes. In adjudicative processes, a judge or an arbitrator decides the case and determines the rights and obligations of the parties. Whereas in consensual processes, parties themselves attempt to reach an agreement with or without the help of a third party mediator. Provisions of dispute resolution clauses are imperative in trade and commerce, especially in treaties and contracts. Without these provisions protecting one's rights in property or contract becomes difficult.

The most common form of judicial dispute resolution is litigation. Litigation is initiated when one party files suit against another. The proceedings are very formal and are governed by rules, such as rules of evidence and procedure, which are established by the legislature. Outcomes are decided by impartial judges, based on the factual questions of the case and the applicable law. The verdict of the court is binding; however, both parties have the right to appeal the judgment to a higher court. Judicial dispute resolution is typically adversarial in nature, for example, involving opposing parties or opposing interests seeking an outcome most favourable to their position. Many parties opt for other means of dispute resolution which are more private and quicker, even though it may entail spending more money than what could have been required in cases of litigation.

Methods of dispute resolution that do not involve litigation through courts generally are classified under alternative dispute resolution (ADR) methods. ADR generally depends on agreement by the parties to use ADR processes, either before or after a dispute has arisen. ADR has experienced steadily increasing acceptance and utilization because of a perception of greater flexibility and speedy resolution of disputes, among other perceived advantages.

Alternative Dispute Resolution is a term used to describe several different modes of resolving legal disputes other than filing law suits and get timely justice. The Courts are backlogged with dockets resulting in delay of a year or more for the parties to have their cases heard and decided. To solve this problem of delayed justice ADR Mechanism has been developed in response thereof. Its methods can help the parties to resolve their disputes at their own terms expeditiously.

Alternative dispute redressal techniques can be employed in several categories of disputes, especially civil, commercial, industrial and family disputes. The term "Alternative Disputes Resolution" takes in its fold, various

modes of settlement including, Lok Adalats, arbitration conciliation and Mediation

It was suggested by the Law Commission of India that the Court may require attendance of any party to the suit or proceedings to appear in person with a view to arriving at an amicable settlement of dispute between the parties and make attempts to settle the dispute between the parties amicably.

Section 89 of the Civil Procedure Code lays down:

1. **Settlement of disputes outside the court:** Where it appears to the Court that there exist elements of a settlement which may be acceptable to the parties, the Court shall formulate the terms of settlement and give them to the parties for their observations and after receiving the observations of the parties, the Court may reformulate the terms of a possible settlement and refer the same for:

   a) arbitration;

   b) conciliation;

   c) judicial settlement including settlement through Lok Adalat; or

   d) mediation

2. **Where a dispute has been referred:**

   a) for arbitration or conciliation, the provisions of the Arbitration and Conciliation Act, 1996 (26 of 1996) shall apply as if the proceedings for arbitration or conciliation were referred for settlement under the provisions of that Act;

   b) to Lok Adalat, the Court shall refer the same to the Lok Adalat in accordance with the provisions of sub-section (1) of section 20 of the Legal Services Authority Act, 1987 (39 of 1987) and all other provisions of that Act shall apply in respect of the dispute so referred to the Lok Adalat;

   c) for judicial settlement, the Court shall refer the same to a suitable institution or person and such institution or person shall be deemed to be a Lok Adalat and all the provisions of the Legal Services Authority Act, 1987 (39 of 1987) shall apply as if the dispute were referred to a Lok Adalat under the provisions of that Act;

   d) for mediation, the Court shall effect a compromise between the parties and shall follow such procedure as may be prescribed."

The Code of Civil Procedure (Amendment) Act, 1999 by which Section 89 was amended into the Code also amended a new Section 16 in the Court Fees Act, 1870 which states the following:

Refund of fee: Where the court refers the parties to the suit to any one of the modes of settlement of dispute referred to in Section 89 of the Code of Civil Procedure, 1908 the plaintiff shall be entitled to a certificate from the court authorizing him to receive back from the Collector, the full amount of the fee paid in respect of such plaint.

Arbitration

Arbitration, a form of alternative dispute resolution (ADR), is a technique for the resolution of disputes outside the courts, where the parties to a dispute refer it to one or more arbitrators, by whose decision they agree to be bound. It is a resolution technique in which a third party reviews the evidence in the case and imposes a decision that is legally binding for both sides and enforceable. There are limited rights of review and appeal of arbitration awards. Arbitration is not the same as judicial proceedings or any other kind of alternate dispute resolution method. Arbitration can be either voluntary or mandatory. It can be referred to by the courts also.

The advantages of arbitration can be summarized as follows:

a) It is often faster than litigation in Court

b) Arbitral proceedings and an arbitral award are generally non-public, and can be made confidential

c) If the subject matter of the dispute is highly technical, arbitrators with an appropriate degree of expertise can be appointed as one cannot choose judge in litigation.

The Arbitration and Conciliation Act, 1996 lays down provisions relating to arbitration and conciliation procedures. Without an arbitration agreement, usually recourse to arbitration does not happen.

Section 7 Arbitration agreement:

1. In this Part, "arbitration agreement" means an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.
2. An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.
3. An arbitration agreement shall be in writing.
4. An arbitration agreement is in writing if it is contained in:
   a) a document signed by the parties;
   b) an exchange of letters, telex, telegrams or other means of telecommunication [including communication through electronic means] which provide a record of the agreement; or
   c) an exchange of statements of claim and defence in which the existence of the agreement is alleged by one party and not denied by the other.
5. The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement if the contract is in writing and the reference is such as to make that arbitration clause part of the contract.

Section 8 Power to refer parties to arbitration where there is an arbitration agreement:

1. A judicial authority, before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party to the arbitration agreement or any person claiming through or under him, so applies not later than the date of submitting his first statement on the substance of the dispute, then, notwithstanding any judgment, decree or order of the Supreme Court or any Court, refer the parties to arbitration unless it finds that prima facie no valid arbitration agreement exists.
2. The application referred to in sub-section (1) shall not be entertained unless it is accompanied by the original arbitration agreement or a duly certified copy thereof:

   Provided that where the original arbitration agreement or a certified copy thereof is not available with the party applying for reference to arbitration under sub-section (1), and the said agreement or certified copy is retained by the other party to that agreement, then, the party so applying shall file such application along with a copy of the arbitration agreement and a petition praying the Court to call upon the other party to produce the original arbitration agreement or its duly certified copy before that Court.
3. Notwithstanding that an application has been made under sub-section (1) and that the issue is pending before the judicial authority, an arbitration may be commenced or continued and an arbitral award made.

The method of appointing arbitrators is also mentioned within the Act.

Section 10 Number of arbitrators:

1. The parties are free to determine the number of arbitrators, provided that such number shall not be an even number.
2. Failing the determination referred to in sub-section (1), the arbitral tribunal shall consist of a sole arbitrator.

Section 11 Appointment of arbitrators:

1. A person of any nationality may be an arbitrator, unless otherwise agreed by the parties.
2. Subject to sub-section (6), the parties are free to agree on a procedure for appointing the arbitrator or arbitrators.
3. Failing any agreement referred to in sub-section (2), in an arbitration with three arbitrators, each party shall appoint one arbitrator, and the two appointed arbitrators shall appoint the third arbitrator who shall act as the presiding arbitrator.
4. If the appointment procedure in sub-section (3) applies and:
   a) a party fails to appoint an arbitrator within thirty days from the receipt of a request to do so from the other party; or
   b) the two appointed arbitrators fail to agree on the third arbitrator within thirty days from the date of their appointment, the appointment shall be made, upon request of a party, by the Supreme Court or, as the case may be, the High Court or any person or institution designated by such Court;
5. Failing any agreement referred to in sub-section (2), in an arbitration with a sole arbitrator, if the parties fail to agree on the arbitrator within thirty days from receipt of a request by one party from the other party to so agree the appointment shall be made, upon request of a party, by the Supreme Court or, as the case may be, the High Court or any person or institution designated by such Court.
6. Where, under an appointment procedure agreed upon by the parties,:
   a) a party fails to act as required under that procedure; or
   b) the parties, or the two appointed arbitrators, fail to reach an agreement expected of them under that procedure; or
   c) a person, including an institution, fails to perform any function entrusted to him or it under that procedure, a party may request [the Supreme Court or, as the case may be, the High Court or any person or institution designated by such Court] to take the necessary measure, unless the agreement on the appointment procedure provides other means for securing the appointment.

(6A) The Supreme Court or, as the case may be, the High Court, while considering any application under sub-section (4) or sub-section (5) or sub-section (6), shall, notwithstanding any judgment, decree or order of any Court, confine to the examination of the existence of an arbitration agreement.

(6B) The designation of any person or institution by the Supreme Court or, as the case may be, the High Court, for the purposes of this section shall not be regarded as a delegation of judicial power by the Supreme Court or the High Court.

7. A decision on a matter entrusted by sub-section (4) or sub-section (5) or sub-section (6) to the Supreme Court or, as the case may be, the High Court or the person or institution designated by such Court is final

and no appeal including Letters Patent Appeal shall lie against such decision.

Conciliation

Conciliation is an alternative dispute resolution process whereby the parties to a dispute use a conciliator, who meets with the parties separately in order to resolve their differences. They do this by interpreting issues, providing technical assistance, exploring potential solutions and bringing about a negotiated settlement. Conciliation is voluntary where the parties involved agree and choose to resolve their differences by conciliation. The process is flexible, allowing parties to define the time, structure and content of the conciliation proceedings. These proceedings are not public. The conciliator when proposing a settlement, takes into account the legal, commercial and financial positions of the parties. The conciliator is usually a trained and qualified neutral person who facilitates negotiations between disputing parties. Conciliation involves discussions among the parties and the conciliator with an aim to explore sustainable and equitable resolutions by targeting the existent issues involved in the dispute and creating options for a settlement that are acceptable to all parties. The process is risk free and not binding on the parties till they arrive at and sign the agreement. According to procedure, usually one conciliator is appointed to resolve the dispute between the parties. The parties can appoint the sole conciliator by mutual consent. There is no bar to the appointment of two or more conciliators. In conciliation proceedings with three conciliators, each party appoints one conciliator. The third conciliator is appointed by the parties by mutual consent. Unlike arbitration where the third arbitrator is called the Presiding Arbitrator, the third conciliator is not so. The conciliator is supposed to be impartial and conduct the conciliation proceedings in an impartial manner. He is guided by the principles of objectivity, fairness and justice, and by the usage of the trade concerned and the circumstances surrounding the dispute, including any previous business practices between the parties. The conciliator is not bound by the rules of procedure and evidence. The conciliator does not give any award or order. If no consensus could be arrived at between the parties and the conciliation proceedings fail, the parties can then resort to arbitration.

Mediation:

Dispute settlement through mediation is a voluntary and relatively informal process of dispute resolution. It includes a party centric approach where a neutral third party assists the parties in amicably resolving their disputes by using specified communication and negotiation techniques. Involvement of parties in the control over the whole process is peculiar to this dispute resolution method. The mediator only acts as a facilitator in helping the parties to reach a negotiated settlement of their dispute. The mediator makes no decisions or awards. In the mediation process, each side meets with an experienced neutral mediator. The session begins with each side describing the problem and the resolution they desire which is ameliorated by conducting separate and joint meetings culminating finally in an agreement of both parties.

The advantages of the mediation are that the agreement which is that of the parties themselves; the dispute is quickly resolved without great stress and expenditure; the relationship between the parties are preserved; and the confidentiality is maintained.

Lok Adalats:

Lok Adalats or people's courts have been established by the government to settle disputes by way of compromise or conciliation. This is another way of alternate dispute resolution that has been provided for. It is a judicial institution and a dispute settlement agency developed by the people themselves for social justice based on settlement or compromise reached through systematic negotiations. Lok-Adalats accept even cases pending in the regular courts within their jurisdiction. Section 89 of the Civil Procedure Code also provides for referring disputes to Lok Adalat wherein provisions of the Legal Services Authorities Act, 1987 gets applied.

Legal Terminology and Maxims

1.7

A legal maxim is an established principle or proposition of law or a legal policy usually stated in Latin. These principles are used in Courts to denote the application of certain laws. Such principles do not have the authority of law but when Courts apply the maxims in deciding issues of law or the legislature incorporates such maxims while framing laws, they have the force of law.

- Ab Initio – From the beginning.
- Actionable per se – The very act is punishable, and no proof of damage is required.
- Actio personalis moritur cum persona – A personal right of action dies with the person. In other sense, if he dies, the right to sue is gone.
- Actori incumbit onus probandi – The burden of proof is on the plaintiff.
- Actus me invito factus non est mens actus – An act done by me against my will is not my act. Read with section 94 of IPC.
- Actus non facit reum nisi mens sit rea – An act does not make one guilty unless it is accompanied by a guilty mind.
- Actus reus – Guilty act.
- Actus Reus Non Facit Reum Nisi Mens Sit Rea – Conviction of a crime requires proof of a criminal act and intent. Or an act does not make a defendant guilty without a guilty mind. Or an act does not constitute guilt unless done with a guilty intention.
- Ad hoc – For the particular end or case at hand.
- Alibi – At another place, elsewhere.
- Amicus Curiae – A friend of court or member of the Bar who is appointed to assist the court.
- Ante Litem Motam – Before suit brought; before controversy instituted, or spoken before a lawsuit is brought.
- Assentio mentium – The meeting of minds, i.e. mutual assents.
- Audi alteram partem – No man shall be condemned unheard.

- Bona fide – In good faith.
- Bona vacantia – Goods without an owner.
- Boni judicis est ampliare jurisdictionem – It is the part of a good judge to enlarge his jurisdiction, i.e. remedial authority.
- Caveat – A caution registered with the public court to indicate to the officials that they are not to act in the matter mentioned in the caveat without first giving notice to the caveator.
- Caveat actor – Let the doer beware.
- Caveat emptor – Let the buyer beware.
- Caveat venditor -Let the seller beware.
- Certiorari – A writ by which orders passed by an inferior court is quashed.
- Communis hostis omnium – They are common enemies of all. The common enemy of everyone.
- Corpus – Body.
- Corpus delicti – The facts and circumstances constituting a crime and Concrete evidence of a crime, such as a corpse (dead body).
- Damnum sine injuria – Damages without injuries.
- De facto – In fact.
- De jure – By law.
- De minimis – About minimal things.
- De Minimis Non Curat Lex – The law does not govern trifles (unimportant things). Or law is not concerned with small or insignificant things/matters.
- De novo – To make something anew.
- Dictum – Statement of law made by the judge in the course of the decision but not necessary to the decision itself.
- Doli capax – Capable of forming necessary intent to commit a crime.
- Doli incapax – Incapable of crime. Or incapable of forming the intent to commit a crime.
- Detinue – Tort of wrongfully holding goods that belong to someone else.
- Donatio mortis causa – Gift because of death. Or a future gift given in expectation of the donor's imminent death and only delivered upon the donor's death.
- Estoppel – Prevented from denying.
- Ex gratia – As favour.

- Ex officio – Because of an office held.
- Ex parte – Proceedings in the absence of the other party.
- Ex post facto – Out of the aftermath. Or after the fact.
- Factum probans – Relevant fact.
- Fraus est celare fraudem – It is a fraud to conceal a fraud.
- Functus officio – No longer having power or jurisdiction.
- Furiosi nulla voluntas est – Mentally impaired or mentally incapable persons cannot validly sign a will, contract, or form the frame of mind necessary to commit a crime. Or a person with mental illness has no free will.
- Furiosis furore suo puiner – A madman is best punished by his own madness.
- Furiosis nulla voluntas est – A madman has no will.
- Habeas corpus – A writ to have the body of a person to be brought in before the judge.
- Ignorantia facit doth excusat, Ignorance juris non-excusat – Ignorance of fact is an excuse, but ignorance of the law is no excuse.
- Ignorentia juris non excusat – Ignorance of law is not an excuse..
- Injuria sine damnum – Injury without damage.
- Ipso facto – By the mere fact.
- In promptu – In readiness.
- In lieu of – Instead of.
- In personam – A proceeding in which relief I sought against a specific person.
- Innuendo – Spoken words that are defamatory because they have a double meaning.
- In status quo – In the present state.
- Inter alia – Among other things.
- Inter vivos – Between living people
- Jus cogens or ius cogens – Compelling law.
- Jus in personam – Right against a specific person.
- Jus in rem – Right against the world at large.
- Jus naturale – Natural law. Or in other words, a system of law based on fundamental ideas of right and wrong that is natural law.

- Jus Necessitatis – It means a person's right to do what is required for which no threat of legal punishment is a dissuasion.
- Jus non scriptum – Customary law.
- Jus scriptum – Written law.
- Jus – Law or right.
- Justitia nemini neganda est – Justice is to be denied to nobody.
- Jus soli – Right of soil.
- Jus sanguins – Right of blood or descent.
- Lex non a rege est violanda – The law must not be violated even by the king.
- Locus standi – Right of a party to an action to appear and be heard by the court.
- Mala fide – In bad faith.
- Mandamus – 'We command'. A writ of command issued by a higher court to government and public authority to compel the performance of public duty.
- Mens rea – Guilty mind.
- Misnomer – A wrong or inaccurate name or term.
- Modus operandi – Way of working. Or mode of operation.
- Modus Vivendi – Way of living.
- Mutatis Mutandis – With the necessary changes having been made. Or with the respective differences having been considered.
- Nemo bis punitur pro eodem delicto – Nobody can be twice punished for the same offence.
- Nemo debet bis vexari pro una et eadem causa – It means no man shall be punished twice for the same offence.
- Nemo debet esse judex in propria causa or Nemo judex in causa sua or Nemo judex in sua causa – Nobody can be the judge in his own case.
- Nemo moriturus praesumitur mentire – A man will not meet his maker (God) with a lie in his mouth. Or, in other words, 'no man at the point of death is presumed to lie.' This maxim is related to dying declaration.
- Nemo Potest esse tenens et dominus – Nobody can be both a landlord and a tenant of the same property.
- Nolle prosequi – A formal notice of abandonment by a plaintiff or prosecutor of all or part of a suit.
- Novation – Transaction in which a new contract is agreed by all parties to replace an existing contract.
- Nullum crimen sine lege, nulla poena sine lege – There must be no crime or punishment except in accordance

with fixed, predetermined law.

- Non Sequitur – A statement (such as a response) that does not follow logically from or is not clearly related to anything previously said.
- Obiter dictum – Things said by the way. It is generally used in law to refer to a non-binding opinion made by a judge. It does not act as a precedent.
- Onus probandi – Burden of proof.
- Pacta Sunt Servanda – Agreements must be kept.
- Pari passu – With an equal step. At par.
- Per curiam (decision or opinion) – By the court. In other words, the decision is made by the court (or at least, a majority of the court) acting collectively.
- Per se – By itself.
- Persona non grata – A person who is unacceptable or unwelcome.
- Prima facie – At first sight. Or on the face of it.
- Alimony – A husband's (or wife's) provision for a spouse after separation or divorce; maintenance.
- Per curiam – By a court.
- Quantum meruit – What one has earned. Or the amount he deserves.
- Qui facit per alium, facit per se – He who acts through another acts himself.
- Quid pro quo – Something for something.
- Qui sentit commodum, sentire debet et onus – It means he who receives advantage must also bear the burden.
- Quo warranto – By what authority. A writ calling upon one to show under what authority he holds or claims a public office.
- Quod necessitas non habet legem or Necessitas non habet legem – Necessity knows no law.
- Ratio decidendi – Principle or reason underlying a court judgement. Or the rule of law on which a judicial decision is based.
- Respondeat superior – Let the master answer. For example, there are circumstances when an employer is liable for acts of employees performed within the course of their employment.
- Res ipsa loquitor – The thing speaks for itself.
- Res Judicata – A matter already judged.
- Res Judicata Pro Veritate Accipitur – It means that a judicial decision must be accepted as correct.

- Rex non protest peccare – The king can do no wrong.
- Salus populi est suprema lex – The welfare of the people is the supreme law.
- Status quo – State of things as they are now.
- Sine die – indefinitely
- Sine qua non – "Without which nothing". An essential condition. A thing that is absolutely necessary. Basically a component of an argument that, if debunked, causes the entire argument to crumble.
- Suo Motu – On its own motion.
- Uberrima fides (sometimes uberrimae fidei) – Utmost good faith.
- Ubi jus ibi remedium – Where there is a right, there is a remedy.
- Veto – Ban or order not to allow something to become law, even if it has been passed by a parliament.
- Vice versa – Reverse position.
- Vis major – Act of God.
- Volenti non fit injuria – Damage suffered by consent gives no cause of action. Or harm caused with consent cannot be considered an injury.
- Vox populi – Voice of the people. Or the opinion of the majority of the people.
- Waiver – Voluntarily giving up or removing the conditions.

EXERCISE

Multiple Choice Question:

1. Right to Property is a:
   a) Fundamental Right
   b) Fundamental Duty
   c) Constitutional Right
   d) None of the above
2. The Constitution of India describes India as:
   a) A federation
   b) Quasi-federal
   c) A Union of states
   d) None of the above
3. Constitution is the:
   a) Law of the land
   b) Administrative Law of the land
   c) Constitutional Law of the land
   d) None of the above
4. On which date was the Constitution of India adopted by Constituent Assembly?
   a) August 15, 1947
   b) January 26, 1950
   c) November 26, 1949
   d) January 30, 1948
5. What is the chief source of legal authority in India?
   a) People
   b) Constitution of India
   c) Parliament
   d) President of India

State TRUE or FALSE

1. Fundamental rights are not enforceable in the court of law in India.
2. Freedom of speech is an unfettered right and cannot be curtailed under any circumstances.
3. Custom is a source of law.
4. India's Constitution is the longest Constitution in the world.
5. Right to Equality is a fundamental right.
6. Secularism is a feature enshrined in the Preamble.

Fill in the blanks

1. The_____ is an exception to equality before law.
2. Indian Constitution permits discrimination on____
3. Fundamental Rights in Indian Constitution is based on____
4. Right to Property is a _____ right
5. ___, mediation, negotiation and conciliation are alternate dispute resolution methods.

Short Essay Type Questions

1. Discuss the concept of primary and secondary legislation.

2. What are the objectives of the Preamble?
3. Write short notes on-
   (a) Conciliation & Mediation
   (b) Subordinate Legislation

- **Essay Type Questions**

1. Explain judicial precedents as a source of law.
2. Elaborate on the concept of alternate dispute resolution
3. Explain how fundamental rights guarantee equality?
4. Explain how customs are a source of law?

- **Unsolved Cases**

1. A has been accused of theft by his employer. He was tried in a court but got acquitted. However, the employer found new evidence about A being the thief and instituted another case in the Court. Can A be tried again according to the fundamental rights that the Indian Constitution guarantees him?
2. A works for a certain political party and is notorious for making hate speeches against a certain religious community which often leads to communal riots pursuant to his inciting speeches. A was asked not to speak at a congregation which was to be held publicly. Is A's freedom to speech impeded?

Answer:

Multiple Choice Question

1. c; 2. c; 3. a; 4. c; 5. b.

State TRUE or FALSE

1. False; 2. False; 3. True; 4. True; 5. True; 6. True.

Fill in the blanks

1. President; 2. Nothing/no ground; 3. USA constitution; 4. Constitutional; 5. Arbitration

Indian Contracts Act, 1872

2

This Module includes -

2.1 Essential elements of a Contract, Offer and Acceptance

2.2 Void and Voidable Agreements

2.3 Consideration

2.4 Legality of Object

2.5 E-Contracts - Essential Requirements for Enforceablity

2.6 Constraints to Enforce Contractual Obligations

2.7 Quasi-Contracts, Contingent Contracts, Termination or Discharge of Contracts

2.8 Assignment of Contractual Rights and Obligations

2.9 Representations and Warranties

2.10 Impossibility and Force Majeure

2.11 Termination by Novation

2.12 Tender Procedure of Government Contract

2.13 Special Contract - Indemnity and Guarantee, Bailment and Pledge, Laws of Agency

Indian Contracts Act, 1872

SLOB Mapped against the Module

To develop an understanding as to the effects of such contracts and the subsequent transfers of title and performance of such contracts.

Module Learning Objectives:

After studying this module, the students will be able to -

- To develop understanding on laws governing formation, discharge and remedies for breach of various kinds of contracts
- To gain an insight into special contracts of indemnity, bailment, guarantee, pledge and agency

Essential Elements of a Contract, Offer and Acceptance

2.1

Contracts are crucial for carrying on our daily lives. In absence of contracts and its corresponding regulations, there could be anarchy. Opposed to popular belief, contracts are not only used in business deals, but also while carrying out our daily activities like taking the public transport, buying groceries or a cinema ticket or buying anything online, among others.

Contracts are those relationships that lay down rights and obligations of the parties to it which are more often than not negotiated and agreed to by themselves. Contracts exist in every sphere of our lives. These negotiated terms and conditions provide a lucid record of such a transaction which needs to be carried out in good faith. If such obligations are breached, the contracts even mention a way of dispute resolution. A perfect contract is one where all terms and conditions along with all details have been clearly defined leaving nothing to ambiguity or arbitrary construction. Contracts and its corresponding regulations have been a boon to the society for many reasons, economic development being one of the most important out of all.

The Indian Contract Act was enacted in 1872 which enlists provisions that could help the adjudicating authority in deciding the rights and liabilities of the parties.

All essentials of a valid contract, indemnities as applicable, limit of liabilities and grounds for termination are the clauses that the Act essentially deals with among other provisions.

Contracts minimize the risk of commercial transactions by a great deal. They bind the parties to their obligations and reduces the likelihood of breach. Conflict resolution can also be done in a relatively hassle-free way under contract laws.

The laws relating to contract enforce clarity between parties and helps in increasing productivity. From buying shares in a company to working for a company, in whatever capacity, all relationships are governed through contracts. Contracts generally enhance transparency and a well-defined law that governs these relationships help in observance of such contracts in good faith.

Essential elements of a Contract, Offer and Acceptance

To constitute an agreement, it is essential that there exists an offer. Such offer when accepted, gives rise to an agreement. However, to conclude a contract the fulfilment of other pre-requisites of consideration, legality of object, competence of parties and so on, is required. Contracts are legally enforceable. However, every agreement may not be enforceable under law.

In law, an agreement has been defined under Section 2(e) as every promise, and every set of promises, forming the consideration for each other. Whereby as per Section 2(f), promises that form the consideration or part of the consideration for each other are called reciprocal promises.

Contract

Moreover, The Indian Contract Act defines a contract under Section 2(h) as an agreement enforceable by law. As per Section 2(j), a contract which ceases to be enforceable by law becomes void when it ceases to be enforceable.

Example: A offered to sell his book to B for ₹100. B paid A ₹100 and bought the book. A is the offeror, B is the offeree/acceptor, ₹100 is the consideration. Similarly A's offer to sell the book is his promise, and B's acceptance to pay the money is his promise. When this aforementioned agreement fulfils Section 10 of the Indian Contract Act, 1872, it becomes a contract.

This brings us to the question of how an offer is defined.

Offer

The term 'proposal' is otherwise called as 'offer'. An offer is a proposal by one person, whereby he expresses his willingness to enter into a contractual obligation in return for promise, act or forbearance. Section 2(a) of the Act defines 'proposal' or offer as when one person signifies to another his willingness to do or abstain from doing anything with a view to obtaining the assent of that other to such act or *abstinence*. The person making the proposal is called as 'offeror' or proposer' and the person the proposal is made is called as 'offeree'.

Therefore, to constitute a valid offer, such an offer:

- must be in clear, definite, complete and final in terms and not be vague in terms;
- must be communicated to the offeree.
- is communicated either in writing or is oral;
- may be in expressed terms or in implied terms.

Example: Ram tells Ghanshyam that he wants to sell his house to him just before he dies. Ram mortgages the house in favour of the State Bank of India for loans. Ghanshyam sues Ram for doing so as there was a contract between Ghanshyam and Ram for the sale of the same house. In this situation, Ram has not told at what price does he want to sell the house to Ghanshyam or the exact time of sale. Hence this cannot be a contract as the offer was unclear, not definite, incomplete and vague.

The offer may be general or specific. If an offer is made to a specific person, it is called specific offer. Such offer can be accepted by such specific person; if an offer is made to the world at large, it is a general offer. It can be accepted by any member of the general public by fulfilling the condition laid down in the offer.

Section 4 of The Indian Contract Act, 1872 lays down provisions relating to communication of offer is complete when it comes to the knowledge of the person to whom it is made. It states an offer which has been communicated properly continues as such until it lapses or revoked by the offer or rejected or accepted by the offeree. An ideal offer should have all the essentials of a valid contract as once it is accepted by the offeree, it becomes a contract.

However, an offer can also be revoked. Section 5 provides that a proposal may be revoked at any time before the communication of acceptance is complete as against the proposer but not afterwards.

Example: A proposes, by a letter sent by post, to sell his house to B; B accepts the proposal by a letter sent by post. A may revoke his proposal at any time before or at the moment when B posts his letter of acceptance, but not afterwards.

Acceptance

To constitute a promise, the intention of the parties must be communicated. One cannot accept an offer which had not been communicated to him. In general, uncommunicated offer cannot result in a promise.

The term 'acceptance' means admitting and agreeing to something to accede to something or to accept something. An offer to enter into legal relations, upon definite terms, to create legal relations, must be followed by an intention of the offeree to accept that offer.

In the case of Thawardar Pherumal vs. Union of India (AIR 1955 SC 468) the Supreme Court held that before an offer can become a binding promise and result in an agreement it must be accepted, either by words or acts.

A person cannot be bound by a one-sided offer which is never accepted particularly when the parties intended that the contract should be reduced in writing. A promise cannot bind its make unless the promise has assented to it. Acceptance must be absolute and unqualified.

Example: Mina tells Tina she wants to sell her scooty for ₹ 10,000. Tina says she will buy her scooty only if Ukraine wins the war against Russia and lavender trees grow in Japan. This is not a contract as the acceptance is not absolute and unqualified.

Section 4 provides that the communication of an acceptance is complete-

- as against the proposer, when it is put in a course of transmission to him, so as to be out of the power of the acceptor.
- as against the acceptor when it comes to the knowledge of the proposer

Example: A proposes, by letter, to sell a house to B at a certain price. B accepts A's proposal by a letter sent by post. The communication of the acceptance is complete, as against A when the letter is posted and as against B, when the letter is received by A.

The following points shall be taken into account in the case of acceptance-

- Acceptance may be oral or in writing;
- It may be expressed or implied;
- If a particular method of acceptance is prescribed, the offer must be accepted in the prescribed manner;
- It must be unqualified and absolute and must correspond with all terms of the offer;
- The conditional acceptance will amount to rejection of offer;
- A counter offer for acceptance will also amount to reject of offer but the counter offer may be accepted or rejected by the other party;
- It must be communicated to the offerer, since acceptance is completed the moment it is communicated;
- Mere silence on the part of the offeree does not amount to acceptance;
- The acceptance should be given if there is a time limit is fixed or otherwise at a reasonable time and before he offer lapses or is revoked.

Revocation of acceptance

Section 5 provides that an acceptance may be revoked at any time before the communication of acceptance is complete as against the acceptor but not afterwards.

Example: A proposes, by a letter sent by post, to sell his house to B; B accepts the proposal by a letter sent by post; B may revoke his acceptance at any time before or at the moment when the letter communicates it reaches A, but not afterwards.

Section 4 provides that the communication of a revocation is complete as against the person who makes it, when it is put into a course of transmission to the person to whom it is made, so as to be out of the power of the person who makes it and as against the person to whom it is made, when it comes to his knowledge.

Example: B revokes his acceptance by telegram. B's revocation is complete as against B when the telegram is dispatched and as against A when it reaches him.

As per Section 2(b), when the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted, becomes a promise.

Section 2(c) defines that the person making the proposal is called the "promisor", and the person accepting the proposal is called the "promisee".

Voidable contract

Section 2(i) defines a voidable contract as an agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others.

Essentials of a valid contract

Section 10 provides that all agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not otherwise expressly declared to be void.

The following are the requirements for a valid contract

- There shall be an offer or proposal by one party and acceptance of the proposal by the other party which results in an agreement.
- There shall be an intention to create legal relations or an intent to legal consequences.
- The agreement shall be supported by lawful consideration.
- The parties to the contract shall be competent to contract.
- There shall be free consent between the parties to the contract.
- The object and consideration of the contract shall be legal and the same shall not be opposed to public policy.
- The terms of the consent shall be certain.
- The agreement is capable of being performed and it is not impossible of being performed.

Examples:

1. A proposes, by letter, to sell a house to B at a certain price. B accepts A's proposal by a letter sent by post. The communication of the acceptance is complete, as against A when the letter is posted and as against B, when the letter is received by A.
2. Ramesh offers Mahesh his house for sale at ₹ 1 Crore on 5th July, 2022. Mahesh agrees to buy the same at the given time and price asked by Ramesh. Both Ramesh and Mahesh are 40 years old and are of sane mind. This is a contract as per Section 10 of the Indian Contract Act, 1872.

Void and Voidable Agreements

2.2

2.2.1 Void Agreement

According to Section 2(g), an agreement not enforceable by law is said to be void.

The following agreements are considered to be void:

- If considerations and objects are unlawful in part – Section – 24;
- Agreements without consideration – Section 25;
- Agreement in restraint of marriage – Section 26;
- Agreement in restraint of trade – Section 27;
- Agreements in restraint of legal proceedings – Section 28;
- Agreements void for uncertainty – Section 29;
- Agreements by way of wager – Section 30;

Considerations and objects unlawful in part

Section 24 provides that if any part of a single consideration for one or more objects or any one or any part of any one of several considerations for a single object is unlawful, the agreement is void.

Example – A promises to superintend, on behalf of B, a legal manufacture of indigo and an illegal traffic in other articles, B promises to pay to A salary of ₹10,000 a year. The agreement is void, the object of A's promise, and the consideration for B's promise, being in part unlawful.

This section has no application to a contract which is a single contract and has no contingent part.

2.2.2 Agreement without consideration

Section 25 provides that an agreement made without consideration is void unless-

1. **It is in writing and registered –** It is expressed in writing and registered under the law for the time being in force for the registration of documents and is made on account of natural love and affection between parties standing in a near relation to each other; or unless
2. **If is a promise to compensate for something done –** It is a promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, or something which the promisor was legally compellable to do; or unless
3. **It is a promise to pay a debt, barred by limitation law –** It is a promise, made in writing and signed by the person to be charged herewith, or by his agent generally or specially authorized in that behalf, to pay wholly or in part a debt of which the creditor might have enforced payment but for the law for the limitation of suits.

In any of these cases, such an agreement is a contract.

Explanation 1 – to this Section provides that nothing in this section shall affect the validity, as between the donor and done of any gift actually made.

Explanation 2 – to this Section provides that an agreement to which the consent of the promisor is freely given is not void merely because the consideration is inadequate; but the inadequacy of the consideration may be taken into account, by the Court in determining the question of whether the consent of the promisor was freely given.

Examples:

- A promises, for no consideration, to give B ₹1,000. This is a void agreement;
- A, out of love and affection, promises to give his son B, ₹1,000. A put his promise to B into writing and registers it. This is a contract.
- A finds B's purse and gives it to him. B promises to give A ₹50. This is a contract;
- A supports B's infant son. B promises to pay A's expenses in so doing. This is a contract;
- A owes B ₹1,000 but the debt is barred by the Limitation Act. A signs written promises to pay B ₹500 on account of the debt. This is a contract;
- A agrees to sell a horse worth of ₹1,000 for ₹10. A's consent to the agreement was freely given. The agreement is a contract notwithstanding the inadequacy of the consideration;
- A agrees to sell a horse worth of ₹1,000 for ₹10. A denies that his consent to the agreement was freely given.

The inadequacy of the consideration is a fact which the Court should take into account in considering whether or not A's consent was freely given.

2.2.3 Voidable Contract

Section 2(i) defines a voidable contract as an agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others.

Agreement in restrain of marriage: Any agreement to restrain the marriage of anyone unless it is that of a minor, is void.

Example: Meenu married Ashish when she was 14 years old. After she turned 18 years, she wants to leave Ashish and get married to someone else. She can opt out of this marriage contract as she was a minor when she entered into the marriage.

Agreement in restraint of trade

Section 27 provides that every agreement by which any one is restrained from exercising a lawful possession, trade or business of any kind, is to that extent void.

The exception to this section is saving of agreement not to carry on business of which goodwill is sold. One who sells the goodwill of a business may agree with the buyer to refrain from carrying on a similar business, within specified local limits, so long as the buyer, or any person deriving title to the goodwill from him, carries on a like business therein. Provide that such limits appear to the Court reasonable, regard being had to the nature of business.

Agreements in restraint of legal proceedings

Section 28 provides that every agreement-

a) by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights; or

b) which extinguishes the rights of any party thereto, or discharges any party thereto, from any liability, under or in respect of any contract on the expiry of a specified period so as to restrict any party from enforcing his rights, is void to that extent.

Exceptions – The following are the exceptions to this Section:

- **Saving of contract to refer to arbitration dispute that may arise –** This section shall not render illegal a contract, by which two or more persons agree that any dispute which may arise between them in respect of any subject or class of subjects shall be referred to arbitration and that only the amounts awarded in such arbitration shall be recoverable in respect of the dispute so referred;
- **Saving of contract to refer to questions that have already arisen –** Nor shall this section render illegal any contract in writing, by which two or more persons agree to refer to arbitration any question between them which has already arisen, or affect any provision of any law in force for the time being as to references to arbitration.
- **Saving of a guarantee agreement of a bank or a financial institution –** This section shall not render illegal a contract in writing by which any bank or financial institution stipulates a term in a guarantee or any agreement making a provision for guarantee for extinguishment of the rights or discharge of any party thereto from any liability under or in respect of such guarantee or agreement on the expiry of a specified period which is not less than one year from the date of occurring or non- occurring of a specified event for extinguishment or discharge of such party from the said liability.

Example: In a contract between a computer manufacturing company and a customer, there was a clause that the company will not be liable to be sued for damages for anything pertaining to the product in any court of law. Such a contract is void as it restricts the right of the customer to avail legal recourse for enforcing his rights against the company.

2.2.4 Agreements void for uncertainty

Section 29 provides that agreements, the meaning of which is not certain, or capable of being made certain are void.

Examples:

a) A agrees to sell to B, 'a hundred tons of oil'. There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty;

b) A agrees to sell to B, 'One hundred tons of oil of specified description known as an article of commerce. There is no uncertainty here to make to agreement void;

2.2.5 Agreement by way of wager

Section 30 provides that agreements by way of wager are void; and no suit shall be brought for recovering anything alleged to be won on any wager, or entrusted to any person to abide the result of any game or other uncertain event on which any wager is made.

Exception in favour of certain prizes for horse-racing – This section shall not be deemed to render unlawful a subscription, or contribution, or agreement to subscribe or contribute, made or entered into for or toward any plate, prize, or sum of money, of the value or amount of ₹ 500 or upwards, to be awarded to the winner or winners of any horse-race.

Section 294A of the Indian Penal Code not affected – Nothing in this section shall be deemed to legalize any transaction connected with horse-racing to which the provisions of Section 294A of the Indian Penal Code, apply.

Example: Mr. X had an agreement with Mr. Y regarding the outcome of India Pakistan match. If Pakistan won he would pay to Mr. Y ₹ 1 Crore. These kind of agreements are wafering agreements and not enforceable in India.

Consideration

2.3

Section 2(d) of the Act defines the term 'consideration' as, when, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise. Consideration is essential for every contract. The following are the fundamental principles for consideration-

- Consideration must be at the desire of the promisor;
- Consideration may move from the promise or any other person;

In 'Chinnaya v. Ramaya' – (1882) Mad. 137 it was held that a lady by a deed of gift made over certain property to her daughter directing her to pay an annuity to the donors brothers as had been done by the donor herself before she gifted the property. On the same day, her daughter executed in writing in favor of the donors' brother agreeing to pay the annuity. Afterwards the done declined to fulfill her promise to pay her uncle saying that no consideration had moved from him. The court held that the uncle could sue even though no part of the consideration received by the niece moved from him. The consideration from her mother was sufficient consideration.

Types of consideration

Consideration may be of the following three types:

i) **Executory or future –** it means it makes the form of promise to be performed in the future;

Example – A makes an engagement with B to marry her in future.

ii) **Executed or present –** it is an act or forbearance made or suffered for a promise.

iii) **Past –** it means a past act or forbearance, that is to say, an act constituting consideration, took place and is complete before the promise is made.

Legal Rules Regarding Consideration

1. It must move at the desire of the promisor
2. It may move from the promisee or any other person
3. Consideration must be something of value.
4. It may be an act, abstinence or forbearance or a return promise.
5. It may be past, present or future which the promisor is already not bound to do.
6. It must not be unlawful.

7. Consideration need not be adequate.
8. It must not be illusory.
9. It must not be opposed to public policy.
10. Pre-existing obligations.

No Consideration - No Contract:

According to Section 25 of The Indian Contract Act, 1872, the general rule *is ex-nudopacto non oritur action* i.e. an agreement made without consideration is void. For example if A promises to pay B ₹1000 without any obligation from B, this is a void agreement for want of consideration. However, the Act itself provides exceptions to this rule in section 25 itself. As per section 25, an agreement made without consideration is not void in the following circumstances:

a) Promise made on account of natural love and affection.
b) Promise to compensate for voluntary services.
c) Promise made to pay a time barred debt.

Also, an agreement without consideration is not void in the following cases:

1. Gift actually made.
2. Creation of agency.
3. Charitable subscription

Example: Ram told Shyam that he will sell his office space to him if he killed a Union Minister. This consideration in lieu of office space is an unlawful consideration and hence this will not become a contract.

Legality of Object

2.4

The object of the contract is the ultimate purpose which the contract sub serves. In contract the subject matter or the agreement is its object.

Section 23 discusses about the legality of the object or consideration. The said section provides that the consideration or object of an agreement is lawful, unless-

- it is forbidden by law; or
- is of such nature that, if permitted, it would defeat the provisions of any law; or
- is fraudulent; or
- involves or implies, injury to the person or property of another; or
- the Court regards it as immoral, or opposed to public policy. In each of these cases, the consideration or object of an agreement is said to be unlawful. Every agreement of which the object or consideration is unlawful is void.

Examples:

a) A agrees to sell his house to B for ₹10,000. Here B's promise to pay the sum of ₹10,000 is the consideration for A's promise to sell the house and A's promise to sell the house is the consideration for B's promise to pay ₹10,000. These are lawful considerations;

b) A promises to pay B ₹1,000 at the end of six months, if C who owes that sum to B, fails to pay it. B promises to grant time to C accordingly. Here the promise of each party is the consideration for the promise of the other party, and they are lawful considerations;

c) A promises for a certain sum paid to him by B, to make good to B the value of his ship if it is wrecked on a certain voyage. Here, A's promise is the consideration for B's payment and B's payment is the consideration for A's promise, and these are lawful considerations;

d) A promises to maintain B's child and B promises to pay A ₹1,000 yearly for the purpose. Here, the promise of each party is the consideration for the promise of the other party. They are lawful considerations;

e) A, B and C enter into an agreement for the division among them of gains acquired, or to be acquired, by them by fraud. The agreement is void, as its object is unlawful;

f) A promises to obtain for B an employment in the public service, and B promises to pay ₹1,000 to A. The agreement is void, as the consideration for its unlawful;

g) A being agent for a landed proprietor, agrees for money, without the knowledge of his principal to obtain

for B a lease of land belonging to the principal. The agreement between A and B is void, as it implies a fraud by concealment by A, on his principal;

h) A promises B to drop a prosecution which he has instituted against B for robbery, and B promises to restore the value of the things taken. The agreement is void, as its object is unlawful;

i) A's estate is sold for arrears of revenue under the provisions of an Act of the Legislature, by which the defaulter is prohibited from purchasing the estate. B, upon an understanding with A, becomes the purchaser, and agrees to convey the estate to A upon receiving from him the price which B has paid. The agreement is void as it renders the transaction in effect, a purchase by the defaulter and would so defeat the object of the law;

j) A, who is B's mukhtar, promises to exercise his influence, as such, with B in favor of C and C promises to pay ₹ 1,000 to A. The agreement is void, because it is immortal;

k) A agrees to let her daughter to hire B for concubinage. The agreement is void, because it is immoral, though the letting may not be punishable under the Indian Penal Code.

E-Contracts - Essential Requirements for Enforceablity

2.5

Electronic contracts are paperless contracts and are in electronic form. It is the change of technology and legal requirements lead the contract to be in electronic form. E-contract is a contract modelled, specified, executed and deployed by a software system. They are conceptually very similar to traditional commercial contracts. E-contract also requires the basic elements of a contract. The following are ingredients of the E-contracts-

- An offer is to be made;
- Offer is to be accepted;
- There shall be a lawful consideration;
- There shall be an intention to create legal relations;
- The parties must be competent to contract;
- There must be free and genuine consent;
- The object of the contract must be lawful;
- There must be certainty and possibility of performance.

The main feature of this type of contract is speed, accuracy and reliability. The parties to the contract have to obtain digital signature from the competent authority and they have to affix the digital signature instead of manual signing. The Information Technology Act, 2000 regulates such e-contracts.

In this type of contract the web site of the offeror acts as a display to the world at large. E-mails are used to negotiate and agree on contract terms and to send and agree to the final contract. An email contract is enforceable if the requirements of the contract are fulfilled. Electronically signed contracts cannot be denied because they are in electronic form and delivered electronically.

Example: Anil buys Microsoft Office, online, for his Macbook. Microsoft lays down terms and conditions that will now bind both Anil and Microsoft with respect to the sale of Microsoft Office. When Anil clicks on "I agree to the terms and Conditions" and makes the payment, he is now bound by the e-contract.

Constraints to Enforce Contractual Obligations

2.6

2.6.1 Who are competent to contract?

As per Section 11 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 of sound mind, and is not disqualified from contracting by any law to which he is subject.

From the above provisions of the section, it means the following types of persons are not competent to contract:

i) A person who has not attained the age of majority, i.e. minor.

ii) A person of unsound mind

iii) A person who is disqualified from contracting by some law.

a) Minor:

As per section 3 of the Indian Majority Act of 1875, every person in India is a minor if he has not attained the age of 18 years of age. However in case of a minor of whose person or property or both a guardian has been appointed under the Guardian and Wards Act, 1890 or whose property is under the superintendence of any court of wards before he attains 18 years of age is 21 years.

The position of Minor's agreement and effect thereof is as under:

1. An agreement with a minor is void ab-initio.
2. The law of estoppel does not apply against a minor. It means a minor can always plead his minority despite earlier misrepresenting to be a major. In other words, he cannot be held liable on an agreement on the ground that since earlier he had asserted that he had attained majority.
3. Doctrine of Restitution does not apply against a minor. In India, the rules of restitution by minor are similar to those found in English laws. The scope of restitution of contract by minor was examined by the Privy Council in Mohiri Bibi case when it has held that the restitution of money under section 64 of the Indian Contract Act cannot be granted under section 65 because a minor's agreement is not voidable but absolutely void ab-initio. Similarly no relief can be granted under section 65 as this section is applicable where the agreement is discovered to be void or the contract becomes void.
4. No Ratification on Attaining Majority - Ratification means approval or confirmation. A minor cannot confirm an agreement made by him during minority on attaining majority. If he wants to ratify the agreement, a fresh agreement and fresh consideration for the new agreement is required.
5. Contract beneficial to Minor - A minor is entitled to enforce a contract which is of some benefit to him. Minority is a personal privilege and a minor can take advantage of it and bind other parties.
6. Minor as an agent - A minor can be appointed an agent, but he is not personally liable for any of his acts.

7. Minor's liability for necessities - If somebody has supplied a minor or his dependents with necessities, minor's property is liable but a minor cannot be held personally liable
8. A minor cannot be adjudged insolvent as he is incapable of entering into a contract.
9. Where a minor and an adult jointly enter into an agreement with another person, the minor is not liable and the contract can be enforced against the major person.

b) Person of Sound Mind:

What is a Sound Mind for the Purposes of Contracting? (Section 12)

A person is said to be of sound mind for the purposes of making a contract if, at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effect upon his interests. A person, who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind. A person, who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind.

Illustration:

a) A patient in a lunatic asylum, who is at intervals of sound mind, may contract during those intervals.

b) A sane man, who is delirious from fever or who is so drunk that he cannot understand the terms of a contract or form a rational judgment as to its effect on his interests, cannot contract whilst such delirium or drunkenness lasts.

Solution

Going by the spirit of the section, it is clear that a person is of sound mind if he fulfils the two conditions at the time when he makes it namely :

i) He/she is capable of understanding the contract.

ii) He/she is capable of forming a rational judgment about the effects of such contract on his interest.

In both the cases person not satisfying any of these two conditions is not treated as a person of sound mind.

c) Other Disqualified Persons:

The persons who are disqualified from entering into contract due to certain other reasons may be from legal status, political status or corporate status. Some of such categories of persons are given below:

i) **Alien Enemy:** An agreement with an Alien Enemy is void. But agreement with an Alien friend is perfectly valid and enforceable. When the Government of an Alien is at war with the Government of India, the alien is called Alien enemy, who cannot enter into any contract with any Indian citizen without the permission of Government of India as the same is against the public policy. Contract entered into with an alien before war is put into suspension during the duration of war.

ii) **Foreign Sovereign and Ambassadors:** Foreign sovereigns and their representatives enjoy certain privileges and immunities in every country. They cannot enter into contract except through their agents residing in India. They can sue the Indian citizen but an Indian citizen cannot sue them.

iii) **Convicts:** A convict cannot enter into a contract while he is undergoing imprisonment.

iv) **Insolvents:** An insolvent person is one who is unable to discharge his liabilities and therefore has applied for being adjudged insolvent or such proceedings have been initiated by any of his creditors. An insolvent person cannot enter into any contract relating to his property.

v) **Company or Statutory bodies:** A contract entered into by a corporate body or statutory body will be valid only to the extent it is within its Memorandum of Association.

2.6.2 Free Consent

Consent: 'Two or more persons are said to consent when they agree upon the same thing in the same sense.' - [Sec 13]

If the parties have not agreed upon the same thing in the same sense, there is no real consent and hence no contract is formed.

As per section 14 of the Indian Contract Act, 1872 consent is said to be free when it is not caused by:

i) Coercion (Sec 15), or

ii) Undue influence (Sec 16), or

iii) Fraud (Sec 17), or

iv) Misrepresentation (Sec 18), or

v) Mistake, subject to the provisions of Sec 20, 21 and 22.

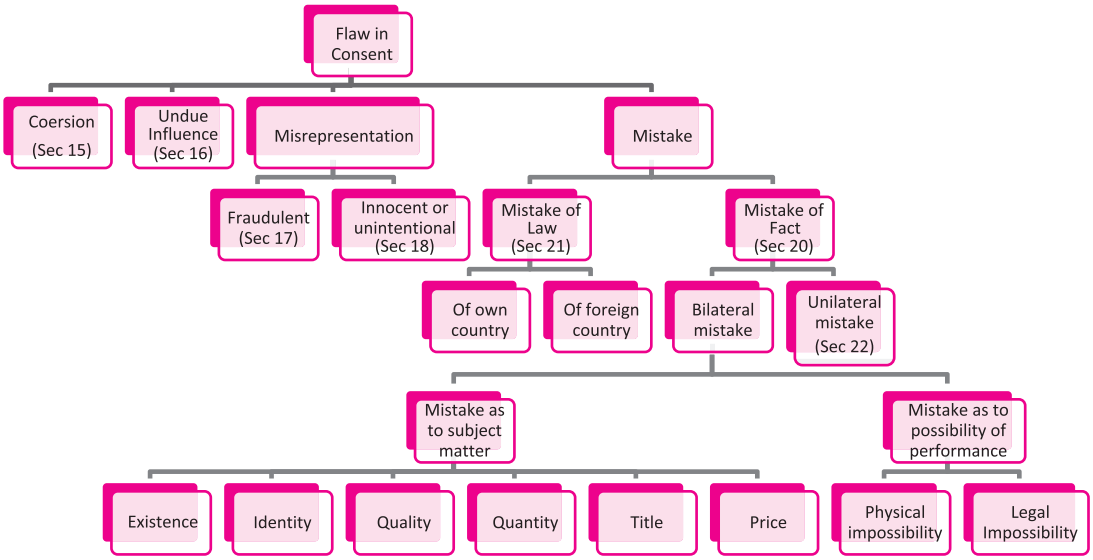

Fig. 2.1 Flow in Consent

2.6.2.1 Coercion: [Sec. 15]

The term "Coercion" has been defined in Section 15 of the Act as the committing or threatening to commit, any act forbidden by the Indian Penal Code, or the unlawful detaining, or threatening to detain, any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement.

Explanation**:** It is immaterial whether the Indian Penal Code is or is not in force in the place where the coercion is employed.

From the above definition of coercion given in section 15, consent is said to be caused by coercion, when it is obtained by any one of the following;

1. Committing or threatening to commit any act forbidden by Indian Penal Code;
2. Unlawful detaining or threatening to detain the property of another person. Coercion may come from a person party to the contract or even third person not connected with the contract directly.

Unlawful detaining also amounts to coercion: If a person unlawfully detains or gives a threat to detain any property to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement amounts to coercion.

Effect of coercion

According to section 19 when the consent is caused by coercion, fraud or misrepresentation, the agreement is avoidable at the option of the party whose consent was so caused. The aggrieved party may opt to rescind the contract. If the aggrieved party seeks to rescind the contract, he must restore the benefit so obtained under the contract from other party.

It should be noted that threat to commit suicide also amounts to coercion.

Some special cases which are prone to be construed cases of coercion are discussed as under;

1. **Prosecution:** A mere threat to prosecute a man or file suit against him does not constitute coercion. In the case of Andhra Sugar Lts V State of AP AIR 1968 SC 599, it was held that compulsion of law is not a coercion, fraud, misrepresentation, mistake or even undue-influence.
2. **High prices and high interest Rates:** Charging high interest rate, high price etc is not coercion as the same is not prohibited under the Indian Penal code.
3. **A threat to commit suicide:** Consent to an agreement may at times be obtained by threatening to commit suicide. The Madras High court has held that threat to commit suicide amounts to coercion. In *Amraju v Seshamma 1917 41 Mad 33* it was argued by Oldfield J, one of the judge of the Bench which decided this case, that section 15 of the Indian Contract Act, must be construed strictly and that an act which is not punishable under the Indian Penal Code cannot be said to be forbidden by it. Suicide is not punishable by the Indian Penal Code, only the attempt to suicide is punishable.

2.6.2.2 Undue Influence [Section 16]

Section 16 of the Indian Contract Act defines undue influence as under:

i) A contract is said to be induced by "undue influence" where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.

ii) In particular and without prejudice to the generality of the foregoing principle, a person is deemed to be in a position to dominate the will of another—

   a. Where he holds a real or apparent authority over the other, or where he stands in a fiduciary relation to the other; or

   b. Where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness, or mental or bodily distress.

iii) Where a person, who is in a position to dominate the will of another, enters into a contract with him, and the transaction appears, on the face of it or on the evidence adduced, to be unconscionable, the burden of proving that such contract was not induced by undue influence shall lie upon the person in a position to dominate the will of the other.

Nothing in this sub-section shall affect the provisions of section 111 of the Indian Evidence Act, 1872 (1 of 1872).

There is presumption of undue influence in the following relationships:

i) Parent and child

ii) Guardian and ward

iii) Doctor and patient

iv) Solicitor and client

v) Trustee and beneficiary

vi) Religious advisor and disciple

vii) Fiancé and fiancée

There is however no presumption of undue influence in case of relationship of —

i) Landlord and tenant

ii) Debtor and creditor

iii) Husband and wife. The wife has to be *pardanashin* for such presumption. In these relationships undue influence has to be proved.

Going through the definition of undue influence in section 16 we find that two elements are found in undue influence:

a) The relationship subsisting between the parties is such that one party is in a position to dominate the will of other and

b) He uses that position to obtain an unfair advantage over the other. The person intending to avoid the contract on the ground of undue influence must prove both the above two elements

Examples:

a) A having advanced money to his son, B, during his minority, upon B's coming of age obtains, by misuse of parental influence, a bond from B for a greater amount than the sum due in respect of the advance. A employs undue influence.

b) A, a man enfeebled by disease or age, is induced, by B's influence over him as his medical attendant, to agree to pay B an unreasonable sum for his professional services, B employs undue influence.

c) A, being in debt to B, the money-lender of his village, contracts a fresh loan on terms which appear to be unconscionable. It lies on B to prove that the contract was not induced by undue influence.

d) A applies to a banker for a loan at a time when there is stringency in the money market. The banker declines to make the loan except at an unusually high rate of interest. A accepts the loan on these terms. This is a transaction in the ordinary course of business, and the contract is not induced by undue influence.

Effect of undue influence: Section 19A provides that when the consent is caused by undue influence, the agreement is voidable at the option of the party whose consent was so caused. The aggrieved party may opt to rescind the contract. If the aggrieved party seeks to rescind the contract, he must restore the benefit so obtained under the contract from other party, upon such terms and conditions as to the court may seem just. The following illustrations are appended to the section.

a) A's son has forged B's name to a promissory note. B, under threat of prosecuting A's son, obtains a bond from A for the amount of the forged note. If B sues on this bond, the Court may set the bond aside.

b) A, a moneylender, advances ₹100 to B, an agriculturist, and, by undue influence, induces B to execute a bond for ₹200 with interest at 6 per cent per month. The Court may set the bond aside; ordering B to repay ₹100 with such interest as may seem just.

The court has discretion to direct the aggrieved party for giving back the benefit whether in whole or in part or set aside the contract without any direction for refund of benefit.

In a case for avoiding a contract on the ground of undue influence, the plaintiff has to prove that:

a) the other party was in a position to dominate the will; and

b) he actually used his influence to obtain the plaintiff's consent to the contract; it will be then for the defendant to show that the plaintiff freely consented.

The presumption is raised at least in the following cases:

a) Unconscionable bargains

b) Contracts with pardanashin women

2.6.2.3 Fraud [Section 17]

As per section 17 of the Indian Contract Act:

"Fraud" means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract:

i) The suggestion, as a fact, of that which is not true by one who does not believe it to be true;

ii) The active concealment of a fact by one having knowledge or belief of the fact;

iii) A promise made without any intention of performing it;

iv) Any other act fitted to deceive;

v) Any such act or omission as the law specially declares to be fraudulent.

Explanation: Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the case are such that, regard being had to them, it is the duty of the person to keep silence or unless his silence is, in itself is equivalent to speech.

Does silence amount to fraud?

At times one of the parties to a contract be silent to some of the facts relating to the subject matter of contract. The matter on which silence is maintained by party may be material fact. Does this amount to passive fraud under the Indian Contract Act or not depends upon various factors?

Explanation to Section 17 of the Indian Contract Act provides that mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud unless the circumstances of case are such that having regard to them, it is the duty of the person keeping silence to speak or unless silence itself is equivalent to speech.

Thus. we can say that there is exception to the rule that mere silence does not amount to silence. These two exceptions are provided in explanation to section 17 and these are as under.

i) When there is a duty to speak.

ii) Where silence is equivalent to speech.

However, in the following two types of cases, silence amounts to fraud, as held by the courts in various cases:

a) **Where there is change in circumstances-** A representation may be true when made but with the passage of time or changed circumstances it may become false. Accordingly, this must be communicated to other party otherwise it amounts to fraud.

b) **When there is half-truth-** Even when a person is not bound to disclose a fact, he may be held guilty of fraud if he volunteers to disclose a state of fact partly. This is so when the undisclosed part renders the disclosed part false.

Examples:

a) A sells, by auction, to B, a horse which A knows to be unsound. A says nothing to B about the horse's unsoundness. This is not fraud in A.

b) B is A's daughter and has just come of age. Here, the relation between the parties would make it A's duty to tell B if the horse is unsound.

c) B says to A—"If you do not deny it, I shall assume that the horse is sound." A says nothing. Here, A's silence is equivalent to speech.

d) A and B, being traders, enter upon a contract. A has private information of a change in prices which would affect B's willingness to proceed with the contract. A is not bound to inform B.

Effect of Fraud: According to section 19 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.

A party to a 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 in the position in which he would have been, if the representations made had been true.

However, there is one exception to the rule of voidability of contract at the option of aggrieved party. If such consent was caused by misrepresentation, or by silence, fraudulent within the meaning of section 17, the contact, nevertheless, is not voidable, if the party whose consent was so caused had the means of discovering the truth with ordinary diligence.

2.6.2.4 Misrepresentation [Section 18]

A statement of fact which one party makes in the course of negotiation with a view to induce the other party to enter into a contract is known as misrepresentation. It must relate to some fact which is material to the contract. It may be expressed by words spoken or written or implied from the acts and conduct of the parties.

A representation when wrongly made either innocently or unintentionally is a misrepresentation. When it is made innocently or unintentionally, it is misrepresentation and when made intentionally or wilfully it is fraud.

Misrepresentation has been defined in Section 18 of the Act as under:

"Misrepresentation" means and includes—

The positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true.

1. The positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true;
2. Any breach of duty which, without an intent to deceive, gains an advantage to the person committing it, or

any one claiming under him, by misleading another to his prejudice or to the prejudice of anyone claiming under him;

3. Causing, however innocently, a party to an agreement to make a mistake as to the substance of the thing which is the subject of the agreement.

From the above definition of the term Misrepresentation, the following two types of misrepresentations are noticed:

a) **Unwarranted statements:** When a person positively asserts or makes an absolute and explicit statement of facts, that fact is true, though he has no reliable source to form this opinion, he believes it to be true. This is one type of misrepresentation.

b) **Breach of duty:** Any breach of duty which brings advantages to the person committing it by misleading the other to his prejudice is a misrepresentation.

Effect of Misrepresentation

As per section 19 when consent to an agreement is caused by misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused. A party to a contract, whose consent was caused by misrepresentation, may, if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been, if the representations made had been true.

Exception: If such consent was caused by misrepresentation or by silence, fraudulent within the meaning of section 17, the contract, nevertheless, is not voidable, if the party whose consent was so caused had the means of discovering the truth with ordinary diligence.

Explanation: A fraud or misrepresentation which did not cause the consent to a contract of the party on whom such fraud was practised, or to whom such misrepresentation was made, does not render a contract voidable.

Examples:

a) A, intending to deceive B, falsely represents that five hundred maunds of indigo are made annually at A's factory, and thereby induces B to buy the factory. The contract is voidable at the option of B.

b) A, by a misrepresentation, leads B erroneously to believe that, five hundred maunds of indigo are made annually at A's factory. B examines the accounts of the factory, which show that only four hundred maunds of indigo have been made. After this B buys the factory. The contract is not voidable on account of A's misrepresentation.

c) A fraudulently informs B that A's estate is free from incumbrance. B thereupon buys the estate. The estate is subject to a mortgage. B may either avoid the contract, or may insist on its being carried out and the mortgage debt redeemed.

d) B, having discovered a vein of ore on the estate of A, adopts means to conceal, and does conceal, the existence of the ore from A. Through A's ignorance B is enabled to buy the estate at an under-value. The contract is voidable at the option of A.

e) A is entitled to succeed to an estate at the death of B, B dies: C, having received intelligence of B's death, prevents the intelligence from reaching A, and thus induces A to sell him his interest in the estate. The sale is voidable at the option of A.

2.6.2.5 Mistake [Sections 20, 21 and 22]

Mistake means an erroneous belief about something. It has not been defined in the Indian Contract Act.

Mistake can be –

A) Mistake of law, or (Section 21)

B) Mistake of fact (Section 20)

A) Mistake of law may be:

1. mistake of law of the country
2. mistake of law of a foreign country

1. Mistake of law of the country:

When a party enters into a contract, without the knowledge of law in the country, the contract is affected by such mistake but it is not void. A contract is not voidable because it was caused by a mistake as to any law in force in India. The reason here is that ignorance of law is not an excuse at all. However, if a party is *induced* to enter into a contract by the mistake of law, then such a contract may be avoided.

2. Mistake of law of foreign country: Such a mistake is treated as mistake of fact and agreement is such case is void.

B) Mistake of fact may be:

1. Bilateral mistake, or
2. Unilateral mistake

1. Bilateral mistake

Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void.

Explanation: An erroneous opinion as to the value of the thing which forms the subject-matter of the agreement is not to be deemed a mistake as to a matter of fact.

In order to render an agreement void due to bilateral mistake, the following two conditions must be met:-

a) Mistake must be mutual: Both the parties must misunderstand each other and should be at cross purpose.

b) Mistake must relate to a matter of fact essential to the agreement: What is essential fact of an agreement depends upon the nature of promise in each case.

The various types of mistakes falling under bilateral mistakes are as under:

I) **Mistake as to subject matter covers following cases:**

a) **Mistake as to *existence* of subject matter:** If both the parties are at mutual mistake as to existence of the subject matter, the agreement is void.

b) **Mistake as to *identity* of subject matter:** It usually happens when both the parties have different subject matter of contract in their mind. The agreement is void due to mistake of identify of subject matter.

c) **Mistake as to the *quality* of the subject matter:** If the subject matter is something essentially different from what the parties thought to be, the agreement is void.

d) **Mistake as to *quantity* of subject matter:** Bilateral mistake as to quantity of subject matter would render the agreement void.

e) **Mistake as to *title* of subject matter:** The agreement is void due to bilateral mistake as to title of the subject matter

f) **Mistake as to *price* of the subject matter:** Mutual mistake as to price of the subject matter would render the agreement void.

II) Mistake as to possibility of performance of Contract

Impossibility may be:

a) **Physical impossibility:** An agreement is void, if it is identified to be non-feasible due to physical factors, like time, distance, height, etc.

b) **Legal impossibility:** An agreement is void, if it provides that something shall be done which as a matter of law cannot be done.

Examples:

a) A agrees to sell to B a specific cargo of goods supposed to be on its way from England to Bombay. It turns out that, before the day of the bargain, the ship conveying the cargo had been cast away and the goods lost. Neither party was aware of the these facts. The agreement is void.

b) A agrees to buy from B a certain horse. It turns out that the horse was dead at the time of bargain, though neither party was aware of the fact. The agreement is void.

c) A, being entitled to an estate for the life of B, agrees to sell it to C. B was dead at the time of the agreement, but both parties were ignorant of the fact. The agreement is void.

2. Unilateral Mistake as to fact

As per section 22, a contract is not voidable merely because it was caused by one of the parties to it being under a mistake as to a matter of fact. A unilateral mistake is not allowed as a defence in avoiding a contract unless brought about by another party's fraud or misrepresentation.

Quasi-Contracts, Contingent Contracts, Termination or Discharge of Contracts

2.7

2.7.1 Quasi-Contracts

Sometimes the law implies a promise imposing obligations on one party and conferring the right in favor of the other even when there is no offer, no acceptance, no consensus ad idem, and in fact, there is neither agreement nor promise. Such cases are not contracts but the court recognizes them as relations resembling those of contracts and enforces them as if they were contracts. Such is called as a quasi-contract.

This type of contract rests on the equitable principle that a person shall not be allowed to enrich himself unjustly in the experience of another. It is obligation which the law creates in the absence of any agreement, when any person is in the possession of one person's money or its equivalent under such circumstances that in equity and good conscience, he ought not to retain it and which in justice and fairness belongs to another. It is the duty and not an agreement or intention which defines it.

Example: A restaurant owner delivered the food parcel to the neighbour of the family which ordered the food. The receiver neighbour knew that it had been delivered by mistake but made no efforts to return the same, and consumed it. The neighbour is bound by a quasi-contract to replenish the unjust benefits received by them, to the original family which ordered.

In the Act, the following type of quasi contracts are discussed-

Section 68 – Claim for necessaries supplied to person incapable of contracting, or on his account.

This section provides that if a person, incapable of entering into a contract, or any one whom he is legally bound to support, is supplied with another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person.

Examples:

- A supplies B, a lunatic, with necessaries suitable to his condition in life. A is entitled to be reimbursed from B's property.
- A supplies the wife and children of B, a lunatic, with necessaries suitable to their condition in life. A is entitled to be reimbursed from B's property.

Section 69 – Reimbursement of persons paying money due by another, in payment of which he is interested – This section provides that a person who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other.

Example:

B holds land in Bengal, on a lease granted by A, the zamindar. The revenue payable by A to the Government being in arrear, his land is advertised for sale by the Government. Under the revenue law, the consequence of such sale will be the annulment of lease. B, to prevent the sale and the consequent annulment of his own lease, pays to the Government the sum due from A. A is bound to make good to B the amount so paid.

Section 70 – Obligation of person enjoying benefit of non-gratuitous act – This section provides that where a person lawfully does anything for another person, or delivers anything to him, not intending to do so gratuitously, and such other person enjoys the benefit thereof, the latter is bound to make compensation to the former in respect of, or to restore, the thing so done or delivered – it is otherwise called as quantum meruit.

Examples:

a) A, a tradesman, leaves goods at B's house by mistake. B treats the goods as his own. He is bound to pay A for them.

b) A saves B's property from fire. A is not entitled to compensation from B, if the circumstances show that he intended to act gratuitously.

Section 71 – Responsibility of finder of goods – This section provides that a person who finds goods belonging to another, and takes them into his custody, is subject to the same responsibility as a bailee.

Section 72 – Liability of person to whom money is paid or thing delivered, by mistake or under coercion– This section provides that a person to whom money has been paid, or anything delivered, by mistake or under coercion, must repay or return it.

Examples :

a) A and B jointly owe ₹ 100 to C, A alone pays the amount to C, and B, not knowing this fact, pays ₹ 100 over again to C. C is bound to repay the amount to B.

b) A railway company refuses to deliver up certain goods to the consignee, except upon the payment of an illegal charge for carriage. The consignee pays the sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive.

2.7.2 Contingent Contracts

Section 31 defines 'contingent contract' as a contract to do or not to do something, if some event, collateral to such contract, does or does not happen.

The following are the essentials of contingent contract:

- Uncertainty and futurity of the event to which it is related;
- Uncertain future event must be collateral to the contract.
- An agreement to sell unspecified half share in the property is not contingent contract as held in 'Harbakhash Singh Gill V. Ram Rattan' AIR 1988 P&H 60. In 'Bhairon Prasad Chaurasiya V. Smt. Tara Devi', AIR 1980 All. 36 it was held that an agreement to sell a house is by no means a 'contingent contract'. An agreement to purchase a property is neither a contingent contract nor can it be characterized as a mere possible right or interest. It was contended that the contract is a 'contingent contract' because of either of the parties to the contract may refuse to perform his part on the contract. The Court held that the argument is fallacious. Such a contingency would not be a collateral to a contract. An agreement to purchase a property is neither a 'contingent contract' nor can it be characterized as a mere possible right of interest.
- Reciprocal promises are not contingent contracts as they cannot be said to be collateral to each other. The law allows the enforcement of a contingent contract after the event upon which it was contingent has happened. The contingency which is the essence of a condition must be distinguished from mere futurity. An obligation is not to be classified as conditional because its performance is not yet due.
- A contingent contract need not necessarily be independent on any external event. It may be conditional on the voluntary act or the future conduct of one of the parties or a third person.

Enforcement of contingent contract

Section 32 provides that contingent contracts to do or not to do anything, if an uncertain future event happens

cannot be enforced by law unless and until that event has happened. If the event becomes impossible, such contracts become void.

Examples:

a) A makes a contract with B to buy B's horse if A survives C. This contract cannot be enforced in law unless and until C dies in A's lifetime.

b) A makes a contract with B to sell a horse to B at a specified price if C, to whom the horse has been offered, refused to buy him. The contract cannot be enforced by law unless and until C refuses to buy the horse.

c) A contract to pay B a sum of money when B marries C. C dies without being married to B. The contract becomes void.

Section 33 provides for enforcement of contacts contingent on an event not happening. This section provides that contingent contracts to do or not to do anything if an uncertain future event does not happen, can be enforced when the happening of that event becomes impossible, and not before.

Explanation – A agrees to pay B a sum of money, if a certain ship does not return. The ship is sunk. The contract can be enforced when the ship sinks.

Section 34 discusses about deemed impossible contract. The said section provides that if the future event on which a contract is contingent is the way in which a person will act at an unspecified time, the event shall be considered to become impossible when such person does anything which renders it impossible that he should so act within any definite time, or otherwise than under further contingencies.

Example: A agrees to pay B a sum of money if B marries C, C marries D. The marriage of B to C must now be considered impossible; although it is possible that D may die and that C may afterwards marry B.

Section 35 provides for the contracts which are contingent on happening of specified event within fixed time. The said section provides that contingent contracts to do or not to do anything, if a specified uncertain event happens within a fixed time, become void if, at the expiration of the time fixed, such event has not happened, or if, before the time fixed, such event becomes impossible. Contingent contracts to or not to do anything, if a specified uncertain event does not happen within a fixed time, may be enforced by law when the time fixed has expired and such event has not happened, or before the time fixed has expired, if it becomes certain that such event will not happen.

Examples:

a) A promises to pay B a sum of money if a certain ship returns within a year. The contract may be enforced if the ship returns within the year and becomes void if the ship is burnt within the year;

b) A promises to pay B a sum of money if a certain ship does not return within a year. The contract may be enforced if the ship does not return within the year, or is burnt within the year.

Agreements contingent on impossible event void

Section 36 provides that contingent agreement to do or not to do anything, if an impossible event happens, are void, whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.

Example:

a) A agrees to pay B ₹1,000 if two straight lines should enclose a space. This agreement is void.

b) A agrees to pay B ₹1,000 if B will marry A's daughter C. C, was dead at the time of the agreement. The agreement is void.

2.7.3 Discharge of Contracts

When the rights and obligations created by a contract come to an end, the contract is said to be discharged or

terminated. In other words, discharge of contract means termination of contractual relationship between the parties.

Modes of discharge of contracts:

The following are the various modes or methods by which a contract is discharged. Discharge amounts to end of a contract.

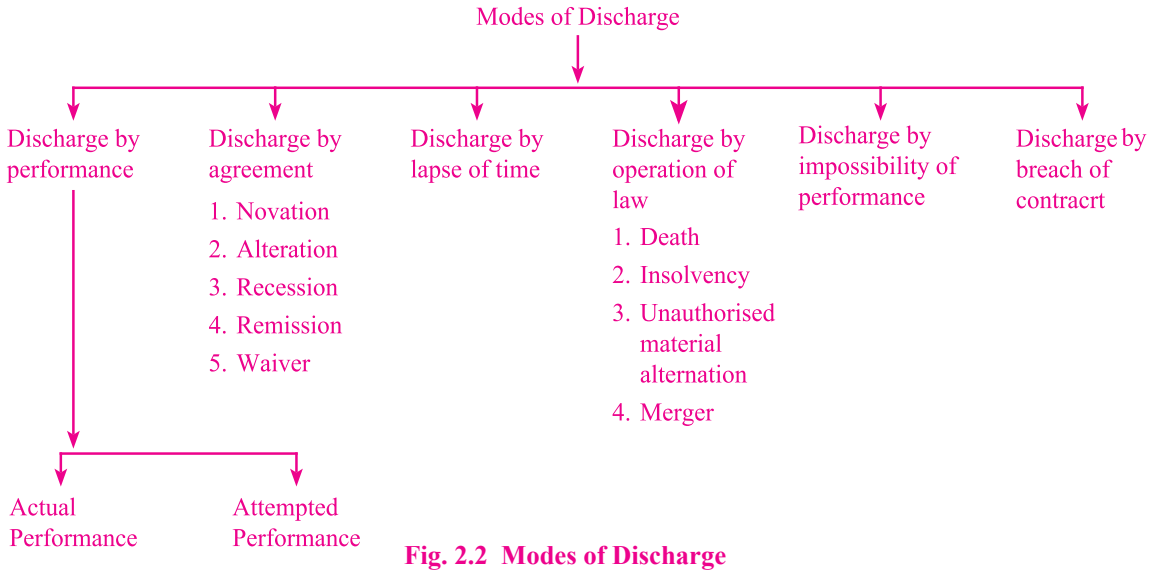

Fig. 2.2 Modes of Discharge

1. **Discharge by performance:** Performance is the usual mode of discharge of a contract.

   Performance may be:

   (a) actual performance

   (b) attempted performance.

   Actual performance is the fulfilment of the obligations arising from a contract by the parties to it, in accordance with the terms of the contract.

   Offer of performance is also known as attempted performance or tender of performance. A valid tender of performance is equivalent to performance.

2. **Discharge by agreement:** The parties may agree to terminate the existence of the contract by any of the following ways:

   a) **Novation:** Substitution of a new contract in place of the existing contract is known as "Novation of Contract". It discharges the original contract. The new contract may be between the same parties or between different parties. Novation can take place only with the consent of all the parties.

      Example: A owes money to B under a contract. It is agreed between A, B and C that B should accept C as his debtor, instead of A. The old debt of A and B is at an end and a new debt from C to B has been contracted. There is novation involving change of parties.

   b) **Alteration:** Alteration means change in one or more of the terms of the contract. In case of novation, there may be a change of the parties, while in the case of alteration, the parties remain the same. But there is a change in the terms of the contract.

   c) **Rescission:** Rescission means "cancellation". All or some of the terms of a contract may be cancelled.

Rescission results in the discharge of the contract.

Example: A promises to deliver certain goods to B at a certain date. Before the date of performance, A and B mutually agree that the contract need not be performed. The contract stands discharged by rescission.

d) **Remission:** Remission means acceptance of a lesser performance that what is actually due under the contract. There is no need of any consideration for remission.

Example: A has borrowed ₹500 from B. A agrees to accept ₹250 from B in satisfaction of the whole debt. The whole debt is discharged.

e) **Waiver:** Waiver means giving up or foregoing certain rights. When a party agrees to give up its rights, the contract is discharged.

Example: A promises to paint a picture of B. B afterwards forbids him to do so. A is no longer bound to perform the promise.

3. **Discharge by lapse of time:** Every contract must be performed within a fixed or reasonable period. Lapse of time discharges the contract. The Indian Limitation Act has prescribed the period within which the existing rights can be enforced in courts of law.

   Example: If a creditor does not file a suit within three years of debt, the debt becomes time-barred. He is deprived of his legal remedy.

4. **Discharge by operation of law:** A contract may be discharged by operation of law in the following cases.

   a) **Death:** In contracts involving personal skill or ability, death terminates the contracts. In other cases, the rights and liabilities of the deceased person will pass on to his legal representatives.

   b) **Insolvency:** The insolvency of the promisor discharges the contract. The promisor is discharged from all liabilities incurred prior to his adjudication.

   c) **Unauthorized material alteration:** Material alteration in the terms of the contract without the consent of the other party discharges the contract. Change in the amount of money to be paid, date of payment, place of payment etc. are examples of material alteration.

   d) **Merger:** When inferior rights of a person under a contract merge with superior rights under a new contract, the contract with inferior rights will come to an end.

   Example: Where a part-time lecturer is made full-time lecturer, merger discharges the contract of part-time lectureship.

5. **Discharge by impossibility of performance:** Impossibility of performance results in the discharge of the contract. An agreement which is impossible is void, because law does not compel to do impossible things.

6. **Discharge by breach:** Breach means failure of a party to perform his obligations under a contract. Breach brings an end to the obligations created by a contract.

   Example: A and B wanted to marry each other. Before the time fixed for marriage, A goes mad. The contract becomes void.

2.7.4 Termination of Contract

The proper way, in which the agreement could have been terminated by issuing of a notice to the plaintiff, calling upon to complete the transaction within a particular time, failing which the contract will be treated as cancelled.

That this is the proper way of terminating the contract is cleared from what has been observed in ''Narayana Swami Pillai vs. Dhanakodi Ammal', (1971) 1 Mys. L.J., 245 that when the contract is for the sale of immovable property the vendor must give reasonable notice requiring the performance within a definite time.

Assignment of Contractual Rights and Obligations

2.8

Assignment means transfer of contractual rights or liability by a party to a contract to another person who is a stranger to the said contract. Assignments are used to make transactions simpler and expedited. Assignments can take place in various kinds of transactions like in marketplace, in commercial transactions, with respect to intellectual property and so on. Assignment has also been widely used in the context of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, whereby loans have been secured by banks by way of assignment of their contractual rights, as a creditor even with respect to mortgage and so on, to an asset reconstruction company who then undertakes to recover the loan amount from the debtor. When a contract is assignable and there is an assignment of the same in favour of the plaintiff, the plaintiff can sue upon it, and the plea that there is no privity of contract with plaintiff can be of no avail.

Example: if A owes B ₹500 and B owes C a like amount, B has the right to receive from A and is under liability to pay C. B can ask A to pay directly to C and if A accepts, that will be an assignment of B's right to C.

Section 37 of the Indian Contract Act, 1872 enables parties to dispense with performance by way of assignment. It lays down obligation of parties to contracts. It states that the parties to a contract must either perform, or offer to perform, their respective promises, unless such performance is dispensed with or excused under the provisions of this Act, or of any other law. Promises bind the representatives of the promisors in case of the death of such promisors before performance, unless a contrary intention appears from the contract.

Example: Amit, a well-known artist, promises to paint a picture for Sumit by a certain day, at a certain price. Amit dies before the day. The contract cannot be enforced either by Amit's representatives or by Sumit.

Section 38 of The Indian Contract Act, 1872, discusses the effect of refusal to accept offer of performance. It states that where a promisor has made an offer of performance to the promisee, and the offer has not been accepted, the promisor is not responsible for non-performance, nor does he thereby lose his rights under the contract.

Every such offer must fulfil the following conditions

1. it must be unconditional;
2. it must be made at a proper time and place, and under such circumstances that the person to whom it is made may have a reasonable opportunity of ascertaining that the person by whom it is made is able and willing there and then to do the whole of what he is bound by his promise to do;
3. if the offer is an offer to deliver anything to the promisee, the promisee must have a reasonable opportunity of seeing that the thing offered is the thing which the promisor is bound by his promise to deliver. An offer to one of several joint promisees has the same legal consequences as an offer to all of them.

Representations and Warranties 2.9

Representations are those statements that are made based on true facts that exist on the day of execution of the contract. Representations induce parties to enter into contracts and inaccurate or false representations are regulated by the Indian Contract Act, 1872. In Indian Contract Act representation has not been defined however, misrepresentations have been explained under Section 18 of the Indian Contract Act, 1872.

Representations have not been defined under The Indian Contract Act, 1872. However, fortunately "misrepresentations" have been defined. Section 18 of The Indian Contract Act, 1872 defines misrepresentation. It states that misrepresentation means and includes:

1. the positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true;
2. any breach of duty which, without an intent to deceive, gains an advantage to the person committing it, or any one claiming under him; by misleading another to his prejudice, or to the prejudice of any one claiming under him;
3. causing, however innocently, a party to an agreement, to make a mistake as to the substance of the thing which is the subject of the agreement.

Section 19 of The Indian Contract Act, 1872 lays down provisions relating to voidability of agreements without free consent.

It 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. A party to a 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 in the position in which he would have been if the representations made had been true.

Exception: If such consent was caused by misrepresentation or by silence, fraudulent within the meaning of section 17, the contract, nevertheless, is not voidable, if the party whose consent was so caused had the means of discovering the truth with ordinary diligence.

Explanation: A fraud or misrepresentation which did not cause the consent to a contract of the party on whom such fraud was practiced, or to whom such misrepresentation was made, does not render a contract voidable.

In the case of National Highway Authority of India vs Pune Solapur Road Development Corporation Ltd (O.M.P. (COMM) 128/2018 & I.A. No. 3857/2018, the Delhi High Court confirmed the award passed by the arbitral tribunal in favour of the Respondent. The Arbitral Tribunal relied upon the clause relating to breach of representations and warranties and awarded damages to the Respondent holding that the Petitioner had represented and warranted that it had full power and authority to deliver and perform its obligations under

the agreement and carry out the transaction contemplated therein such as the ones under Clause 7.2 (g) of the agreement, where the Petitioner had warranted that it had complied with the applicable laws in all material aspects and under clause 7.2 (j) where it had warranted that the Petitioner had a good and valid right to the site and had power and authority to grant a license in respect thereof to the concessionaire.

Warranties are the promise of indemnity. Warranty has not been defined under The Indian Contract Act, 1872. However, if warranties are breached, it generally gives rise to indemnification. Section 124 of The Indian Contract Act, 1872 defines contract of indemnity. It states that a contract by which one party promises to save the other from loss caused to him by the contract of the promisor himself, or by the conduct of any other person, is called a "contract of indemnity".

Example: Mukil contracts to indemnify Sukil against the consequences of any proceedings which Tukil may take against Sukil in respect of a certain sum of ₹2 Lakhs. This is a contract of indemnity.

Section 125 of The Indian Contract Act, 1872 lays down provisions relating to rights of indemnity-holder when sued:

The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor:

1. all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;
2. all costs which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorized him to bring or defend the suit;
3. all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorized him to compromise the suit.

Impossibility and Force Majeure

2.10

Section 32 of the Indian Contract Act, 1872 lays down provisions relating to enforcement of contracts contingent on an event happening. It states that contingent contracts to do or not to do anything based on an uncertain future event happening, cannot be enforced by law unless and until that event has happened. If the event becomes impossible, such contracts become void.

Examples:

a) A makes a contract with B to buy B's horse if C dies before A. This contract cannot be enforced by law unless and until C dies during A's lifetime.

b) Ms. X contracts to pay Mr. Y a sum of money if Mr. Y married Ms. X. Unfortunately, Ms. X dies without being married to Mr. Y. The contract becomes void.

Section 36 of the Indian Contract Act, 1872 states that an agreement contingent on impossible events is void. Contingent agreements to do or not to do anything, if an impossible event happens, are void, whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.

Whereas, Section 56 of The Indian Contract Act, 1872 states that an agreement to do an act impossible in itself is void.

Contract to do an act afterwards becoming impossible or unlawful: A contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.

Compensation for loss through non-performance of act known to be impossible or unlawful: Where one person has promised to do something which he knew, or, with reasonable diligence, might have known, and which the promisee did not know, to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the non-performance of the promise.

Examples:

1. A agrees to marry B if B gets A the moon in the sky. The agreement is void.
2. A agrees with B to discover treasure by magic. The agreement is void:
3. A and B contract to marry each other. Before the time fixed for the marriage. A goes mad. The contract becomes void.
4. Indian company has a contract for supply of sugar to Pakistan with the Government of Pakistan. However war is declared between the two nations. The contract becomes void as it is with an enemy country, pursuant to the declaration of war.

Illustration:

Anil and Sunil entered into the contract where Anil promised to deliver 100 labourers for building his house. At the time of making the contract they included the clause "Force Majeure". But Anil could not deliver the labourers to Sunil due to Covid-19 lockdown. Under this situation Anil is under no obligation to perform the contract - Justify.

Solution

Force Majeure clause is a ground for avoiding obligations emanating out of a contract due to circumstances that are out of control of either of the parties. The pandemic was one such instance when most contracts could not be completed due to the sudden lockdown leading to the invoking of the force majeure clause. The lockdown was pursuant to the directions by the Government. However, many events take place that cannot be controlled that in turn may lead to the impossibility of performance of a contract. Thus, under Section 56 of the Indian Contract Act, 1872, it becomes now impossible for either party to perform its obligations thereby making it void.

A force majeure clause is decided beforehand by parties before the execution of the contract, whereby the parties identify the events, which would attract the applicability of the Force majeure clause. However, the term 'Force majeure' is not defined anywhere in The Indian Contract Act, 1872.

Termination by Novation

2.11

Section 62 of the Indian Contract Act, 1872 lays down the effect of novation, rescission, and alteration of contract. It states that if the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract, need not be performed.

Examples:

a) Ram owes Shyam some money under a contract. It is agreed between Ram, Shyam and Kiran that Shyam shall thenceforth accept Kiran as his debtor, instead of Ram. The old debt of Ram to Shyam is at an end, and a new debt from Kiran to Shyam has been contracted.

b) A owes B ₹10,000. A enters into an arrangement with B, and gives B a mortgage of A's estate for ₹5,000 in place of the debt of ₹10,000. This is a new contract and extinguishes the old.

To fulfil Section 62, the requirements are that there must be a meeting of minds and there must have been a pre-existing contract between the parties which has now been terminated. In the case of Lata Construction & Ors vs. Dr. Rameshchandra Ramniklal Shah, the court held that novation of a contract leads to substitution of a new contract for the old contract. Such a substitution leads to the discharge of the old contract which no longer has to be performed. A contract of novation requires a party to agree to extinguish or discharge his obligation or debt. Unless this has been accomplished there can be no novation.

For example, in a lease agreement, where the tenant gives the lease to another party and makes him responsible for the obligations and responsibility arising from the lease agreement.

Many kinds of special contracts can be terminated and The Indian Contract Act, 1872 also enlists the authorities who have the power to terminate such contracts. Contracts can also be terminated between parties by rescinding them. Rescission under contract law means a party to the contract can cancel or terminate the contract. Parties can also legally terminate a contract by mutual consent. As per Section 64, consequences of rescission of voidable contract has been laid down. It states that when a person at whose option a contract is voidable rescinds it, the other party thereto need not perform any promise therein contained in which he is promisor. The party rescinding avoidable contract shall, if he has received any benefit thereunder from another party to such contract, restore such benefit, so far as may be, to the person from whom it was received.

Section 66 of The Indian Contract Act, 1872, lays down the mode of communicating or revoking rescission of voidable contract: The rescission of a voidable contract may be communicated or revoked in the same manner, and subject to the same rules, as apply to the communication or revocation of a proposal.

As per Section 75, party rightfully rescinding contract is entitled to compensation:

A person who rightfully rescinds a contract is entitled to compensation for any damage which he has sustained through the non-fulfilment of the contract.

For example, A, a waiter, contracts with B, the manager of a hotel, to work at his hotel for two nights in every week during the next two months, and B engages to pay him ₹ 100 for each night. On the sixth night, A wilfully absents himself from the hotel, and B, in consequence, rescinds the contract. B is entitled to claim compensation for the damage which he has sustained through the non-fulfilment of the contract.

Tender Procedure of Government Contract

2.12

Essentially a tender is construed as an invitation to an offer which invites bids from various contenders. These bids are then construed as offer which when accepted becomes a contract which is binding on both the parties equally. These contracts are usually for the purposes of executing specific work or supply commodities within specified time schedules.

A tender document may also be called as Request for Tender (RFT). This document usually contains the specifications of the work to be carried out or goods to be supplied, time limit for fulfilment of the work and conditions of contract. These tenders may be floated by companies, organizations or by the Government or its agencies. Interested parties then submit a proposal against the tender which is then evaluated and shortlisted for the contract by those who floated the tender.

Example: The local Government school required installation of fans and light bulbs in its classrooms for which they published a request for tender in the national daily. Many electrical companies submitted their bids according to the specifications mentioned in the tender. Honeywell company was selected out of the bidders who quoted the least price for the installation of the fans and light bulbs.

The General Financial Rules (GFR), 2017, by the Department of Expenditure Ministry of Finance, are a compilation of rules and orders of Government of India to be followed by all while dealing with matters involving public finances. These rules and orders are treated as executive instructions to be observed by all Departments and Organisations under the Government and specified Bodies except otherwise provided for in these Rules. The GFR outlines the procurement procedure, contract management, and financial management principles. Under Chapter 6 of GFR 2017 procurement of goods and services has been discussed. Additionally Delegation of Financial Powers Rules (DFPR) along with the GFR, 2017 deals with governmental procurement and government procurement contracts. Apart from the GFR, 2017, there is no central legislation that governs governmental procurement and contract of tender in India. Every state has its own rules and guidelines with respect to government procurement contracts, based on broader principles of GFR, 2017.

Rule 144 of General Financial Rules (GFRs), 2017, by the Department of Expenditure Ministry of Finance, Government of India, lays down the fundamental principles of public buying (for all procurements including procurement of works). It states:

Every authority delegated with the financial powers of procuring goods in public interest shall have the responsibility and accountability to bring efficiency, economy, and transparency in matters relating to public procurement and for fair and equitable treatment of suppliers and promotion of competition in public procurement. The procedure to be followed in making public procurement must conform to the following yardsticks:-

i) The description of the subject matter of procurement to the extent practicable should –

   a) be objective, functional, generic and measurable and specify technical, qualitative and performance characteristics.

b) not indicate a requirement for a particular trade mark, trade name or brand.

ii) The specifications in terms of quality, type etc., as also quantity of goods to be procured, should be clearly spelt out keeping in view the specific needs of the procuring organisations. The specifications so worked out should meet the basic needs of the organisation without including superfluous and non-essential features, which may result in unwarranted expenditure.

iii) Where applicable, the technical specifications shall, to the extent practicable, be based on the national technical regulations or recognized national standards or building codes, wherever such standards exist, and in their absence, be based on the relevant international standards. In case of Government of India funded projects abroad, the technical specifications may be framed based on requirements and standards of the host beneficiary Government, where such standards exist. Provided that a procuring entity may, for reasons to be recorded in writing, adopt any other technical specification.

iv) Care should also be taken to avoid purchasing quantities in excess of requirement to avoid inventory carrying costs.

v) Offers should be invited following a fair, transparent and reasonable procedure.

vi) The procuring authority should be satisfied that the selected offer adequately meets the requirement in all respects.

vii) The procuring authority should satisfy itself that the price of the selected offer is reasonable and consistent with the quality required.

viii) At each stage of procurement, the concerned procuring authority must place on record, in precise terms, the considerations which weighed with it while taking the procurement decision.

(ix) A complete schedule of procurement cycle from date of issuing the tender to date of issuing the contract should be published when the tender is issued.

x) All Ministries/Departments shall prepare Annual Procurement Plan before the commencement of the year and the same should also be placed on their website.

Also, Rule 145 lays down provision relating to authorities competent to purchase goods:

An authority which is competent to incur expenditure may sanction the purchase of goods required for use in public service in accordance with provisions in the Delegation of Financial Powers Rules, following the general procedure contained in the following rules.

Special Contract - Indemnity and Guarantee; Bailment and Pledge; Laws of Agency

2.13

2.13.1 Contract of Indemnity and Guarantee

Chapter VIII of the Act deals with the contract of indemnity and guarantee. Sections 124 and 125 deal with the contract of indemnity. The other provisions deal with the contract of guarantee.

Contract of Indemnity

Section 124 of the Act defines the expression 'contract of indemnity' as a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person.

Example: A contracts to indemnify B against the consequences of the proceedings which C may take against B in respect of a certain sum of ₹2 lakhs. This is a contract of indemnity.

This contract includes indemnifier and indemnity holder. A person who promises to indemnify from losses is called as indemnifier and the person whose loss is made good is called as indemnity holder. To indemnify does not merely means to reimburse in respect of moneys paid, but to save from loss in respect of the liability for which the indemnity has been given.

A contract of indemnity may be either expressed or implied. In 'Kuppan Chettiar v. Ramaswami Chettiar' – ILR (1947) Mad.58 it was held that there is implied by law a contract by the person making the request to keep indemnified the person having the duty against any liability which may result from such exercise of the supposed duty.

In 'The New India Assurance Co. Limited V. State Trading Corporation of India' – AIR 2007 (NOC) 517 (Guj) it was held that almost all insurance other than life and personal accident insurances are contracts of indemnity.

In 'National Overseas vs. Export Credit Guarantee Corporation of India Limited' Air 2008 All 18 it was held that where export risk policy issued by Export Credit Guarantee Corporation and exporter had consigned shipments to buyer at his own risk without resorting to terms of policy, the corporation is not liable to indemnify loss caused to exporter.

Rights of indemnity holder when sued

Section 125 provides the rights of indemnity holder when sued. This section provides that the promise, in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor-

- all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;
- all costs which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorized him to bring or defend the suit;
- all the sums which he may have paid under the terms of any compromise of any such suit, if the compromise

was not contrary to the orders of the promisor, and was one which it would have been prudent for the promise to make in the absence of any contract of indemnity, or if the promisor authorized him to compromise the suit.

This section is not exhaustive and does not set out all the reliefs which an indemnity holder who has been sued may get. It leaves untouched certain equitable reliefs which he may get. The rights of the indemnity holder are not confined to those mentioned in this section. Even before damage is incurred, it is open to him to sue for the specific performance of the contract of indemnity, provided that it is show, that an absolute liability has been incurred by him and that the contract of indemnity covers the said liability.

In 'Pepin V. Chandra Seekur', ILR 5 Cal. 811 it was held that in the case of contract of indemnity, the liability of the party indemnified to a third person is not only contemplated at the time of indemnity, but is the very moving cause of that contract and in case of such a nature, the costs reasonably incurred in resisting or reducing or ascertaining the claim may be recovered.

2.13.2 Contract of Guarantee

Section 126 defines the expression 'the contract of guarantee' as a contract to perform the promise, or discharge the liability of a third person in case of his default. The components of this contract consist of:

- surety – the person who gives the guarantee is called as the 'surety';
- principal debtor – the person in respect of whose default the guarantee is given is called the principal debtor;
- creditor – the person to whom the guarantee is given is called the 'creditor'.

A guarantee may be either oral or written. It is a tripartite agreement which contemplates the principal debtor, the creditor and the surety.

Consideration for Guarantee

Section 127 provides that anything done, or any promise made, for the benefit of the principal debtor, may be a sufficient consideration to the surety for giving guarantee.

Examples:

a) B requests A to sell and deliver to him goods on credit. A agrees to do so, provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A's promise to deliver the goods. This is sufficient consideration for C's promise

b) A sells and delivers goods to B. C afterwards requests A to forbear to sue B for the debt for a year, and promises that, if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. This is a sufficient consideration for C's promise

c) A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void.

This section takes into its fold past consideration also. Like any other contract, a contract of guarantee must be supported by consideration. It is not necessary that the consideration should be received by the surety. Consideration between the principal debtor and the creditor is good consideration for the guarantee given by the surety.

In 'Rajendra V. Mahila Chandrabai' – 2012 (1) MPLJ 164 the case is within the purview of example (c). Merely because the appellant made promise to the plaintiff that in this case first and second defendants who were required to pay the sale price to her, fail to pay the same, he would pay the sale price, that promise was without consideration and therefore the said agreement between the plaintiff and third defendant was void. Needless to say that a void

agreement cannot be enforced by law and therefore, since the status of the appellant (third defendant) is that of a guarantor, his case is covered under the ambit of example © to Section 127 of the Act and he is not liable to pay the sale consideration or any other amount to the plaintiff on account of the failure in making the payment by first and second defendants.

In 'United Breweries (Holding) Limited vs. K.S.I.I. & D.C. Limited' – AIR 2012 (NOC) 154 (Cal.) it was held that it is clear that the question as to whether the deed in question is a deed of guarantee or not depends upon the terms under which the guarantor binds himself. Under law, he cannot be made liable for more than what he has undertaken. There is no ambiguity that the appellant has not undertaken that he would repay the loans of respondent No. 2, in case if respondent No.2 fails to discharge its liability. Therefore, the appellant cannot be made liable for more than what it has undertaken.

2.13.3 Distinction between Indemnity and Guarantee

The contract of indemnity differs from the contract of guarantee in the aspects shown in the following table:

Sl. No.	Contract of Indemnity	Contract of Guarantee
1	In this contract there are **two** parties – the indemnifies and the indemnified	In this contract **three** parties are involved – principal debtors, surety and creditor
2	The primary liability is on the indemnifier	The principal liability is on the principal debtors. Secondary liability is on the surety.
3	The indemnifier is not acting at the request of the debtor.	The surety gives contract at the request of the principal debtor.
4	The possibility of any loss happening is the only contingency against which the indemnifier undertakes to indemnify.	There is an existing debt for which the surety gives guarantee to the creditor on behalf of the principal debtor.
5	The indemnifier cannot sue the third party in his own, unless there is an assignment.	The surety is entitled to proceed against the principal debtor when he is obliged to perform the guarantee
6	The contract is between the indemnifier and indemnified.	The contract is between the principal debtor - creditor; surety - creditor; principal debtor - surety.
7	Defined u/s 124	Defined u/s 126

2.13.4 Liability of surety

The liability of surety arises only when the principal debtor fails to pay the debt to the creditor. Section 128 provides for the liability of surety. The said section provides that the liability of the surety is co- extensive with that of the principal debtor, unless it is otherwise provided by the contract.

Example: A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonored by C. A is liable, not only for the amount of the bill, but also for any charges which may have become due on it. The liability of the surety is co-extensive with that of the principal debtor and the surety is liable to pay the entire amount his liability being immediate as held in 'Gouri Prasad V. Rabo India Finance Limited' – 2013 (2) Mh.L.,J. 195. In 'Swaminatha Pillai vs. Lakshman Ayya' – AIR 1935 Mad 748 it was held that there is no authority for the general proposition that a creditor cannot proceed against the surety unless he has first exhausted all his remedies against the principal debtor.

Where the letter of guarantee issued by a guarantor, guarantees repayment of only the principal sum and does not guarantee the payment of any interest, he could not be made liable for the payment of interest as held in 'S.N. Prasad V. Monnet Finance Limited' – (2011) SCC 320 .

2.13.5 Continuing Guarantee

Section 129 of the Act defines the expression 'continuing guarantee' as a guarantee which extends to a series of transactions.

Examples:

- A, in consideration that B will employ C in collecting the rents of B's zamindari, promises B to be responsible, to the amount of ₹5,000 for the due collection and payment by C of those rents. This is a continuing guarantee.
- A guarantees payment to B, a tea-dealer, to the amount of ₹100, for any tea he may from time to time supply to C, B supplies C with tea to above the value of ₹100 and C pays B for it. Afterwards B supplies C with tea to the value of ₹200. C fails to pay. The guarantee given by A was a continuing guarantee and he is accordingly liable to B to the extent of ₹100.
- A guarantees payment to B of the price of five sacks of flour to be delivered to B to C and to be paid for in a month. B delivers five sacks to C. C pays for them. Afterwards B delivers four sacks to C, which C does not pay for. The guarantee given by A was not a continuing guarantee and accordingly he is not liable for the price of four sacks.

A guarantee for a future performance may either be restricted to a debtor or liability of a certain amount to be incurred once for all, or it may be continuing. If the liability extends to a single transaction, it is specific. In case it extends to a series of transactions it is continuing. In 'Gopinathan V. Nedungadi Bank Limited' – 2013 (3) KLT 115 it was held that on the strength of continuing guarantee, liability of the guarantors continued not withstanding that the personal remedy against the second respondent stood discharged.

Revocation of continuing guarantee

A continuing guarantee can be revoked by two ways

- Revocation by surety;
- Revocation on the death of surety. Revocation of continuing guarantee by surety

Section 130 provides that a continuing guarantee may at any time revoked by the surety, as to future transactions, by notice to the creditor.

Example:

- A, in consideration of B's discounting at A's request, bills of exchange for C, guarantees to B, for 12 months, the due payment of all such bills to the extent of ₹5,000. B discounts bill for C to the extent of ₹2,000. Afterwards, at the end of three months, A revokes guarantee. The revocation discharges A from all liability to B for any subsequent discount. But A is liable to B for ₹2,000 on default of C.
- A guarantees to B, to the extent of ₹10,000/- that C shall pay all the bills that B shall draw upon C. C accepts the bill. A gives notice of revocation. C dishonors the bill at maturity. A is liable upon his guarantee.

Revocation of continuing guarantee by surety's death

Section 131 provides that the death of the surety operates, in the absence of any contract to the contrary, as a revocation of continuing guarantee, so far as regards future transactions.

2.13.6 Discharge of surety

The liability of the surety is discharged under the following circumstances-

- By giving notice to the creditor – Section 130;
- By the death of the surety – Section 131;
- By variance in terms of contract – Section 133;
- By release or discharge of principal debtor – Section 134;
- When creditor compounds with the principal debtor by giving time to, or agrees not to sue principal debtor – Section 135;
- By creditor' act or omission impairing surety's eventual remedy – Section 139;

However, in the following circumstances the liability of the surety is not considered to be discharged-

- Section 136 – Where a contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged;
- Section 137 – Mere forbearance on the part of the creditor to sue the principal debtor or to enforce the other remedy against him, does not, in the absence of any provision in the guarantee to the contrary, discharge the surety;

Example: B owes to C a debt guaranteed by A. The debt becomes payable. C does not sue B for a year after the debt has become payable. A is not discharged from his suretyship.

2.13.7 Rights of surety

The following are the rights available to the surety under this Act

- Section 140 – **Right of surety on payment or performance –** Where a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety, upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor;
- Section 141 – **Surety's right to benefit of creditor's securities –** A surety is entitled to the benefit of every security which the creditor had against the principal debtor at the time when the contract of surety ship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security.

Examples:

- C advances to B, his tenant ₹20,000 on the guarantee of A. C has also a further security for ₹20,000 by a mortgage of B's vehicle. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture;
- C, a creditor whose advance to B is secured by a decree, receives also a guarantee for that advance from A. C afterwards takes B's goods in execution under the decree, and then, without the knowledge of A, withdraws the execution. A is discharged;
- A, as surety for B, makes a bond jointly with B to C, to secure a loan from C to B. Afterwards, C obtains from B a further security for the same debt. Subsequently, C gives up further security. A is not discharged.

Section 140 provides for subrogation where the guarantor clears his liability by payment. He is invested with all rights which the creditor had with the principal debtor. The section enacts that in order that the surety may be invested with all the rights which the creditor had against the principal debtor, the following conditions be fulfilled, namely-

- the guaranteed debt must have become due, or the principal debtor must have made default in performing the guaranteed duty; and
- the surety must have paid the debt, that is, the whole debt, or the surety must have performed all that is liable for.

Unless the said two conditions have been fulfilled, the surety cannot call upon the creditor to invest him with all the rights which he had against the principal debtor.

2.13.8 Invalid Guarantee

The following are considered as invalid guarantee-

- **Guarantee obtained by misrepresentation –** Section 142 provides that any guarantee which has been obtained by means of misrepresentation made by the creditor or with his knowledge and assent, concerning a material part of the transaction is invalid;
- **Guarantee obtained by concealment –** Section 143 provides that any guarantee within the creditor has obtained by means of keeping silence as to material circumstances is invalid.

Examples:

- A engages B as clerk to collect money for him. B fails to account for some of his receipts and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acquaint C with B's previous conduct. B afterwards makes default. The guarantee is invalid;
- A guarantees to C payment for iron to be supplied by him to B to the amount of ₹2000 per tons. B and C have privately agreed that B should pay ₹5 per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as surety.

2.13.9 Co-surety

Section 144 provides that where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join.

Section 146 provides that the co-sureties are liable to contribute equally. This section provides that where two or more persons are co-sureties for the same debt or duty, either jointly or severally, and whether under the same or different contracts, and whether with or without the knowledge of each other, the co-sureties, in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor.

Section 147 of the Act provides that co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

Examples:

a) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of each ₹10,000, B in that of ₹20,000, C in that of ₹40,000, conditioned for D's duly accounting to E. D makes default to the extent of ₹30,000. A, B and C are each liable to pay ₹10,000.

b) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of ₹10,000, B in that of ₹20,000, C in that of ₹40,000, conditioned for D's duly accounting to E. D makes default to the extent of ₹40,000. A is liable to pay ₹10,000, and B and C ₹15,000 each.

c) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of ₹10,000, B in that of ₹20,000, C in that of ₹40,000, conditioned for D's duly accounting to E. D makes default to the extent of ₹70,000. A, B and C have to pay each the full penalty of his bond.

2.13.10 Implied Promise to Indemnify Surety

Section 145 provides that in every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety, and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but no sums which he had paid wrongly.

Examples:

a) B is indebted to C, and A is surety for the debt. C demands payment from A, and on his refusal sues him for the amount. A defends the suit, having reasonable grounds for doing so, but is compelled to pay the amount of the debt, with costs. He can recover from B the amount paid by him for costs, as well as the principal debt.

b) C lends B a sum of money, and A, at the request of B, accepts a bill of exchange drawn by B upon A to secure the amount. C, the holder of the bill, demands payment of it from A and on A's refusal to pay, sues him upon the bill, A, not having reasonable grounds for so doing, defends the suit, and has to pay the amount of the bill and costs. He can recover from B and the amount of the bill, but not the sum paid for costs, as there was no real ground for defending the action;

c) A guarantees to C, to the extent of ₹2,000 payment for rice to be supplied by C to B. C supplies to B rice to a less amount, than ₹2,000, but obtains from A payment of the sum of ₹2,000 in respect of the rice supplied. A cannot recover from B more than the price of the rice actually supplied.

2.13.11 Bailment and Pledge

Chapter IX of the Indian Contract Act, 1872 deals with bailment and pledge.

Bailment

Section 148 defines the term 'bailment' as the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The bailment consists of-

- Bailor – the person delivering the goods is called the 'bailor'; and
- Bailee – the person to whom the goods are delivered is called the 'bailee'.

If a person, already in possession of the goods of other contracts to hold them as a bailee, he thereby becomes the bailee and the owner becomes the bailor of such goods, although they may not have been delivered by way of bailment.

The following are ingredients of the bailment-

- There must be a delivery of specific goods by one person to another;
- The delivery must be for some purpose;
- The delivery must be upon a contract that the goods shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the bailor.

Bailments may be classified into voluntary and involuntary. Voluntary bailments are the outcome of an express contract between the parties. Instances of involuntary bailments are found in cases of finders of good or of goods sent to a wrong place, or in excess of the quantity ordered, or in cases where the bailee dies and the subject of bailment comes into the hands of the bailee's heirs. Where there is no obligation to return the identical article, either in its original or in an altered form, there is no contract of bailment.

Delivery to Bailee how made

Section 149 provides that the delivery to the bailee may be made by doing anything which has the effect of putting the goods in the possession of the intended bailee or any persons authorized to hold them on his behalf.

Bailor's duty

Section 150 lays down three duties, namely-

- It is the duty of the bailor to disclose to the bailee faults in the goods bailed, of which the bailor is aware, and which materially interferen with the use of them, or expose the bailee to extraordinary risks;
- If the bailor does not make such disclosure and some loss or damage results, he is responsible for so much of it as arises to the bailee directly from such faults;
- If the goods are bailed for hire, the bailor is responsible for damage arising to the bailee directly from such faults, whether he was or was not aware of the existence of such faults in the goods bailed.

Examples:

- A lends a horse, which he knows to be vicious, to B. He does not disclose the fact that the horse is vicious. The horse runs away. B is thrown and injured. A is responsible to B for damages sustained.
- A hires a carriage of B. The carriage is unsafe, though B is not aware of it, and A is injured. B is responsible to A for the injury.

Care to be taken by Bailee

Section151 provides that in all cases of bailment the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed.

In 'Nagalinga Chettiyar V. Kayarebana Chettiyar' –AIR 1915 Mad.80 it was held that where the standard of care prescribed by Section151 is not observed the bailee cannot be exonerated from his liability simply because the bailee's goods were also lost along with the goods bailed.

In 'Sirmour Truck Operators Union V. National Insurance Co. Limited' AIR 2011 (NOC) 389 (HP) it was held that the carrier cannot be exempted from its own negligence or negligence by his agent where goods carried at 'owner's risk' and cannot escape from the liability to make good loss.

Bailee when not liable

Section 152 provides that the bailee, in the absence of any special contract, is not responsible for the loss, destruction or deterioration of the thing bailed, if he has taken the amount of care described in Section 151.

Termination of Bailment

Section 153 provides that a contract of bailment is voidable at the option of the bailor, if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment.

Example: A lets to B, for hire, a horse for his own riding. B drives the horse in his carriage. This is at the option

of A, a termination of the bailment.

In 'Neekram vs. Bank of Bengal' – ILR 19 Cal. 322 (PV) it was held that this section is intended for the protection of the bailor whose goods are being used by the bailee in a manner inconsistent with the conditions of the bailment. The bailor may put an end to the bailment although it was created for a specified purpose which has not been accomplished or for a prescribed which has not expired. But merely exercising his rights irregularly by the bailee, e.g., a sub pledge or a premature sale by a pledge will not attract the application of the section.

Liability for unauthorized use of bailed goods

Section 154 provides that if the bailee makes any use of goods bailed, which is not according to the conditions of the bailment, he is liable to make compensation to the bailor for any damage arising to the goods from or during such use of them.

Example:

a) A lends a horse to B for his own riding only. B allows is, a member of his family, to ride the horse. C rides with care, but the horse accidentally falls and injured. B is liable to make compensation to A for the injury done to the horse.

b) A hires a horse in Calcutta from B expressly to march to Benaras. A rides with due care but marches to Cuttack instead. The horse accidentally falls and is injured. A is liable to make compensation to B for the injury to the horse.

In 'Hafizullah V. Montague' – 165 IC 354 it was held that where a car was entrusted to the defendant as a bailee and the evidence establishes that he was using the car for his private purposes in contravention of his agreement with the plaintiff, the bailor, it was held that the defendant was liable for the damages arising from such use.

Mixing of the goods

The goods of the bailor may be mixed with the goods of the bailee. This mixing may be done with or without the consent to the bailor. What would be the effect in such cases? Section 155 provides the solution for the same. This section provides that if the bailee, with the consent of the bailor, mixes the goods of the bailor with his own goods, the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced.

What would be the effect if the goods of the bailor are mixed with the goods of the bailee without the consent of the bailor? Section 156 and 157 provide the solution for the same. Section 156 provides the effect of mixture, without bailor's consent, when the goods can be separated. Section 157 provides the effect of mixture, without bailor's consent, when the goods cannot be separated.

Section 156 provides that if the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods and the goods can be separated or divided, the property in the goods remains in the parties, respectively, but the bailee is bound to bear the expenses of separation or division, and any damage arising from the mixture.

Example:

A bails 100 bales of cotton marked with particular mark to B. B, without A's consent, mixes the 100 bales with other bales of his own, bearing a different mark. A is entitled to have his 100 bales returned, and B is bound to bear all the expenses incurred in the separation of the bales and any other incidental damage.

Section157 provides that if the bailee, without the consent of the bailor, mixed the goods of the bailor with his own goods, in such a manner that it is impossible to separate the goods bailed from the other goods, and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods.

Example:

A bails a barrel of Cap flour worth ₹45 to B. B without A's consent, mixes the flour with country flour of his own, worth only ₹25 a barrel. B must compensate A for the loss of his flour.

Bailor's obligation

Section 158 and 164 impose obligation on the bailor. Section 158 provides that where, by the conditions of the bailment, the goods are to be kept or to be carried, or to have work done upon them by the bailee for the bailor and the bailee is to receive no remuneration, the bailor shall repay to the bailee the necessary expenses incurred by him for the purpose of the bailment.

Section 164 provides that the bailor is responsible to the bailee for any loss which the bailee may sustain by reason that the bailor was not entitled to make the bailment, or to receive back the goods, or to give directions respecting them.

Restoration of goods

The bailed goods should be returned after the bailment is over. Section 159 provides for the restoration of goods lent gratuitously and Section 160 provides for return of goods bailed on expiration of time or accomplishment of purpose. Section 161 provides for the responsibility of the bailee when goods are not duly returned.

Section 159 provides that the lender of a thing for use may at any time require its return, if the loan was gratuitous, even though he lent it for a specified time or purpose. But if, on the faith of such loan made for a specified time or purpose, the borrower has acted in such a manner that the return of the thing lent before the time agreed upon would cause him loss exceeding the benefit actually derived by him from the loan, the lender must, if he compels the return, indemnify the borrower for the amount in which the loss so occasioned exceeds the benefit so derived.

Section 160 provides that it is the duty of the bailee to return, or deliver, according to the bailor's directions, the goods bailed without demand, as soon as the time for which they were bailed has expired, or for the purpose for which they were bailed has been accomplished.

Non delivery of the goods would amount to breach of contract. This section is silent as to the remedies open to a bailor when the bailee has failed to return the goods on his demand. In 'Dhian Singh Sobha Singh vs. Union of India' – AIR 1958 SC 274 the Supreme Court held that a bailor in the event of non-delivery of the goods by the bailee on demand made by him in that behalf was entitled at his election to sue the bailee either for wrongful conversion of the goods or the wrongful detention thereof.

Section 161 provides that if by default of the bailee, the goods are not returned, delivered or tendered at the proper time, he is responsible to the bailor for any loss, destruction or deterioration of the goods from that time.

Section 163 provides that in the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accrued from the goods bailed.

Example: A leaves a cow in the custody of B to be taken care of. The cow has a calf. B is bound to deliver the calf as well as the cow to A.

Section 165 provides that if several joint owners of goods bail them, the bailee may deliver them back to, or according to the directions of, one joint owner without the consent of all, in the absence of any agreement to the contrary.

Section 166 provides that if the bailor has no title to the goods, and the bailee, in good faith, delivers them back to, or according to the directions of, the bailor, the bailee is not responsible to the owner in respect of such delivery.

Termination of gratuitous bailment by death

Section 162 provides that a gratuitous bailment is terminated by the death either of the bailor or of the bailee.

Right of third person

Section 167 provides that if a person, other than the bailor, claims goods bailed he may apply to the Court to stop the delivery of the goods to the bailor, and to decide the title to the goods.

Right of finder of goods

Section 168 provides that the finder of goods has no right to sue the owner for compensation for trouble and expense voluntarily incurred by him to preserve the goods and to find out the owner; but he may retain the goods against the owner until he receives such compensation; and, where the owner has offered a specific reward for the return of goods lost, the finder may sue for such reward, and may retain the goods until he receives it.

Section 169 provides that when a thing which is commonly the subject of sale is lost, if the owner cannot, with reasonable diligence, be found or if he refuses, upon demand, to pay the lawful charges of the finder, the finder may sell it-

- when the thing is in danger of perishing by or of losing the greater part of its value; or
- when the lawful charges of the finder, in respect of the thing found, amount to two thirds of its value.

In 'MJR Steels (P) Limited vs. Chrisomar Corporation' –AIR 2007 (NOC) 234 (Cal.) it was held that it is not always necessary that sale should be by owner himself; sale by agent or anyone with the consent of owner is valid. Finder of asset can also sale and give good title. There can also sale by estoppels.

Bailee's lien

Section 170 provides that when the bailee has in accordance with the purpose of the bailment, rendered any service involving the exercise of labor or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the service he has rendered in respect of them.

Examples:

a) A delivers a rough diamond to B, a jeweller, to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered.

b) A gives, cloth to B, a tailor, to make into a coat. B promises A to deliver the coat as soon as it is finished, and to give a three months' credit for the price. B is not entitled to retain the coat until he is paid.

2.13.12 Pledge

Section 172 of the Act provides that the bailment of goods as security for payment of a debt or performance of a promise is called 'pledge'. The pledge constitutes-

- 'Pawner' – The bailor in this case is called as pawner;
- Pawnee – the bailee in this case is called as pawnee.

A pledge is a bailment of moveable property by way of security. The concept of pledge under this Act is dealt with under Sections 172 to 179. In 'Maharastra State Co-operative Bank Limited vs. Assistant Provident Fund Commissioner' – (2009) 10 SCC 123 it was held that in a pledge the pledge is in possession of and has a special property in the goods which he is entitled to detain to secure repayment. Unlike a mortgage, a pledge does not

have the effect of transferring any interest in the property in favour of the pledge. Delivery of goods is necessary to complete a pledge.

Difference between pledge and bailment

Section 172 of the Act define s a pledge to be the bailment of goods as security for payment of debt or performance of a promise whereas Section 148 provides that a bailment is the delivery of goods by one person to another person for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the persons delivering them.

Rights of pawnee

The rights of the pawnee are described in Section 173, 175 and 176. Section173 provides that the pawnee may retain the goods pledged, not only for the payment of the debt or the performance of the promise, but for the interest of the debt and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.

Section175 provides that the pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged.

Section 176 provides that if the pawnor makes default in payment of the debt, or performance at the stipulated time of the promise, in respect of which the goods were pledged, the pawnee may bring a suit against the pawner upon the debt or promise and retain the goods pledged as a collateral security, or he may sell the things pledged, on giving the pawner a reasonable notice of the sale. If the proceeds of such sale are less than the amount due in respect of the debt or promise, the pawner is still liable to pay the balance. If the proceeds of the sale are greater than the amounts so due, the pawnee shall pay over the surplus to the pawner.

Retaining of the goods by pawnee

Section174 provides that the pawnee shall not, in the absence of a contract to that effect, retain the goods pledged for any debt or promise other than the debt or promise for which they are pledged; but such contract, in the absence of anything to the contrary, shall be presumed in regard to subsequent advances made by the pawnee.

Pledge by Mercantile Agent

Section 178 provides that where a mercantile agent is, with the consent of the owner, in possession or goods or the documents of the title of goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorized by the owner of the goods to make the same, provided the pawnee acts in good faith and has not at the time of the pledge notice that the pawner has no authority to pledge.

The term 'mercantile agent' is defined under Section 2(2) of Sale of Goods Act as an agent having in the course of ordinary business having authority, either to sell goods or to consign goods for the purposes of sale or to buy goods or to raise money on the security of the money.

Pledge in a voidable contract

Section178A provides that when the pawner has obtained possession of the goods pledged by him under a contract voidable under Section 19 or Section19A, but the contract has not been rescinded at the time of pledge, the pawnee acquires a good title to the goods, provided he acts in good faith and without notice of the pawner's defect of title.

Limited interest of pawner

Section 179 provides that where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of that interest.

Suit against wrong doers

Section 180 provides that if a third person wrongfully deprives the bailee of the use of possession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies as the owner might have used in the like case if no bailment had been made; and either the bailer or the bailee may bring a suit against a third person for such deprivation or injury.

Apportionment of relief

Section 181 provides that whatever is obtained by way of relief or compensation in any such suit shall, as between the bailor and bailee, be dealt with according to their respective interests.

2.13.13 Agency

Chapter-X of the Act deals with Agency.

Section 182 provides that an 'agent' is a person employed to do any act for another or to represent another in dealing with the third person.

Principal

The person for whom such act is done, or who is so represented is called the 'principal'.

Provisions regarding to Agent

- a person may become an agent-
- if he is of the age of majority according to the law to which he is subject;
- he is of sound mind;
- no consideration is necessary for the appointment of agent;
- the authority of an agent may be expressed or implied;

Section187 defines the terms 'expressed authority' and implied authority. An authority is said to be express, when it is given by words spoken or written. An authority is said to be implied when it is to be inferred from the circumstances of the case; and things spoken or written, or the ordinary course of dealing, may be accounted circumstances of the case.

Example: A owns a shop in Serampur, himself living in Calcutta, and visiting the shop occasionally. The shop is managed by B, and he is in the habit of ordering goods from C in the name of A for the purposes of the shop, and of paying for them out of A's funds with A's knowledge. B has an implied authority from A to order goods from C in the name of A for purposes of the shop.

Section 184 provides that as between the principal and third persons, any person may become agent, but no person who is not of the age of the majority and of sound mind can become an agent, so as to be responsible to his principal according to the provisions in that behalf.

Section 185 provides that no consideration is necessary to create an agency

Section 188 provides that an agent having an authority to do an act has authority to do every lawful thing which is necessary in order to do such act. An agent having an authority to carry on a business has authority to do every lawful thing necessary for the purpose, or usually done in the course of conducting such business.

Examples:

a) A is employed by B, residing in London to recover at Bombay a debt due to B. A may adopt any legal

process necessary for the purpose of recovering the debt, and may give a valid discharge for the same;

b) A constitutes B his agent to carry on his business of a ship builder. B may purchase timber and other materials, and hire workmen, for the purposes of carrying on his business.

Section 189 provides the agent's authority in an emergency. According to this section, an agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.

Examples:

a) An agent for sale may have goods repaired if it be necessary;

b) A consigns provisions to B at Calcutta, with direction to send them immediately to C at Cuttack. B may sell the provisions at Calcutta, if they will not bear the journey to Cuttack without spoiling.

Section 190 provides that when agent cannot delegate his authority. An agent cannot lawfully employ another to perform acts which he has expressly or impliedly undertaken to perform personally, unless by the ordinary custom of a trade a sub-agent may, or from the nature of the agency, a sub-agent must, be employed.

Sub agent

Section 191 defines the term 'sub-agent' as a person employed by, and acting under the control of, the original agent in the business of the agency.

Section 192 provides that where a sub agent is properly appointed, the principal is, so far as regard third persons, represented by the sub agent, and is bound by and responsible for his acts, as if he were an agent originally appointed by the principal.

The agent is responsible to the principal for the acts of the sub agent. The sub agent is responsible for his acts to the agent, but not to the principal except in cases of fraud or wilful wrong.

Section 193 provides for the responsibility of the agent for sub agent appointed without authority. Where an agent, without having authority to do so, has appointed a person to act as a sub-agent, the agent stands towards such person in the relation of a principal to an agent, and is responsible for his acts both to the principal and to third persons; the principal is not represented by, or responsible for, the acts of the person so employed, nor is that person responsible to the principal.

Section 194 provides that where an agent, holding an express or implied authority to name another person to act for the principal in the business of the agency, has named another person accordingly, such person is not a sub-agent but an agent of the principal for such part of the business of the agency as is entrusted to him.

Examples:

a) A directs B, his solicitor, to sell his estate by auction, and to employ an auctioneer for the purpose. B names C, an auctioneer, to conduct the sale. C is not a sub-agent, but A's agent for the conduct of the sale.

b) A authorizes B, a merchant in Calcutta, to recover the money due to A from C & Co., B instructs D, a solicitor, to take legal proceedings against C & Co for the recovery of the money. D is not a sub-agent, but is a solicitor for A.

Agent's duty

Section 195 provides that in selecting such agent for his principal, an agent is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case; and if he does this, he is not responsible to the principal for the acts or negligence of the agent so selected.

Example:

a) A instructs B, a merchant, to buy a ship for him. B employs a ship surveyor of good reputation to choose a ship for A. The surveyor makes the choice negligently and the ship turns out to be unseaworthy and is lost. B is not, but the surveyor is, responsible to A.

b) A consigns goods to B, a merchant, for sale. B, in due course, employs an auctioneer in good credit to sell the goods of A and allows the auctioneer to receive the proceeds of the sale. The auctioneer afterwards becomes insolvent without having accounted for the proceeds. B is not responsible to A for the proceeds.

Ratification

Section 196 provides for right of person as to acts done for him without his authority. Where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratifies them, the same effects will follow as if they had been performed by this authority.

Section 197 provides that the ratification may be expressed or implied in the conduct of the person on whose behalf the acts are done.

Examples:

a) A, without the authority, buys goods for B. Afterwards B sells them to C on his own account; B's conduct implies a ratification on the purchase made for him by A; A, without B's authority, lends B's money to C. Afterwards B accepts interest on the money from C.

b) B's conduct implies a ratification of the loan.

Section 198 provides that no valid ratification can be made by a person whose knowledge of the facts of the case is materially defective.

Section 199 prescribes the effect of ratifying any unauthorized act forming part of a transaction. A person ratifying any unauthorized act done on his behalf ratifies the whole of the transaction of which such act formed a part.

Section 200 provides that ratification of unauthorized act cannot injure third person. An act done by one person on behalf of another, without such other person's authority, would have the effect of subjecting a third person to damages, or of terminating any right or interest which, if done with authority, of a third person, cannot, by ratification, be made to have such effect.

Examples:

a) A, not being authorized thereto by B, demands on behalf of B, the delivery of a chattel, the property of B, from C, who is in possession of it. This demand cannot be ratified by B, so as to make C liable for damages for his refusal to deliver;

b) A holds a lease from B, terminable on three months' notice. C, an unauthorized person, gives notice of termination to A. The notice cannot be ratified by B, so as to be binding on A.

Termination of Agency

Section 201 provides for the termination of agency. An agency is terminated by the principal-

- revoking his authority; or
- by the agent renouncing the business of the agency; or'
- by the business of the agency being completed; or

- by either the principal or agent dying or becoming of unsound mind; or
- by the principal being adjudicated an insolvent under the provisions of any Act for the time being in force for the relief of insolvent debtors.

Section 202 provides that where the agent has himself an interest in the property which forms the subject matter of the agency, the agency cannot, in the absence of an express contract, be terminated to the prejudice of such interest.

Examples:

a) A gives authority to B to sell A's land and to pay himself, out of the proceeds, the debts due to him. A cannot revoke his authority, nor can it be terminated by his insanity or death;

b) A consigns 1000 bales of cotton to B, who has made advances to him on such cotton, and desires B to sell the cotton and to repay himself out the price, the amount of his own advances. A cannot revoke the authority nor is it terminated by his insanity or death.

Section 208 provides as to the time at which the agent's authority is terminated as to agent and as to third persons. The termination of the authority of an agent does not, so for as regards the agent, take effect before it becomes known to him, or, so far as regards third persons, before it becomes known to them.

Example:

a) A directs B to sell goods for him and agrees to give B 5% commission on the price fetched by the goods. A afterwards, by letter, revokes B's authority. B, after the letter is sent, but before he receives it, sells the goods for ₹100. The sale is binding on A and is entitled to ₹5 as his commission;

b) A, at Madras, by letter directs B to sell for him some cotton lying in a warehouse in Bombay and afterwards, by letter, revokes his authority to sell, and directs B to send the cotton to Madras. B, after receiving the second letter, enters into a contract with C, who knows the first letter, but not of the second, for the sale to him of the cotton. C pays B the money, with which B absconds. C's payment is good as against A.

c) A directs B, his agent, to pay certain money to C. A dies and D takes out probate to his will. B, after A's death, but before hearing of it, pays the money to C. The payment is good as against D, the executor.

Revocation of agent's authority

Section 203 provides for the revocation of agent's authority. The principal may, save as is otherwise provided by Section 202, revoke the authority given to his agent at any time before the authority has been exercised so as to bind the principal. Section 204 provides that the principal cannot revoke the authority given to his agent after the authority has been partly exercised, so far as regards such acts and obligations as arise from acts already done in the agency.

Examples:

a) A authorizes B to buy 1,000 bales of cotton on account of A, and to pay for it out of A's moneys remaining in B's hands. B buys 1,000 bales of cotton in his own name, so as to make himself personally liable for the price. A cannot revoke B's authority so far as regards payment for the cotton.

b) A authorizes B to buy 1,000 bales of cotton on account of A, and to pay for it out of A's moneys remaining in B's hands. B buys 1,000 bales of cotton in A's name, and so as not to render himself personally liable for the price. A can revoke B's authority to pay for the cotton.

Compensation

Section 205 provides for the provision of compensation for revocation by principal or renunciation by agent. When there is an express or implied contract that the agency should be continued for any period of time, the principal must make compensation to the agent, or the agent to the principal, as the case may be, for any previous revocation or renunciation of the agency without sufficient cause.

Notice of revocation

Section 206 provides that reasonable notice must be given before revocation or renunciation of the agency. Otherwise, the damage thereby resulting to the principal or the agent, as the case may be must be made good to the one by the other.

Section 207 provides that revocation and renunciation may be expressed or implied in the conduct of the principal or agent respectively.

Example: A empowers B to let A's house. Afterwards A lets it himself. This is an implied revocation of B's authority.

Agent's duty on termination of agency

Section 209 provides that when an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to take, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of interests entrusted to him.

Termination of sub-agent's authority

Section 210 provides that the termination of the authority of an agent causes the termination of the authority of all sub agents appointed by him.

Agent's duty

Section 211 provides that an agent is bound to conduct the business of his principal according to the directions given by the principal, or in the absence of any such directions, according to the custom which prevails in doing business of the same kind at the place where the agent conduct such business. When the agent acts otherwise, if any loss be sustained, he must make it good to his principal and if any profit accrues, he must account for it.

Examples:

a) A, an agent engaged in carrying on for B a business, in which it is the customs to invest from time to time, at interest, the moneys which may be in hand, omits to make such investment. A must make good to B the interest usually obtained by such investments;

b) B, a broker in whose business it is not the custom to sell on credit, sell goods of A on credit to C, whose credit at the time was very high. C, before payment, becomes insolvent. B must make good the loss to A.

Section 212 provides that an agent is bound to conduct the business of the agency with as much skill as is generally possessed by persons engaged in similar business unless the principal has notice of his want of skill. The agent is always bound to act with reasonable diligence, and to use such skill as he possesses; and to make compensation to his principal in respect of the direct consequences of his own neglect, want of skill, or misconduct, but not in respect of loss or damage which are indirectly or remotely caused by such neglect, want of skill or misconduct.

Examples:

a) A, a merchant in Calcutta, has an agent. B in London, to whom a sum of money is paid on A's account, with orders to remit. B retains the money for a consideration time. A, in consequence of not receiving the

money, becomes insolvent, B is liable for the money and interest, from the day on which it ought to have been paid, according to the usual rate, and any further direct loss – as e.g., by variation of rate of exchange – but not further;

b) A, an agent for the sale of goods, having authority to sell on credit, sells to B on credit, without making the proper and usual enquiries as to the solvency of B. B at the time of such sale is insolvent. A must make compensation to his principal in respect of any loss thereby sustained;

c) A, an insurance broker employed by B to effect an insurance on a ship, omits to see that the usual clauses are inserted in the policy. The ship is afterwards lost. In consequence of the omission of the clauses nothing can be recovered from the underwriters. A is bound to make good the loss to B.

d) A, a merchant in England, directs B, his agent at Bombay, who accepts the agency, to send him 100 bales of cotton by a certain ship. B, having it in his power to send the cotton, omits to do so. The ship arrives safely in England. Soon after her arrival the price of cotton rises. B is bound to make good to A the profit which he might have made by the 100 bales of cotton at the time the ship arrived, but not any profit he might have made by the subsequent rise.

- Section 213 provides that an agent is bound to render proper accounts to his principal on demand.
- Section 214 provides that it is the duty of an agent, in cases of difficulty, to use all reasonable diligence in communicating with his principal and in seeking to obtain his instructions;

Rights of principal

The rights of principal are described in Sections 215 and 216.

- Section 215 provides that if an agent deals on his own account in the business of the agency, without first obtaining the consent of the principal and acquainting him with all material circumstances which have come to his own knowledge on the subject, the principal may repudiate the transaction, if the case shows, either that any material fact has been dishonestly concealed from him by the agent, or that the dealings of the agent have been disadvantageous to him.

Examples:

a) A directs B to sell A's estate. B buys the estate for himself in the name of C. A, on discovering that B has bought the estate for himself, may repudiate the sale, if he can show that B has dishonestly concealed any material act, or that the sale has been disadvantageous to him;

b) A directs B, to sell A's estate. B on looking over the estate before selling it, finds a mine on the estate which is unknown to A. B informs A that he wishes to buy the estate for himself, but conceals the discovery of the mine. A allows B to buy, in ignorance of the existence of the mine. A, on discovering that B knew of the mine at the time he bought the estate, may either repudiate or adopt the sale at his option.

Section 216 provides that if an agent, without the knowledge of his principal, deals in the business of the agency on his own account instead of on account of his principal, the principal is entitled to claim from the agent any benefit which may have resulted to him from the transaction.

Example: A direct B, his agent, to buy a certain house for him. B tells A that it cannot be bought, and buys the house for himself. A may, on discovering that B has bought the house, compel him to sell it to A at the price he gave for it.

Agent's right

The rights of agents are described in Section 217 and 219

- Section 217 provides that an agent may, retain, out of any sums received on account of the principal in the business of the agency, all moneys due to himself in respect of advances made or expenses properly incurred by him in conducting such business and also such remuneration as may be payable to him for acting as agent.
- Section 218 provides that subject to such deductions, the agent is bound to pay to his principal all sums received on his account;
- Section 219 provides that in the absence of any special contract, payment for the performance of any act is not due to the agent until the completion of such act, but an agent may detain moneys received by him on account of goods sold, although the whole of the goods consigned to him for sale may not have been sold, or although the sale may not be actually complete.

Misconduct of agent

Section 220 provides that an agent, who is guilty of misconduct in the business of the agency, is not entitled to any remuneration in respect of that part of the business which he has been misconducted.

Examples:

a) A employs B to recover ₹1 lakh from C, and to lay it out on good security. B recovers ₹1 lakh and lays out ₹90,000 on good security, but lays out ₹10,000 on security which he ought to have known to be bad, whereby A loses ₹2,000. B is entitled to remuneration for recovering ₹1,00,000 and for investing ₹90,000. He is not entitled to any remuneration for investing ₹10,000 and he must make good the ₹2,000 to A;

b) A employs B to recover ₹1,000 from C. Through B's misconduct the money is not recovered. B is entitled to no remuneration for his services, and must make good the loss.

Agent's lien

Section 221 provides that in the absence of any contract to the contrary, an agent is entitled to retain goods, papers and other property, whether movable or immovable, of the principal received by him, until the amount due to himself for commission, disbursements and services in respect of the same has been paid or account for to him.

Obligation of principal to agent

Section 222 provides that the employer of an agent is bound to indemnify him against the consequences of all lawful acts done by such agents in exercise of the authority conferred upon him.

Examples:

a) B, at Singapore, under instructions from A of Calcutta, contracts with C to deliver certain goods to him. A does not send the goods to B, and C sues B for breach of contract. B informs A of the suit and A authorizes him to defend the suit. B defends the suit and is compelled to pay damages and costs and incur expenses. A is liable to B for such damages, costs and expenses.

b) B, a broker at Calcutta, by the orders of A, a merchant there, contracts with C for the purpose of 10 casks of oil for A. Afterwards A refuses to receive the oil and C sues B. B informs A, who repudiates the contract altogether. B defends, but unsuccessfully, and has to pay damages and costs and incur expenses. A is liable to B for such damages, costs and expenses.

Section 223 provides that where one person employs another to do an act, and the agent does the act in good faith, the employer is liable to indemnify the agent against the consequences of that act, though it causes an injury to the rights of third persons.

Examples:

a) A, a decree-holder and entitled to execution of B's goods, requires the officer of the Court to seize certain goods, representing them to be the goods of B. The Officer seizes the goods, and is sued by C, the true owner of the goods. A is liable to indemnify the officer for the sum which he is compelled to pay to C, in consequence of obeying A's directions;

b) B, at the request of A, sells goods in the possession of A, but which A had no right to dispose of. B does not know this and hands over the proceeds of the sale to A. Afterwards C, the true owner of the goods, sues B and recovers the value of the goods and costs. A is liable to indemnify B for what he has been compelled to pay to C and for B's own expenses.

Section 225 provides that the principal must make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill.

Example: A employs B as a bricklayer in building a house, and puts up the scaffolding himself. The scaffolding is unskilfully put up, and B is in consequence hurt. A must make compensation to B.

Non-liability of principal to agent

Section 224 provides that where one person employs another to do an act which is criminal, the employer is not liable to the agent, either upon an express or implied promise to indemnify him against the consequences of that act.

Example:

a) A employs B to beat C, and agrees to indemnify him against all consequences of the Act. B thereupon beats C, and has to pay damages to C for so doing. A is not liable to indemnify B for those losses.

b) B, the proprietor of a newspaper, publishes, at A's request, a libel upon C in the paper, and A agrees to indemnify B against the consequences of the publication, and all costs and damages of any action in respect thereof. B is sued by C and has to pay damages, and also incurs expenses. A is not liable to B upon the indemnity.

Agency with third persons

Section 226 provides for the enforcement and consequences of agent's contracts. Contracts entered into through an agent, and obligations arising from acts done by an agent, may be enforced in the same manner and will have the same legal consequences, as if the contracts had been entered into, and the acts done by the principal in person.

Examples:

a) A, buys goods from B, knowing that he is an agent for their sale, but not knowing who is the principal. B's principal is the person entitled to claim from A the price of the goods, and A cannot, in a suit by the principal, set off against that claim a debt due to himself from B;

b) A, being B's agent, with authority to receive money on his behalf, receives from C a sum of money due to B. C is discharged of his obligation to pay the sum in question to B.

Section 227 provides that when an agent does more than he is authorized to do, and when the part of what he does, which is within his authority, can be separated from the part which is beyond his authority, so much only of what he does as is within his authority, is binding as between him and his principal.

Example: A being owner of a ship and cargo, authorizes B to procure an insurance for ₹4,000 on the ship. B procures a policy for ₹4,000 on the ship, and another for the like sum on the cargo. A is bound to pay the

premium for the policy on the ship, but not the premium for the policy on the cargo.

Section 228 provides that principal is not bound when excess of agent's authority is not separable. Where an agent does more than he is authorized to do, and what he does beyond the scope of his authority cannot be separated from what is within it, the principal is not bound to recognize the transaction.

Example: A authorizes B to buy 500 sheep for him. B buys 500 sheep and 200 lambs for one sum of ₹6,000. A may repudiate the whole transaction.

Notice to agent

Section 229 provides that any notice given to or information obtained by the agent, provided it be given or obtained in the course of the business transacted by him for the principal, shall, as between the principal and third parties, have the same legal consequences as if it had been given to or obtained by the principal.

Examples:

a) A is employed by B to buy from C certain goods, of which C is the apparent owner, and buys them accordingly. In the course of the treaty for the sale, A learns that the goods really belonged to D, but B is ignorant of that fact. B is not entitled to set off a debt owing to him from C, against the price of the goods;

b) A is employed by B to buy from C goods of which C is the apparent owner. A was, before he was so employed, a servant of C, and then learnt that the goods really belonged to D, but B is ignorant of that fact. In spite of the knowledge of his agent, B may set off against the price of the goods a debt owing to him from C.

Enforcement of contract by agent on behalf of principal

Section 230 provides that in the absence of any contract to that effect, an agent cannot personally enforce contracts entered into by him on behalf of his principal nor is he personally bound by him. Such a contract shall be presumed to exist in the following cases-

1. where the contract is made by an agent for the sale or purchase of goods for a merchant resident abroad;

2. where the agent does not disclose the name of his principal;

3) where the principal, though disclosed, cannot be sued.

Right of parties to a contract made by agent

Section 231 provides the right of parties to a contract made by agent not disclosed. If an agent makes a contract with person who neither knows, nor has reason to suspect, that he is an agent, his principal may require the performance of the contract; but the other contracting party has, as against the principal the same rights as he would have had as against the agent if the agent had been principal.

If the principal discloses himself before the contract is completed, the other contracting party may refuse to fulfil the contract, if he can show that, if he had known who was the principal in the contract, or if he had known that the agent was not a principal, he would not have entered into the contract.

Section 232 provides that where one man makes a contract with another, neither he knowing, nor having reasonable ground to suspect that the other is an agent, the principal, if he requires the performance of the contract, can only obtain such performance subject to the rights and obligations subsisting between the agent and the other party to the contract.

Example: A, who owes ₹500 to B, sells ₹1,000 worth of rice to B. A is acting as agent for C in the transaction,

but B has neither knowledge, nor reasonable ground of suspicion that such is the case. C cannot compel B to take the rice without allowing him to set-off A's debt.

Section 233 provides that in cases where the agent is personally liable, a person dealing with him may hold either him or his principal, or both of them liable.

Example: A enters into a contract with B to sell him 100 bales of cotton and afterwards discovers that B was acting as agent for C. A may sue either B or C, or both, for the price of the cotton.

Section 234 provides that when a person who has made a contract with an gent induces the agent to act upon the belief that the principal only will be held liable, or induces the principal to act upon the belief that the agent only will be held liable, he cannot afterward hold liable the agent or principal respectively.

Liability of a pretended agent

Section 235 provides that a person untruly representing himself to be the authorized agent of another, and thereby inducing a third person to deal with him as such agent, is liable, if his alleged employer does not ratify his acts, to make compensation to the other in respect of any loss or damage which he has incurred by so dealing.

Section 236 provides that a person, with whom a contract has been entered into in the character of agent, is not entitled to require the performance of it, if he was in reality acting, not as agent, but on his account.

Section 237 provides that when an agent has, without authority, done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts of obligations, if he has by his words or conduct induced such third persons to believe that such acts and obligations were within the scope of the agent's authority.

Example:

a) A consigns goods for B for sale and gives him instructions not to sell under a fixed price. C, being ignorant of B's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract.

b) A entrusts B with negotiable instruments in blank. B sells them to C in violation of private orders from A. The sale is good.

Effect of misrepresentation or fraud by agent

Section 238 provides that misrepresentation made or frauds committed, by agents acting in the course of their business for their principals, have the same effect on agreements made by such agents as if sum misrepresentations or frauds had been made or committed by the principals; but misrepresentations made, or frauds committed, by agents in matters which do not fall within their authority, do not affect their principles.

Examples:

a) A, being B's agent to the sale of goods, induces C to buy them by a misrepresentation, which he was not authorized by B to make. The contract is voidable, as between B and C, at the option of C.

b) A, the captain of B's ship, signs bills-of-lading without having received on board the goods mentioned therein. The bills-of-lading are void as between B and pretended consignor.

EXERCISE

Multiple Choice Question:

1. Acceptance to be a valid must
   a) Be absolute
   b) Be unqualified
   c) Both be absolute & unqualified
   d) Be conditional
2. A proposal can be accepted
   a) By notice of acceptance
   b) By performance of condition of proposal
   c) By acceptance of consideration for a reciprocal promise
   d) All of the above
3. Competency to contract relates to
   a) Age of parties
   b) Soundness of mind of the parties
   c) Both age and soundness of mind
   d) Intelligence of the parties
4. If only a part of the consideration or object is unlawful, the contract under Section 24 shall be:
   a) Valid
   b) Voidable
   c) Void
   d) Illegal
5. When the consent is caused by undue influence, the contract under Section 19A is:
   a) Valid
   b) Void
   c) Voidable
   d) Illegal

State TRUE or FALSE

1. A guarantee obtained by misrepresentation or concealment is voidable
2. The surety stands discharged by death
3. Under a contract of guarantee is principal debtor is not liable, guarantor is not liable
4. Silence on the part of the offeree amounts to acceptance
5. An agreement to which the consent of the promise is freely given is not void
6. Creditor is a person to whom the guarantee is given
7. Liability of a surety is conditional on default

Fill in the blanks

1. Agreements enforceable by law are called ____ .
2. Agreements without consideration are ____ .
3. Agreements in restraint of marriage is _____ .
4. Section 2 (d) defines _____ .
5. Section 5 provides that a proposal may be revoked at any time ____ the communication of acceptance.
6. Agreements of wagers are_____ .
7. When the person to whom the _____ is made signifies his assent thereto, proposal is said to have been accepted.
8. Proposal is other called as _____ .

9. The person delivering the goods for bailment is called the ____ .
10. No consideration is necessary to create _____ .

Short Essay Type Questions

1. What are the requirements for a valid contract?
2. When an offer may be lapsed?
3. Write short notes on-
   (a) e-contracts;
   (b) Quasi Contracts;
   (c) Contingent contracts.

Essay Type Questions

1. Discuss the consequences of the absence of consent and free consent.
2. Explain the conditions of enforceability of the standard form of contracts.
3. What is the difference between an agent and an employee?
4. What are the essential elements of a contract?
5. Distinguish between illegal and void contracts.
6. Minor's agreement is void. Explain with exceptions.
7. Discuss the concept of impossibility of performance of contracts.
8. Can a contract be made without consideration? Discuss.

Unsolved Cases

1. A intending to deceive B falsely represents that 500 maunds of indigo were made annually at A's factory and thereby induces B buy the factory. Is the contract valid?
2. On B's request A lent gratuitously his scooter to B for his use for one week. After two days A urgently needs his scooter and requires its return from B. B refuses to return the goods unless he is indemnified for his damages, which he would suffer owing to the premature delivery. Is A liable?

Answer:

Multiple Choice Question:

1. c; 2. d; 3. c; 4. c; 5. c.

State whether TRUE or FALSE

1. False; 2. False; 3. True; 4. False; 5. True; 6. True; 7. True.

Fill in the blanks

1. Contracts; 2. Void; 3. Void; 4. Consideration; 5. Before; 6. Void; 7. Offer/proposal; 8. Offer; 9. Bailor; 10. Agency.

Sale of Goods Act, 1930 3

This Module includes -

Sale of Goods Act, 1930

SLOB Mapped against the Module

To learn about the various laws governing the essential features of contracts for sale of goods, such as formation of contracts of sale, subject matter, price and conditions and warranties incidental to such contracts.

Module Learning Objectives:

After studying this module, the students will be able to -

- To learn about the various laws governing the essential features of contracts for sale of goods, such as formation of contracts of sale, subject matter, price and conditions and warranties incidental to such contracts.
- To develop an understanding as to the effects of such contracts and the subsequent transfers of title and performance of such contracts.

Essential Conditions of a Contract of Sale

3.1

The Sale of Goods Act, 1930 provides provisions that regulate the contracts entered into between entities for the transfer of goods or the agreement to transfer goods for a certain consideration. This transfer essentially relates to the transfer of title in the goods thereby effecting a sale. Therefore, through this transfer, the ownership of goods is transferred from one person to the next. Additionally such a transfer should be accompanied by a definite price and be done at a given period of time. Sale of goods is undertaken in specialized kinds of contract itself. This piece of legislation helps mostly in business and commerce.

The economy of the country is immensely benefitted with such laws that regulate the transfer of goods by sale. This Act deals with the essential definitions, lays down provisions as to how sale can be made, the kinds of goods that make the subject matter of the contract, conditions and warranties relating to the goods and effect of such contracts. The Act additionally talks about rights and obligations of the parties to such contracts, performance of contract, provisions relation to lien, and remedies in case there is a breach in the contract.

Essential Conditions of a Sale and agreement to sell

Chapter II of the Sale of Goods Act, 1930 talks about formation of contract. In this section, the legislation lays down the provisions relating to contract of sale.

Section 4 of the Act contemplates Sale and agreement to sell:

1. A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. There may be a contract of sale between one part-owner and another.
2. A contract of sale may be absolute or conditional.
3. Where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell.
4. An agreement to, sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.

Difference between Contact of Sale and Agreement to Sell

Basis	Contract of sale	Agreement to sell
Transfer of property	The property of the goods passes from the buyer to the seller.	The transfer of property takes place at a future time or subject to certain conditions to be fulfilled.
Type of contract	It is an executed contract.	It is an executory contract.

Basis	Contract of sale	Agreement to sell
Type of goods	Sales takes place only for existing and specific goods.	Future and contingent goods.
Risk of loss	If the goods are destroyed, the loss falls on the buyer despite the goods are in the possession of the seller.	If the goods are destroyed, the loss falls on the seller despite the goods are in the possession of the buyer.
Breach of contract	The seller can sue the buyer for price and for damages in case of breach by the buyer.	The seller can sue for damages only in case of breach by the buyer.
General and particular property	It gives buyer to enjoy the goods as against the world at large including the seller.	It gives a right to the buyer against the seller to sue for damages.
Insolvency of the buyer	In the absence of lien over the goods the seller is to return the goods to the Official receiver or assignee. He is entitled to get the dividend declared by the Official receiver which will be at the reduced rate.	The seller is not bound to part with the goods until the price is paid to him.
Insolvency of the seller	The buyer, becoming the owner, is entitled to recover the same from the Official receiver or assignee.	The buyer cannot claim the goods but the dividend declared by the Official receiver or assignee.

Example: Mr. A entered into a contract to sell his car to Mr. B. The contract was set for discharge on a specific date and for a certain specified amount. However, if the certain amount was not given on the specified date, the sale would not take place.

Whereas, Section 5 of the Act talks about the way in which a contract of sale is made:

1. A contract of sale is made by an offer to buy or sell goods for a price and the acceptance of such offer. The contract may provide for the immediate delivery of the goods or immediate payment of the price or both, or for the delivery or payment by instalments, or that the delivery or payment or both shall be postponed.
2. Subject to the provisions of any law for the time being in force, a contract of sale may be made in writing or by word of mouth, or partly in writing and partly by word of mouth or may be implied from the conduct of the parties.

For the purposes of this Act, various terms have been defined under Section 2. For instance, for every contract of sale to take place, there must exist a buyer and the corresponding seller. A buyer as has been defined by the Act means a person who buys goods and a seller is one who sells or agrees to sell the goods. These goods may be specific goods, which means those goods that are identified and agreed upon at the time a contract of sale is made or future goods, which means those goods that are to be manufactured or produced or acquired by the seller after the making of the contract of sale.

Through such contracts what is intended to be transferred is the "document of title to goods" which includes a bill of lading, dock warrant, warehouse keeper's certificate, wharfingers' certificate, railway receipt according to the Act. Additionally, the said contract needs to contain certain specifics as to the "price" which means the money consideration for a sale of goods; and as to the quality of goods which includes the state or condition of the goods to be transferred through the contract of sale.

Essentials Conditions of a Contract of Sale

- One of the pre-requisites of a contract of sale is that it must involve two parties. For a contract of sale to

fructify, the goods need to transfer from one entity to the next. The goods cannot be bought from one's own self and be called a contract.

- The other essential component is that the transfer must involve the transfer of title to the goods or the transfer of ownership of the goods in question, without which the contract of sale cannot be effected.
- A contract of sale is not complete unless there is a certain subject matter which is to be transferred in lieu of a specific amount of consideration. Section 2 (7) of the Act suggests what the meaning of "goods" is. It means every kind of moveable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale;
- Finally, the condition that needs to be present in such contracts of sale is the component of consideration. The consideration in such contracts needs to be a designated amount payable in money and not in exchange of other goods of similar value or otherwise.

Section 4(3) of the Sale of Goods Act specifically states that where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell. Moreover, an agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred.

Whereas, Section 5 mandates that a contract of sale is made by an offer and its corresponding acceptance to deliver goods immediately in lieu of payment or at a later point of time. Such contracts could be in writing, by word of mouth or be implied from conduct of the parties.

Example: Ms. Anne asked her class of 60 students that whoever wanted to buy her books may keep ₹100 on her desk by 3PM with their name slip. This act of students of keeping the money on Ms. Anne's desk with their name slips was an implied acceptance of Ms. Anne's offer resulting in a binding contract.

However, the subject matter of the contract is a crucial component. The subject matter of the contracts are the goods which can be either existing or future goods. Such goods can additionally be goods perishing before making contract or goods perishing before sale but after agreement to sell.

Section 6 of the Act states that:

1. The goods which form the subject of a contract of sale may be either existing goods, owned or possessed by the seller, or future goods.
2. There may be a contract for the sale of goods the acquisition of which by the seller depends upon a contingency which may or may not happen.
3. Where by a contract of sale the seller purports to effect a present sale of future goods, the contract operates as an agreement to sell the goods.

The aforementioned section is about existing or future goods which may be sold through contracts of sale, that may be based on a contingent event, among other things.

Example: Ramcharan, a merchant, contracted with Bholu, a potato farmer, in January, to buy potatoes in June out of his fresh harvest. Ramcharan also determined a specific price at which he would be buying the specified quantity, irrespective of the market price of potatoes in June. These potatoes are the future goods.

However, Section 7 of the Act states that:

Where there is a contract for the sale of specific goods, the contract is void if the goods without the knowledge of the seller have, at the time when the contract was made, perished or become so damaged as no longer to

answer to their description in the contract.

The aforementioned provision states in case of goods perishing before making of contract, such contracts would be void. This is because the subject matter ceases to exist even before the contract has been made.

Example: Mahesh asked his friend Rakesh to deliver 40 kilograms of mangoes for manufacturing mango jam. This delivery was supposed to be made to Mahesh in the next two months. However due to bad climatic conditions, the mangoes that were ripe and ready to be plucked, got spoilt and were no longer in a state to be delivered for manufacturing jam. Such a contract is now void.

Section 8 of the Act provides that

Where there is an agreement to sell specific goods, and subsequently the goods without any fault on the part of the seller or buyer perish or become so damaged as no longer to answer to their description in the agreement before the risk passes to the buyer, the agreement is thereby avoided.

Fixing of a definite price in the contract of sale is a *sine qua non,* of every such contract. Therefore, Section 9 of the Act talks about ascertainment of price, which states that the price in the contract of sale has to be fixed by the contract itself or be fixed in a manner agreed between the parties or determined by their course of dealing. However, the same provision suggests a solution to those situations where the price has not been fixed. In such cases, the buyer shall pay the seller a reasonable price which would be determined based on the relevant circumstances of each particular case.

Example: A and B have a contract between them to perform their respective promises. A promised to sell to B his car, in return B promised to pay A ₹1 Lakh for the same. This is a contract of sale that is accompanied by a definite price.

However, there may arise a situation where there is an agreement to sell at valuation. In such cases the Act stipulates under Section 10:

1. Where there is an agreement to sell goods on the terms that the price is to be fixed by the valuation of a third party and such third party cannot or does not make such valuation, the agreement is thereby avoided:

   Provided that, if the goods or any part thereof have been delivered to, and appropriated by, the buyer, he shall pay a reasonable price therefor.

2. Where such third party is prevented from making the valuation by the fault of the seller or buyer, the party not in fault may maintain a suit for damages against the party in fault.

Also, the Act suggests provisions relating to the time of payment, which may not be so crucial unless mentioned within the contract. Section 11 states, unless a different intention appears from the terms of the contract, stipulations as to time of payment are not deemed to be of the essence of a contract of sale. Whether any other stipulation as to time is of the essence of the contract or not depends on the terms of the contract.

Transfer of Ownership

3.2

The Sections 18 to 26 of the Sale of Goods Act, determine when the property passes from the seller to the buyer and other provisions relating to transfer of ownership.

3.2.1 Rules for Ascertaining Passing of Property

a) **Goods must be ascertained [Section 18]:** As per section 18 in a contract for sale of unascertained goods, the property in the goods does not pass to the buyer unless and until the goods are ascertained.

b) **Intention of the parties for such transfer [Section 19]:** As per section 19(1), in a contract for the sale of specific or ascertained goods, the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred. Section 19(2) provides that the intention of the parties is ascertained from the terms of the contract, the conduct of the parties and the circumstances of the case.

When intention of the parties cannot be ascertained, rules contained in Sections 20 to 24 are required to be applied for ascertaining the time of transfer of property and the same are discussed hereunder:

i) Specific goods [Sections 20 to 22]

a) **Specific goods in a deliverable state [Section 20]**

In an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made, and it is immaterial whether the time of payment of the price or the time of delivery of the goods, or both, is postponed. Goods are said to be in deliverable state when they are in such a state that the buyer would under the contract is bound to take delivery thereof.

b) **Specific goods to be put into a deliverable state [Section 21]**

Where there is a contract for the sale of specific goods and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state, the property does not pass until such thing is done and the buyer has notice thereof.

c) **Specific goods in a deliverable state, when the seller has to do anything thereto in order to ascertain price [Section 22]**

If there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done and the buyer has notice thereof.

ii) Unascertained goods [Section 23]

a) Where there is a contract for the sale of unascertained or future goods by description and goods of

that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be expressed or implied, and may be given either before or after the appropriation is made.

b) **Delivery to carrier:** Where, in pursuance of the contract, the seller delivers the goods to the buyer or to a carrier or other bailee for the purpose of transmission to the buyer and does not reserve the right of disposal, he is deemed to have unconditionally appropriated the goods for the purpose of the contract.

iii) Goods on approval or 'on sale or return' [Section 24]

In order to push up the sales generally there is a practice of sending goods to the customer with the clear cut understanding that he has option to approve or return the goods within a given period. This type of sales is known as "approval or sale or return". In such cases, the transaction does not culminate into sale until the goods are approved by the customer and the property in goods still remains with the seller.

When goods are delivered to the buyer on approval or on sale or return or other similar terms, the property therein passes to the buyer:

a) When he signifies his approval or acceptance to the seller

b) When he does any other act adopting the transaction.

c) If he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection, then, if a time has been fixed for the return of the goods, on the expiration of such time, and, if no time has been fixed, on the expiration of a reasonable time.

3.2.2 Reservation of Right of Disposal [Section 25]

Section 25(1) – Where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation, reserve the right of disposal of the goods until certain conditions are fulfilled. In such case, notwithstanding the delivery of the goods to a buyer, or to a carrier or other bailee for the purpose of transmission to the buyer, the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled.

Section 25(2) – Where goods are shipped or delivered to a railway administration for carriage by railway and by the bill of landing or railway receipt, as the case may be, the goods are deliverable to the order of the seller or his agent, the seller is prima facie deemed to reserve the right of disposal.

Section 25(3) – Where the seller of goods draws on the buyer for the price and transmits to the buyer the bill of exchange together with the bill of lading or, as the case may be, the railway receipt, to secure acceptance to payment of the bill of exchange, the buyer is bound to return the bill of lading or the railway receipt if he does not honour the bill of exchange, and, if he wrongfully retains the bill of lading or the railway receipt, the property in the goods does not pass to him.

Example: Magic Co. Ltd., based in England, shipped 50 tons of wool to Mr. Norton, based in Spain. Mr. Norton was supposed to claim the shipment through the bill of lading he received from Magic Co. Ltd. However, when the shipment arrived, Mr. Norton was not present in person at the dock. The wharfinger therefore took the shipment to his cloak room for safekeeping. Thereupon upon producing the bill of lading, the wharfinger will then deliver the same goods to the buyer.

3.2.3 Effect of Destruction of Goods

As per section 26 of the Act, unless otherwise agreed, the goods remains at the seller's risk until the property

therein is transferred to the buyer, but when the property in goods is transferred to the buyer, the goods are at the risk of the buyer whether delivery of the goods has been made or not. Thus, risk prima facie passes with property unless otherwise is agreed by the parties. In other word, the parties may in the contract have different stipulation as to time of passing of risk irrespective of what is provided in section 26 of the Act.

3.2.4 Risk Prima Facie Passes with Property: Exceptions

The rule regarding risk passes with the property enshrined in section 26 is subject to the following exceptions:

a) This rule of 26 will apply only if there is no agreement to the contrary. It is permissible for the parties to provide in the agreement that although the property does not pass, the risk passes and they may fix the point of time when it is to pass.

b) Where delivery has been delayed through the fault of either party the buyer or the seller, the goods are at the risk of the party at fault as regards any loss which might not have been occurred but for such fault. The goods are at the risk of the party who is at fault in delay of delivery.

c) If there is a custom in that particular trade that the risk does not pass with property, in such a case the risk will pass as per the custom.

d) Risk and property may be separated by agreement between the parties. Section 40 of the Act also provides that where the seller agrees to deliver the goods at his own risk at a distant place from where they are, the buyer shall unless otherwise agreed, not take any risk of deterioration in the goods incidental to the transit. This will be discussed subsequently in the paragraph dealing with delivery of goods.

3.2.5 Transfer of Title by Non-Owners of Goods

As per section 27 of the Sale of Goods Act, where goods are sold by a person who is not the owner thereof and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had, unless the owner of the goods is by conduct precluded from denying the seller's authority to sell.

A buyer cannot get good title to the goods unless he purchased the goods from a person who is the owner thereof and sell them under the authority or with the consent of real owner.

"Nemo dat quod non habet" means that no one can give what he himself does not have. It means a non-owner cannot make valid transfer of property in goods. If the title of the seller is defective, the buyer's title will also be subject to same defect. If the seller has no title, the buyer does not acquire any title although he might have acted honestly and might have acquired the goods after due payment. This rule is to protect the real owner of the goods. Though this doctrine seeks to protect the interest of real owners, but in the interest of the trade and commerce, there must be some safeguard available to a person who acquired such goods in good faith for value.

Accordingly, the Act provides the following exceptions to this doctrine which seek to protect the interest of bona fide buyers:

1. **Sale by a mercantile agent:** If a mercantile agent is authorized by the owner of the goods to sell on his behalf, then such sale shall be valid. In such cases, the buyer can acquire a good title of the goods. This exception will be implemented subject to fulfilment of the following conditions:-

   - The person must be in possession of goods or documents of title to the goods in his capacity as a mercantile agent and with the consent of his owner
   - The person must sell the goods while acting in the ordinary course of business.

- The buyer must act in good faith without having any notice, at the time of contract that the mercantile agent has no authority to sell the goods.

2. **Transfer of title by Estoppels:** This exception is based on the principle of personal estoppels. Sometime, the real owner may lead the buyers by virtue of his conduct or words or by act to believe that the seller is the owner of the goods or has the authority to sell them. In such case, he may not thereafter deny the seller's authority to sell.
3. **Sale by a joint owner:** As per Section 28, it there are several joint owners of goods, one of them if has sole possession of the goods by permission of the co-owners, then the property in goods is transferred to any person who buys them from such joint owner. In order to apply this exception, following conditions must be fulfilled:
   - One of the several owners must be in sole possession of the goods.
   - The joint owner must have permission of co-owners.
   - The buyer must purchase goods in good faith.
   - The buyer should not have notice regarding the matter that the seller has no authority to sell.
4. **Sale by person in possession under voidable contract:** According to the Section 29 a person in possession of goods under a voidable contract which is not rescinded, can transfer a good title to the buyer. The buyer should purchase the goods in good faith and without notice of the seller's defective title.
5. **Sale by seller in possession after sale:** Under Section 30(1) it is laid down that where a person has sold goods but he continues in possession of goods or of the documents of title to the goods, he may sell them to a third person and if such person obtains delivery thereof in good faith and without notice of the previous sale, the person can get a good title to them. In order to apply this exception, the seller must be in possession after sale of goods and there must be delivery or transfer of the goods or documents of title by the seller.
6. **Sale by buyer in possession after sale:** Under Section 30(2), it is laid down that where a buyer having bought or having agreed to buy goods, obtain with the consent of the seller the possession of the goods or documents of title to the goods, he can resell the goods to a bona fide transfer. If at the time of this sale, buyer was not in possession, then this exception will not apply.
7. **Sale by an unpaid seller:** If the unpaid seller has exercised right of lien or stoppage in transit, resells the goods, then the buyer acquires a good title as against the original buyer, even though the resale is not justified in the circumstances
8. **Exception under other Acts:** According to some Acts, a person although he is not the owner of the goods may sell the goods and pass a better title than he himself has. As for example-
   i. Under Section 169 of the Indian Contract Act, a finder of the goods has the right to sell.
   ii. Under Section 176 of the Indian Contract Act, a pawnee of goods has the right to sell the
   iii. goods pawned subject to satisfying some conditions.
   iv. In certain cases, a special right of sale is given to officers of court, liquidators of the companies, receivers of insolvents estate, custom officers for dues and duties remaining unpaid etc.
   v. A person who takes a negotiable instrument in good faith and for value becomes the true owner even if he takes it from a thief or finder.

Conditions and Warranties

3.3

Section 12(1) provides that a stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or a warranty.

3.3.1 Condition [Section 12(2)]

A condition is a stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated. A condition in a contract of sale of goods is of fundamental nature for breach of which the buyer can repudiate the contract.

Example: Ramesh is the landlord who rents out his house to tenants. He put it down in the rent agreement that all tenants have to pay the rent upfront in cash and not in cheques or bank transfers and so on. This was because Ramesh thought the cheques and other instruments were subject to clearing, and he needed the money upfront on the first day on every month. With this mandatory condition, Ramesh added, that any diversion from this method of payment would lead to repudiation of the contract. If Mahesh is Ramesh' tenant, and does not pay the money upfront in cash when the rent was due, then Ramesh is well within his rights to repudiate the contract.

3.3.2 Warranty [Section 12(3)]

A warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated.

Whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract. A stipulation may be a condition, though called a warranty in the contract.

Example: Standard Oil Company entered into a contract with XYZ Petrol Pump for supply of 1000 Litres of Petrol over a one year period. Therefore, Standard Oil decided to continuously sell the petrol in instalments over the one year. However at the end of the year it was found only 800 Litres were supplied and the remaining 200 Litres of petrol was denied by the petrol pump as there was no sale. Standard oil can now claim damages from petrol pump, as they had reserved the same for the petrol pump.

3.3.3 Difference between Condition and Warranty

Sl. No.	Condition	Warranty
1.	A condition is a stipulation which is essential to the main purpose of the contract.	A Warranty is a stipulation which is collateral to the main purpose of the contract.
2.	The aggrieved party can repudiate the contract of sale in case there is a breach of a condition.	The aggrieved party can claim damages only in case of breach of a warranty.
3.	A breach of condition may be treated as a breach of a warranty. This would happen where the aggrieved party is contended with damages only.	A breach of a warranty, can not be treated as a breach of a condition.

3.3.4 When condition to be treated as warranty?

Section 13 provides that where a contract of sale is-

- subject to any condition to be fulfilled by the seller, the buyer may waive the condition or elect to treat the breach of the condition as a breach of warranty and not as a ground for treating the contract as repudiated;
- not severable and the buyer has accepted the goods or part thereof, the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty and not as a ground for rejecting the goods and treating the contract as repudiated, unless there is a term of the contract, express or implied, to that effect.

Nothing in this section shall affect the case of any condition or warranty fulfilment of which is excused by law by reason of impossibility or otherwise.

3.3.5 Remedies Available to the Buyer for Breach of Conditions

a) Affected party may claim refund of price and reject the goods;

b) Elect to treat breach of condition as breach of warranty and claim damages or compensation;

c) When the affected party treat, breach of condition as breach of warranty he cannot repudiate the contract but claim damages only;

d) No remedy is available when the fulfilment of condition is excused by law by means of impossibility or otherwise 13(3).

3.3.6 Consequences of Breach of Warranty

a) The breach of warranty gives right to a claim for damages but not to reject the goods and treat the contract as repudiated.

b) Buyer may sue for damages.

c) No remedy is available if the fulfilment of warranty becomes impossible by law.

3.3.7 Implied conditions are of the following types

i) **Condition as to title [Section 14(a)]:** In a contract of sale, unless the circumstances of the contract are such as to show a different intention, there is an implied condition on the part of the seller that, in the case of a sale, he has a right to sell the goods and that, in the case of an agreement to sell, he will have a right to sell the goods at the time when the property is to pass.

ii) **Sale by description [Section 15]:** Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description, and, if the sale is by sample as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description. Goods are sold by description when they are described in the contract, and the buyer contracted relying on such description of goods by the seller.

iii) **Condition as to quality or fitness [Section 16]:** As per Sec 16 of the Sale of Goods Act, the buyer is supposed to satisfy himself about the quality of goods he purchased and is also charged with the responsibility of seeing that the goods suit the purpose for which they were purchased by him. Later on if the goods does not turn out to be as per his purpose, the seller cannot be asked to compensate him. This is based on the famous doctrine of *Caveat Emptor* which means 'let the buyer beware'.

iv) **Sale by sample [Section 17]:** A contract of sale is a contract for sale by sample where there is a term in the contract, express or implied, to that effect.

In the case of a contract for sale by sample there is an implied condition -

- That the bulk shall correspond with the sample in quality.
- That the buyer shall have a reasonable opportunity of comparing the bulk with the sample.
- That the goods shall be free from any defect, rendering them un-merchantable, which would not be apparent on reasonable examination of the sample.

Example: David sold Indian variant of sunflower seeds at his shop and sold it in bulk for who ever wanted to buy the same. Tatiana tested the sample of the seeds at David's shop and decided to order it in bulk. However when David sent the seeds in bulk, Tatiana decided to sow the seeds. Months later Tatiana discovered that the seeds were of Swedish variant and not the Indian variant that she has requested for. Tatian now wanted full refund for the seeds that were delivered to her by David. David is now bound to either reimburse her the whole amount or give her the quantity of Swedish variant that she requested for.

In case of eatables and provisions, in addition to the implied condition as to merchantability, there is another implied condition that the goods shall be wholesome.

3.3.8 Implied warranties are of following types

- **Warranty of quiet possession [Section 14 (b)]:** If the buyer in any way is disturbed from enjoying the quiet possession of goods purchased because of seller's defective title, the buyer can claim damages from seller. It is a warranty that neither the seller shall nor shall anybody claiming under a superior title or under his authority interfere with the quite enjoyment of the superior title or under his authority interfere with the quite enjoyment of buyer.
- **Warranty of freedom from encumbrances [Section 14(c)]:** The buyer is also entitled to additional warranty that the goods are free from any charge or right of any third party, not declared or known to the buyer. It is presumed that the goods are free of third parties charges, if it is otherwise the buyer is entitled to claim damages from the seller.
- **Warranty as to quality or fitness by usage of trade:** An implied warranty as to quality or fitness for a particular purpose may be annexed by usage of trade
- **Warranty to disclose dangerous nature of goods:** Where a person sells goods knowing that the goods are inherently dangerous or they are likely to be dangerous to the buyer and the buyer is ignorant of the danger, he must warn the buyer of the probable danger, otherwise he will be liable in damages

3.3.9 Doctrine of Caveat Emptor

The term "caveat emptor" is a Latin word which means "let the buyer beware". This principle states that it is for the buyer to satisfy himself that the goods which he is purchasing are of the quality which he requires. If he buys goods for a particular purpose, he must satisfy himself that they are fit for that purpose. The doctrine of caveat emptor is embodied in Section 16 of the Act which states that "subject to the provisions of this Act and of any other law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale". It is not the seller's duty to give to the buyer the goods which are fit for a suitable purpose of the buyer. If he makes a wrong selection, he cannot blame the seller if the goods turn out to be defective or do not serve his purpose.

The principle was applied in the case of Ward v. Hobbs, (1878), where certain pigs were sold by auction and no warranty was given by seller in respect of any fault or error of description. The buyer paid the price for healthy pigs. But they were ill and all but one died of typhoid fever. They also infected some of the buyer's own pigs. It was held that there was no implied condition or warranty that the pigs were of good health. It was the buyer's duty to satisfy himself regarding the health of the pigs.

Example: Sharon went to buy a second-hand car. Aaron was the owner of the second-hand car which clearly had a door broken. Sharon did not say anything but after buying the car she complained against Aaron for selling her a car with a broken door. Aaron is not bound to compensate for the damage that the car had which was easily discoverable or seen by Sharon. Neither is Sharon eligible to revoke the contract of sale on the same grounds.

However, there are some exceptions to Section 16 which are as under:

a) Where the buyer, expressly or by implication, makes it known to the seller the particular purpose for which the goods are required, so as to show that the buyer relies on the seller's skill or judgment, and the goods are of a description which it is in the course of the seller's business to supply (whether he is the manufacturer or producer or not), there is an implied condition that the goods shall be reasonably be fit for such purpose. However, in the case of a contract for the sale of a specified article under its patent or other trade name, there are no implied conditions as to its fitness for any particular purpose.

b) Where goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition that the goods shall be of merchantable quality. However, if the buyer has examined the goods, there shall be no implied conditions as regards defects which such examination ought to have revealed.

   In order to apply the implied condition as to merchantability the following requirements must be satisfied:

   i) the seller should be dealer in goods of that description;

   ii) the buyer must have not opportunity to examine the goods or there must be some latent defect in the goods which would not be apparent on reasonable examination of the same.

   Note: The term merchantability has not been defined in the Act. As per English Sale of Goods Act, goods of any kind are merchantable quality if they are as fit for the purpose or purposes for which goods of that kind are commonly brought as it is reasonable to expect having regard to any description applied to them, the price and all other relevant circumstances.

c) An implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade. In some cases the purpose for which the goods are required may be ascertained from the acts and conducts of the parties to the sale or from the nature of the description of the article purchased. For example if a hot water bottle is purchased, the purpose for which it is purchased is implied in the thing itself. In such a case the buyer need not tell the seller the purpose for which the bottle is purchased. Similarly if a thermometer is purchased in common usage, the purpose of thermometer is well known, the buyer need not tell the seller.

d) An express warranty or condition does not negative a warranty or condition implied by this Act unless inconsistent therewith.

Performance of the Contract of Sale 3.4

Chapter IV of the Act describes the procedure for performance of the contract of sales. Section 31 provides that it is the duty of the seller to deliver the goods and the buyer to accept and pay for them, in accordance with the terms of the contract. The performance of contract involves the following-

- Payment and delivery are concurrent conditions
- Delivery
- Buyer's right of examining the goods
- Acceptance of goods
- Buyer's liability

Example: Mr. X sells his land mower to Mr. Y for ₹5,000. Mr. X and Mr. Y enter into a contract to that effect enlisting alongside the defects of the land mower. Mr. Y pays ₹5,000 to Mr. X and Mr. X delivers the land mower to his home. Mr. Y accepts it. This concludes a contract of sale.

Payment and delivery are concurrent conditions. Section 32 provides that the delivery of the goods and payment of the price are concurrent conditions unless otherwise agreed.

- The seller shall be ready and willing to give the possession of the goods to the buyer in exchange for the price.
- The buyer shall be ready and willing to pay the price in exchange for the possession of the goods.

Delivery

Section 33 provides that the delivery of goods sold may be made-

- by doing anything which the parties agree; or
- which has the effect of putting the goods in the possession of the buyer or of any person authorized to hold them on his behalf;

Section 35 provides that the seller of goods is not bound to deliver them until the buyer applies for the delivery apart from any express contract.

Part delivery

Section 34 deals with the effect of part delivery. A delivery of part of goods, in progress of the delivery of the whole, has the same effect as a delivery of the whole for the purpose of passing the property in such goods. If a delivery of part of the goods is done with an intention of severing it from the whole, then it does not operate as a delivery of the reminder.

Rules as to delivery

Section 36 provides rules for the delivery as detailed below:

- Apart from any contract, goods sold are to be delivered
- at the place at which they are at the time of the sale; and
- goods agreed to be sold are to be delivered at the place at which they are at the time of the agreement to sell; or
- if not then in existence, at the place at which they are manufactured or produced;
- Where under the contract of sale the seller is bound to send the goods to the buyer, but no time for
- sending them is fixed, the seller is bound to send them within a reasonable time;
- Where the goods at the time of sale are in the possession of a third person, there is no delivery by seller to buyer unless until such third person acknowledges to the buyer that he holds the goods on his behalf;
- This shall not affect the operation of the issue or transfer of any document of title to the goods;
- Demand or tender of delivery may be treated as ineffectual unless made at reasonable hour;
- Unless otherwise agreed, the expenses of and incidental to putting the goods into a deliverable state shall be borne by the seller.

Delivery of wrong quantity

The transfer of goods, in a sale, is expected to be delivered as agreed to in the contract. If there is a variation in the quantity of goods delivered, the following action may be taken by the buyer:

- Section 37(1) provides that where the sellers delivers to the buyer a quantity of goods less than he contracted to sell, the buyer may reject them. If the buyer accepts the goods so delivered he shall pay for them at the contract rate
- Section 37(2) provides that where the seller delivers to the buyer a quantity of goods larger than he contracted to sell, the buyer may accept the goods included in the contract and the reject the rest. Or he may reject the whole. If the buyer accepts the whole of the goods so delivered, he shall pay for them at the contract rate;
- Section 37(3) provides that where the seller delivers to the buyer the goods he contracted to sell mixed with goods of a different description not included in the contract, the buyer may accept the goods which are in accordance with the contract and reject the reject or may reject the whole;
- Section 37(4) provides that the provisions of this section are subject to any usage of trade, special agreement or course of dealing between the parties.

Instalment deliveries

Section 38(1) provides that the buyer of the goods is not bound to accept the delivery of goods by instalments unless otherwise agreed to between both the parties.

Section 38(2) provides that where there is a contract for the sale of goods to be delivered by stated instalments which are to be separately paid for and:

- the seller makes no delivery or defective delivery in respect of one or more instalments; or,

- the buyer neglects or refuses to take delivery of or pay for one or more instalments

However, it is a question in each case, depending on the terms of the contract and circumstances of the case as to whether the breach of contract is:

- a repudiation of the whole contract; or
- whether it is severable breach giving rise to a claim for compensation but not to treat the whole contract as repudiated.

Delivery to carrier or wharfinger

Section 39(1) provides that if the seller is authorized or required to send the goods to the buyer, through a carrier whether it is named by the buyer or not or delivery of the goods to a wharfinger for safe custody, the delivery of goods to such a carrier or wharfinger shall be deemed to be a delivery of the goods to the buyer.

Section 39(2) provides that the seller shall make contract with the carrier or wharfinger on behalf of the buyer as may be reasonable having regard to the nature of the goods and other circumstances of the case. If the seller omits so to do and the goods are lost or damaged in the course of transit or whilst in the custody of the wharfinger, the buyer:

- may decline to the treat the delivery to the carrier or wharfinger as a delivery to himself; or
- may hold the seller responsible for damages.

Section 39(3) provides that where goods are sent by the seller to the buyer by a route involving sea transit, in circumstances in which it is usual to insure the seller shall give such notice to the buyer as may enable him to insure them during their sea transit. If the seller fails so to do, the goods shall be deemed to be at his risk during such sea transit.

Delivery of goods at a distant place

Section 40 provides that where the seller of goods agrees to deliver them at his own risk at a place other than that where they are when sold, the buyer shall, nevertheless, unless otherwise agreed, take any risk of deterioration in the goods necessarily incident to the course of transit.

Buyer's right of examining the goods

According to Section 41, the buyer is having right to examine the goods, which have not been examined by him previously before acceptance. The examination of the goods by the buyer is for the purpose of ascertaining whether they are in conformity with the contract. The seller is also bound to afford an opportunity to the buyer for examining the goods for the purpose of ascertaining whether they are in conformity with the contract.

Acceptance

Section 42 provides that the buyer is deemed to have accepted the goods-

- when he intimates to the seller that he has accepted them; or
- when the goods have been delivered to him and he does any act in relation to them which is inconsistent with the ownership of the seller; or
- when, after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them.

Examples:

a) Ram sold his car to Shyam for ₹ 1 Lakh. Shyam paid the same in advance and Ram delivered the car after two days of the payment. Shyam immediately rented the car out to a company ABC Ltd. for an amount for six months. However, Shyam realized that Ram had sold the car with a scratch on its body which was clearly visible even at the time of delivery. Shyam now refuses to accept the car after one month and seeks full refund of the car. However, Shyam will not succeed in the same, because he had accepted it at the time of delivery thereby discharging the contract.

Return of rejected goods

Section 43 provides that where goods are delivered to the buyer and he refuses to accept them, the buyer is not bound to return them to the seller. It is sufficient if he intimates to the seller that he refuses to accept them.

Liability of the buyer

Section 44 provides that where the seller is ready and willing to deliver the goods and requests the buyer to take delivery and the buyer does not within a reasonable time take delivery of the goods he is liable to the seller any loss occasioned by his neglect or refusal to take delivery and also for a reasonable charge for the care and custody of the goods. The rights of the seller shall not be affected by this section where the neglect or refusal of the buyer to take delivery amounts to a repudiation of the contract.

Rights of Unpaid Seller

3.5

According to Section 45(1), the seller of the goods is deemed to be 'unpaid seller' within the meaning of this Act-

- when the whole of the price has not been paid or tendered;
- when a bill of exchange or other negotiable instrument has been received as conditional payment, and the condition on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise;

Section 45(2) defines the term 'seller' as including any person who is in the position of a seller as for instance an agent of the seller to whom the bill of lading has been endorsed or a consignor or agent who has himself paid, or is directly responsible for the price.

3.5.1 Rights of an Unpaid Seller against the Goods

According to Section 46, an unpaid seller's right against the goods are:

a) A lien or right of retention

b) The right of stoppage in transit.

c) The right of resale.

d) The right to withhold delivery

Right of Lien [Sections 47-49 and 54]: An unpaid seller who is in possession of goods sold, may exercise his lien on the goods, i.e., keep the goods in his possession and refuse to deliver them to the buyer until the payment or tender of the price in cases where:

- the goods have been sold without any stipulation as to credit; or
- the goods have been sold on credit, but the term of credit has expired; or
- the buyer becomes insolvent.

The lien depends on physical possession. The seller's lien is possessory lien, so that it can be exercised only so long as the seller is in possession of the goods. It can only be exercised for the non-payment of the price and not for any other charges.

Examples:

a) Rajnish sold his car to Manish under a contract. However, Manish gave Rajnish a cheque for the amount due. However, Manish became insolvent and filed for bankruptcy. Since the cheques would not get encashed anymore, Rajnish withheld the car by exercising his right of lien until the payment under the contract of

sale was made for the same.

b) XYZ Co. Ltd. manages the Haldia Port. They have constructed a godown on their wharf to store goods. Diana Ship came to the wharf and alighted their goods. Mr. Prem Bhageria had to claim the goods from the wharf. However, Mr. Bhageria did not turn up on the day the ship arrived. Therefore, XYZ Co. Ltd. kept the consignment of goods in their store room. After 3 months, Mr. Bhageria came to claim the goods, however, XYZ Co. Ltd. asked Mr. Bhageria to pay ₹20 Lakhs in rent for the store room facility utilized by the goods. Mr. Bhageria refused to pay the same. XYZ Co. Ltd. then refused to release the goods to Mr. Bhageria by exercising their right of lien over the goods.

A lien is lost –

a) When the seller delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer, without reserving the right of disposal of the goods;

b) When the buyer or his agent lawfully obtains possession of the goods;

c) By waiver of his lien by the unpaid seller

Stoppage in transit [Sections 50-52]: The right of stoppage in transit is a right of stopping the goods while they are in transit, resuming possession of them and retaining possession until payment or tender of the price.

The right to stop goods is available to an unpaid seller:

- when the buyer becomes insolvent; and
- the goods are in transit.

The buyer is insolvent if he has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due. It is not necessary that he has actually been declared insolvent by the court.

The goods are in transit from the time they are delivered to a carrier or other bailee like a wharfinger or warehouse keeper for the purpose of transmission to the buyer and until the buyer takes delivery of them.

The transit comes to an end in the following cases:

a) If the buyer obtains delivery before the arrival of the goods at their destination;

b) If, after the arrival of the goods at their destination, the carrier acknowledges to the buyer that he holds the goods on his behalf, even if further destination of the goods is indicated by the buyer;

c) If the carrier wrongfully refuses to deliver the goods to the buyer.

If the goods are rejected by the buyer and the carrier or other bailee holds them, the transit will be deemed to continue even if the seller has refused to receive them back.

The right to stop in transit may be exercised by the unpaid seller either by taking actual possession of the goods or by giving notice of the seller's claim to the carrier or other person having control of the goods. On notice being given to the carrier, he must redeliver the goods to the seller who must pay the expenses of the re-delivery.

The seller's right of lien or stoppage in transit is not affected by any sale on the part of the buyer unless the seller has assented to it. A transfer, however, of the bill of lading or other document of seller to a bona fide purchaser for value is valid against the seller's right.

Right of re-sale [Section 54]:

The unpaid seller may re-sell:

- where the goods are perishable;
- where the right is expressly reserved in the contract;
- where in exercise of right of lien or stoppage in transit, the seller gives notice to the buyer of his intention to re-sell, and the buyer, does not pay or tender the price within a reasonable time.

If on a re-sale, there is a deficiency between the price due and amount realised, he is entitled to recover it from the buyer. If there is a surplus, he can keep it. He will not have these rights if he has not given any notice and he will have to pay the buyer profit, if any, on the resale.

Example: Ram contracted with Shyam to buy 50 litres of Milk from Shyam on 16th March, 2020 for ₹100 per litre. However, Ram failed to claim the consignment on the said date. Shyam runs the risk of getting the milk spoiled. Ram failed to claim the consignment until 20th March, 2020 and Shyam had to sell the same to Dham. Shyam is justified in doing so even though he had a valid contract with Ram with respect to the same milk.

Rights to withhold Delivery

If the property in the goods has passed, the unpaid seller has right as described above. If, however, the property has not passed, the unpaid seller has a right of withholding delivery similar to and co-extensive with his rights of lien and stoppage in transit.

3.5.2 Rights of an unpaid seller against the buyer

An unpaid seller in addition to his rights against the goods has the following rights against the buyer personally.

1. **Suit for price [Section 55]:** Where the property in goods has passed to the buyer, and the buyer wrongfully neglects or refuses to pay the price, the seller can sue the buyer for price.
2. **Suit for damages for non-acceptance [Section 56]:** Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller can sue him for damages for non-acceptance of the goods.
3. **Suit for repudiation:** Where the buyer repudiates the contract before the date of delivery, the seller may wait till the date of delivery or may treat the contract as cancelled and sue for damages for breach.
4. **Suit for interest [Section 61]:** Where there is specific agreement between the seller and the buyer regarding interest on the price of goods, the seller may claim it from the date when payment becomes due. If there is no specific agreement, the interest is payable from the date notified by the seller to the buyer.

Buyer's Remedies against Seller for Breach of Contract

A buyer also has certain remedies against the seller who commits a breach. These are:

1. **Suit for Damages for Non-Delivery [Section 57]:** When the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue the seller for damages for non-delivery. This is in addition to the buyer's right to recover the price, if already paid, in case of non-delivery.
2. **Suit for price:** Where the buyer has paid the price and the goods are not delivered to him, he can recover the amount paid.
3. **Suit for specific performance [Section 58]:** When the goods are specific or ascertained, a buyer may sue the seller for specific performance of the contract and compel him to deliver the same goods. The court orders for specific performance only when the goods are specific or ascertained and an order for damages would not be an adequate remedy. Specific performance is generally allowed where the goods are of special significance or value e.g. a rare paining, a unique piece of jewellery, etc.

4. **Suit for Breach of Warranty [Section 59]:** Where there is a breach of warranty by the seller, or where the buyer elects or is compelled to treat the breach of condition as breach of warranty; the buyer cannot reject the goods. The buyer may:
   - set up the breach of warranty in extinction or diminution of the price payable by him, or
   - sue the seller for damages for breach of warranty.
5. **Repudiation of contract before the due date [Section 60]:** Section 60 provides that where either party to a contract of sale repudiates the contract before the date of delivery, the other may either treat the contract as subsisting or wait till the date of delivery, or he may treat the contract as rescinded and sue for damages for the breach.
6. **Suit for interest:** The buyer may recover such interest or special damages, as may be recoverable by law. He may also recover the money paid where the consideration for the payment of it has failed. In the absence of a contract to the contrary, the court may award interest, to the buyer, in a suit by him for the refund of the price in a case of a breach on the part of the seller, at such rate as it thinks fit on the amount of the price from the date on which the payment was made.

Auction Sales

3.6

Section 64 provides that in the case of a sale by auction-

- where goods are put up for sale in lots, each lot is prima facie deemed to be the subject of a separate contract of sale;
- the sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner; and until such announcement is made, any bidder may retract his bid;
- a right to bid may be reserved expressly by or on behalf of the seller and, where such right is expressly so reserved, but not otherwise, the seller or any one person on his behalf may, subject to the provisions hereinafter contained, bit at the auction;
- where the sale is not notified to be subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person; and any sale contravening this rule may be treated as fraudulent by the buyer;
- the sale may be notified to be subject to a reserved or set up price;
- if the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.

Section 64 does not deal with the question of passing of the property at auction sale but merely deals with completion of the contract of sale which takes place at the fall of the hammer or at the announcement of the close of the sale in other customary manner by the auctioneer. In other words, all that happens at the fall of the hammer or at the announcement of the closure of the sale in other customary manner is that a contract of sale comes into existence and parties get into the relationship of a promisor and a promisee in an executory contract.

Effect of Tax [Section 64A]

In the event of any tax being imposed, increased, decreased or remitted in respect of any goods after the making of any contract for the sale or purchase of such goods without stipulations as to the payment of tax where tax was not chargeable at the time of the making of the contract, or for the sale or purchase of such good tax- paid where tax was chargeable at that time.

a) if such imposition or increase so takes effect that the tax or increased tax, as the case may be, or any part of such tax is paid or is payable, the seller may add so much to the contract price as will be equivalent to the

amount paid or payable in respect of such tax or increase of tax, and he shall be entitled to be paid and to sue for and recover such addition, and

b) if such decrease or remission so takes effect that the decreased tax only, or no tax, as the case may be, is paid or is payable, the buyer made deduct so much from the contract price as will be equivalent to the decrease of tax or remitted tax, and he shall not be liable to pay, or be sued for, or in respect of, such deduction.

EXERCISE

Multiple Choice Question:

1. A sale is complete when the following is transferred from one.
   a) Money
   b) Ownership
   c) Usage
   d) None of the above
2. The Consideration in contract of sale must be:
   a) Immovable
   b) Movable
   c) Price
   d) None of the above
3. The subject matter of the contract must be:
   a) Sale
   b) Product
   c) Service
   d) None of the above
4. On which date was the Sale of Goods enforced?
   a) 1948
   b) 1930
   c) 1932
   d) 1951
5. As per Sale of Goods Act, this is not included:
   a) Growing crop
   b) Money
   c) Table
   d) Goodwill

State TRUE or FALSE

1. Condition is a stipulation which is essential to the main purpose of the contract.
2. The sale of goods Act only deals only with goods that are immovable in nature.
3. Warranty is a stipulation which is collateral to the purpose of the contract.
4. Caveat Emptor is the concept of "let the buyer beware".
5. The subject matter of the contract under Sale of Goods Act must be goods.
6. Sale under Sale of Goods Act is an executory contract.

Fill in the blanks

1. The goods which form the subject of a contract of sale may be either existing goods, owned or possessed by the seller, or _____ good
2. The _____ in a contract of sale may be fixed by the contract or may be left to be fixed in manner thereby agreed or may be determined by the course of dealing between the parties.
3. A contract of sale is made by an offer to buy or sell goods for a price and the _____of such offer.
4. A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a _____
5. A contract of sale may be ____ or conditional

⊙ Short Essay Type Questions

1. What are the rights of unpaid seller against goods?
2. Discuss the provisions on the re-selling of goods.
3. Write short notes on-
   (a) Auction Sale
   (b) Doctrine of Caveat Emptor
   (c) Agreement to Sell

⊙ Essay Type Questions

1. Discuss the difference between condition and warranty.
2. Explain the concept of Caveat Emptor
3. What are the rights and duties of a seller?
4. What are the rights and duties of a buyer?
5. What are the implied conditions in a contract of sale by sample?
6. What is a contract of sale?
7. What is an agreement to sell?
8. Distinguish between a sale and an agreement to sell?

⊙ Unsolved Cases

1. Ram agreed to send a consignment to Shyam via a ship. This was done on the basis of an agreement where Shyam would have to pay ₹1,000 for the consignment upon delivery. However, Shyam became insolvent and Ram got to know about it before he despatched the goods for delivery to Shyam. Can Ram exercise his right of lien over goods as an unpaid seller against goods?
2. Sita asked for 100 Litres of mustard oil from Gita. However when Gita delivered the same through her agent to Sita, Sita refused saying that it was palm oil and was not what she had contracted for. Gita's mustard oil therefore was not sold and she suffered damages. What can Gita do in this case where there is no default on her part and Sita wrongfully refused to take delivery of the goods within reasonable time?

Answer:

Multiple Choice Question:

1. b; 2. c; 3. a; 4. b; 5. b.

State TRUE or FALSE

1. True; 2. False; 3. True; 4. True; 5. True; 6. False.

Fill in the blanks

1. Future; 2. Price; 3. Acceptance; 4. Price; 5. Absolute.

Negotiable Instruments Act, 1881 4

This Module includes -

4.1 Definition and Features of Negotiable Instrument

4.2 Crossing, Endorsement and Material Alteration

4.3 Acceptance, Assignment and Negotiation

4.4 Rights and Liabilities of Parties

4.5 Dishonour of a Negotiable Instrument (with special emphasis on Section 138)

Negotiable Instruments Act, 1881

SLOB Mapped against the Module

To acquire knowledge on the various kinds of negotiable instruments and features incidental to their negotiability.

Module Learning Objectives:

After studying this module, the students will be able -

- To acquire knowledge on the various kinds of negotiable instruments and features incidental to their negotiability.
- To comprehend the laws governing negotiable instruments and the concepts relating to its holder, transfer, dishonor, and obligations of parties to transactions relating to such negotiable instruments.

Definition and Features of Negotiable Instrument

4.1

The objective of having negotiable instruments was to simplify the transaction in money, such that during the transfer of higher amounts of money, people do not fall prey to thefts or robbery committed on route. Such negotiable instruments came to be legalized and regulated through the Negotiable Instruments Act, 1881. Negotiable instruments are those documents that evidence a contractual right to claim payment and which can be transferred upon delivery. Therefore, the age-old rule that states no one can transfer a better title that the person who has the same, does not hold good in such situations. The system of negotiable instruments gets regulated by the Ministry of Finance that supervises the transfers and negotiability of such instruments.

Negotiable instruments are those documents which are used to transfer money between designated persons. These instruments either contains a promise or an instruction to pay to the other, an assigned sum of money at a particular time.

These instruments could exist in varying formats but have certain distinct features within them, such as, they are easily transferable and mobile, they are almost always in written format, contain a definite time for discharge of payment obligations, and has specific persons mentioned therein.

In most day-to-day transactions, in marketplaces or mandis, different types of trades, negotiable instruments have gained importance. These instruments can be transferred by delivery or by endorsement and delivery. The entire Act has been divided into many sections such as; definitions of various instruments and incidental terms thereto, rights and liabilities of parties to such transactions involving negotiable instruments, how negotiation and its subsequent payments are discharged, and provisions relating to dishonour and compensations.

4.1.1 Definition and Features of Negotiable Instrument

Negotiability is a feature that is distinct from the concept of transferability. By mere delivery or endorsements and delivery, the acquirer of the negotiable instruments gets the best title to the instrument by becoming the holder, which is not the case in instruments that are not negotiable and can bestow upon such rights by the procedures of sale or other means of transfer.

Indian law denotes three instruments which can be called as negotiable instrument and are legally valid. These instruments are: promissory note, bill of exchange and cheque. Section 13 of the Act defines the terms 'negotiable instrument' as a promissory note, bill of exchange or either payable either to order or to bearer.

Essential Features of a Negotiable Instrument:

1. It must be in writing.
2. It should be signed by the maker or drawer.
3. There must be a promise or order to pay.

4. The promise or order must be unconditional.
5. It must call for payment in money and money only.
6. It should call for payment of a certain sum.
7. The property in the instrument may be passed in two ways:
   a) by mere delivery; and
   b) by indorsement and delivery.
8. The consideration is also presumed to have been passed

4.1.2 Promissory Note

Section 4 of the Act defines the term 'promissory note' as an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.

In a promissory note, there are only two parties. One is the payer, the other is the payee. Such instruments can also be negotiated when endorsed and delivered or be delivered only.

Note: Provisions relating to currency notes are regulated by other pieces of legislation, including the Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949.

Example -

- I promise to pay B or order ₹50,000.
- I acknowledge myself to be indebted to B for ₹1 lakh to be paid on demand, for value received.
- The instruments in the above two examples are promissory notes.
- I promise to pay B ₹20,000 seven days after my marriage with Helen.
- I promise to pay ₹50,000 on D's death, provided D leaves me enough to pay that sum. The instruments in the above two examples do not amount to promissory notes.

The High Court in Santsingh vs. Madandas Panika, AIR 1976 MP 144 held that an instrument is a promissory note if there are present the following elements-

- There should be an unconditional undertaking to pay;
- The sum should be a sum of money and should be certain;
- The payment should be the order of a person who is certain, or to the bear of the instrument;
- The maker should sign it.

The High Court, Andhra Pradesh in Bahadurrinisa vs. Vasudev, AIR 1967 AP 123 categorized the promissory note into three types-

- A promise to pay a certain sum of money to a certain person;
- A promise to pay a certain sum of money to the order of a certain person;
- A promise to pay the bearer.

4.1.3 Bill of Exchange

Section 5 defines the expression 'bill of exchange' as an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.

Example: A promise or order to pay is not 'conditional' within the meaning of this section and Section 4, by reason of the time for payment of the amount or any installment thereof being expressed to be on the lapse of a certain period after the occurrence of a specified event which, according to the ordinary expectation of mankind, is certain to happen, although the time of its happening may be uncertain.

The sum payable may be 'certain' within the meaning of this section and section 4, although it includes future interest or is payable at an indicated rate of exchange, or is according to the course of exchange, and although the instrument provides that, on default of payment of an installment, the balance unpaid shall become due.

The person to whom it is clear that the direction is given or that payment is to be made may be a 'certain person' within the meaning of this section and section 4, although he is mis-named or designated by description only.

The Calcutta High Court in Sinha vs. Bidhu Bhusan De, AIR 1955 Cal. 562 narrated the essential character of a bill of exchange which is that it contains an order to accept or to pay and that the acceptor should accept it; in the absence of such a direction to pay, the document will not be a bill of exchange or a hundi.

The following are the bills of exchange-

- A banker's draft – Birbhum Central Co-op bank vs. Pioneer Bank Limited – AIR 1956 Cal. 615;
- A demand draft even if it be drawn upon another office of the same bank – S.N. Shukla vs. Punjab National Bank Limited' – AIR 1960 All. 238;
- An order issued by a District Board Engineer on Government Treasury for payment to or order of a certain person – Rangaswami vs. Sankaralingam – ILR 43 Mad 816.

4.1.4 Cheque

The term 'cheque' is defined under Section 6 of the Act. It 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.

There are three parties in a cheque. The drawer, drawee and the payee. In such cases the drawee is always the bank which has been instructed by the drawer, through the cheque to make the payment to the holder of the instrument which is the payee.

For the purposes of this section, the terms 'a cheque in the electronic form', 'truncated cheque' are defined which has been substituted by the Negotiable Instruments (Amendment) Act, 2015, with effect from 26.12.2015.

'A cheque in the electronic form' is a cheque drawn in electronic form by using any computer resource and signed in a secure system with digital signature (with or without biometric signature) and asymmetric crypto system or with electronic signature, as the case may be.

'A truncated cheque' is a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

The expression 'clearing house' is the clearing house managed by the RBI or a clearing house recognized as such by RBI.

Distinction between Promissory Note and Bill of Exchange

Sl. No.	Promissory Note	Bill of Exchange
1.	It is defined in Sec. 4 of NI Act, 1881.	It is defined in Sec. 5 of the NI Act, 1881.
2.	There are two parties: ⊙ Maker. ⊙ Payee	There are three parties: ⊙ Drawer. ⊙ Acceptor ⊙ Payee.
3.	It contains a Promise to pay.	It contains an order to pay.
4.	No conditions shall be made in a promissory note.	A bill may be accepted conditionally.
5.	The liability of a maker of the promissory note is primary and absolute.	The liability of the drawee of a bill of exchange is secondary and conditional.

Distinction between Promissory Note and Cheque

Sl. No.	Promissory Note	Cheque
1.	It is defined in Sec. 4 of NI Act, 1881.	It is defined in Sec. 6 of the NI Act, 1881.
2.	There are two parties: ⊙ Maer. ⊙ Payee	There are three parties: ⊙ Drawer. ⊙ Drawee. ⊙ Payee.
3.	Promissory note contains a promise to pay the sum with interest or without interest at a later date.	A cheque is payable immediately on demand without any days of grace.
4.	Promissory note is not crossed.	Cheque can be crossed.
5.	No protection is available to the payee of note.	Statutory protection is given to the drawee banker. (Sec. 128)
6.	A promissory note cannot be self drawn.	A cheque can be self -drawn or bearer cheque.
7.	No criminal liability shall be imposed on the maker.	Criminal Liability may be imposed on drawee for the dishonour of cheques in certain circumstances.
8.	Stamp is necessary.	Stamp is not necessary.
9.	Limitation: 3 years	Limitation: 6 months

Distinction between Bill of Exchange and Cheque

Sl. No.	Bill of Exchange	Cheque
1.	It is defined in Sec. 5 of NI Act, 1881.	It is defined in Sec. 6 of the NI Act, 1881.
2.	There are three parties: ⊙ Drawer. ⊙ Drawee. ⊙ Payee.	There are three parties: ⊙ Drawer. ⊙ Drawee. ⊙ Payee.
3.	Bills of exchange are not crossed.	Cheques may be crossed.
4.	Generally three days of grace are given for the payment in case of a bill of exchange. However, this convenience is not allowed in case of bill of exchange payable on demand.	Immediate payment is required in case of cheque. No grace days are allowed.
5.	Anybody including banker may be a drawee in case of bill of exchange.	The drawee is always a baker.
6.	It must be accepted before the acceptor can be made liable upon it.	It requires immediate payment. It does not require acceptance of the maker. Thus the question of acceptance does not arise in case of cheque.
7.	Where a Bill of Exchange is not paid and not honoured, a notice of dishonour should be sent to the drawer to charge him.	Where a cheque is dishonoured, Notice of Dishonour is not strictly necessary. The banker can return the cheque with the memo "Refer to Drawer" which is a sufficient notice.
8.	Statutory protection is not available.	Sec. 85 of the N.I Act, 1881 affords protection to bankers.
9.	Civil Liability in case of dishonour of bill of exchange.	Criminal liability in case of dishonour of a cheque/bouncing of a cheque and is liable to be prosecuted under Sec. 138 of the N.I. Act, 1881.

4.1.5 Parties to the Instruments

The transaction of the instrument requires at least two persons. One is the drawer and other is the drawee. The drawer of the instrument is the person who makes a bill of exchange or a cheque and the person thereby directed to pay is called the drawee. In 'Shivanth vs. Bishambar'- AIR 1935 Lah. 153 it was held that the definition of drawer is not exhaustive; the maker of the promissory note can also be called a drawer.

Drawer in case of need – When in the bill or in any endorsement thereof the name of any person is given in addition to the drawee to be resorted to in case of need, such a person is called a 'drawee in case of need'.

Acceptor – After the drawee of a bill has signed his assent upon the bill, or, if there are more parts thereof than one, upon one such parts, and delivered the same, or given notice of such signing to the holder or to some person on his behalf, he is called the acceptor.

Acceptor for honor – When a bill of exchange has been noted or protested for non-acceptance or for better security and any person accepts it supra protest for honor of the drawer or any one of the endorsers, such person is called an 'acceptor for honor'.

Payee – The person named in the instrument, to whom or to whose order the money is by the instrument directed to be paid, is called the 'payee'.

Holder – Section 8 defines the term 'holder'. The holder of a promissory note or a bill of exchange or cheque is any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto. Where the note, bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction.

In Anjaniaih vs. Nagappa, AIR 1967 AP 61 it was held that the term 'holder' as defined in Section 8 of the Act would not include a person, who, though in possession of the instrument, had no right to recover the amount due from the parties thereto, such as the finder of a lost instrument payable to bearer or a thief in possession of such an instrument, or even the payee himself, is he is prohibited by an order of court from receiving the amount due on the instrument. Where a plaintiff sued not as a holder in possession of the promissory note but claimed to recover the debt, on the basis of a succession certificate, he would be the only person entitled to recover the debt.

Holder in due course – Section 9 defines the term 'holder in due course. It means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to bearer, or the payee or the endorsee thereof, if payable to order, before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

In Braja Kishore Dikshit vs. Purna Chandra Panda, AIR 1957 Ori. 153 the High Court held that the holder in due course under Section 9 has to satisfy the following three conditions-

- An endorsee becomes a holder in due course for consideration;
- He can become an endorsee before the amount mentioned in the promissory note became payable; and
- He should have no sufficient cause to believe that any defect existed in the title of the person from whom he was to derive his title.

As regard to the second condition the promissory note becomes payable either on demand or at maturity.

Difference between holder and holder in due course

Sl. No.	Holder	Holder in due course
1.	Holder is entitled in his own name to possess the instrument and the amount thereon from parties involved.	Holder in due course possesses the instrument for consideration before maturity and in good faith.
2.	Title of the holder is subject to title of the transferor.	Holder in due course gets a better title than transferor.
3.	Holder may receive the instrument without consideration.	Holder in due course always receives the instrument for consideration.
4.	Holder does not get certain privileges available to the holder in due course.	Holder in due course always gets privileges not available to holder.

Payment in due course – Section 10 defines this expression as payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned.

This basically means that the format of the cheque has to be in the format issued by the drawee, and needs to be made and claimed in good faith to and by the intended holder of the instrument.

Example:

Where a bank makes payment in accordance with the apparent tenor of the instrument in good faith and without negligence under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment, payment is said to be done in due course. Therefore, it is said "A banker's duty in paying a cheque is discharged by payment in due course".

Instruments

There are various types of instruments mentioned in this Act as follows:

- **Inland instrument** – a promissory note, bill of exchange or cheque drawn or made in India and made payable in, or drawn upon any person resident in, India shall be deemed to be an inland instrument.
- **Foreign instrument** – a promissory note, bill of exchange or cheque not drawn, made or made payable, in India, shall be deemed to be a foreign instrument.
- **Ambiguous instrument** – where an instrument may be construed either as a promissory note or bill of exchange, the holder may at his election, treat it as either and the instrument shall be thenceforward treated accordingly.
- **Instruments payable on demand** – A promissory note or bill of exchange, in which no time for payment is specified, and a cheque, are payable on demand.
- **Inchoate stamped instruments** – Where one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments for the time being in force in India and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives prima facie authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein and not exceeding the amount covered by the stamp. The person so signing shall be liable upon such instrument, in the capacity in which he signed the same, to any holder in due course for such amount provided that no person other than a holder in due course shall recover from the person delivering the instrument anything in excess of the mount intended by him to be paid there under.

4.1.6 Maturity [Section 22-25]

Section 22 provides the date of the maturity of the instruments. The maturity of a promissory note or bill of exchange is the date at which falls due. If the promissory note or bill of exchange does not express to be payable on demand, at sight or on presentment, the maturity for such cases is the third day on which it is expressed to be payable.

Example: X writes a post-dated cheque in favour of Y. Y cannot claim money by presenting the cheque to the banker before the date falls due.

In Hemadri vs. Seshamma, 1930 M.W.N. 1232 it was held that the term used in this section cannot apply to a promissory note payable on demand.

Calculation of maturity date

Section 23 provides for calculating maturity of bill or note payable so many months after date or sight. In calculating the date at which a promissory note or bill of exchange, made payable a stated number of months after date or after sight, or after a certain event, is at maturity-

- the period stated shall be held to terminate on the day of the month which corresponds with the day on which the instrument is dated; or
- presented for acceptance or sight; or
- noted for non-acceptance; or
- or protested for non-acceptance; or
- the event happens; or
- where the instrument is a bill of exchange made payable a stated number of months after sight and has been accepted for honor with the day on which it was so accepted.

If the month in which the period would terminate has no corresponding day, the period shall held to terminate on the last day of such month.

Crossing, Endorsement and Material Alteration

4.2

Section 123 provides that where a cheque bears across its face an addition of the words 'and company' or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words 'not negotiable' that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally.

Section 124 provides that where a cheque bears across its face an addition of the name of a banker, either with or without the words 'not negotiable' that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed specially, and to be crossed to that banker.

Section 125 provides that where a cheque is not crossed, the holder may cross it generally or specially.

- Where a cheque is crossed generally, the holder may cross it specially;
- Where a cheque is crossed generally or specially, the holder may add the word 'not negotiable'
- Where a cheque is crossed specially, the banker to whom it is crossed may again cross it specially to another banker, his agent, for collection.

Example: Ramesh writes a crossed cheque in favour of Mahesh. The cheque was additionally crossed specially to Punjab National Bank. Therefore, Mahesh can only collect the money through his bank, and not over the counter as cash from Ramesh's banker. Moreover, Mahesh can only collect the same through Punjab National Bank where he must hold an account, since no other bank would be able to collect the money on that cheque.

4.2.1 Payment of Cheque

The payment may be made in respect of the following cases-

- payment of cheque crossed generally;
- payment of cheque crossed specially;
- payment of cheque crossed specially more than once;
- payment in due course of crossed cheque;
- payment of crossed cheque out of due course.

Section 126 provides that where a cheque is crossed generally, the banker, on whom it is drawn, shall not pay it otherwise than to a banker. Section 127 provides that where a cheque is crossed specially to more than one banker, except when crossed to an agent for the purpose of collect, the banker on whom it is drawn shall refuse payment thereof. Section 128 provides that where the banker on whom a cross cheque is drawn has paid the same in due course, the banker paying the cheque, and (in such case cheque has come to the hands of the payee) the drawer thereof, shall respectively entitled to the same rights and be placed in the same position in all respects, as they would respectively be entitled to and placed in it if the amount of the cheque had been paid to and received

by the true owner thereof.

Section 129 provides that any banker paying a cheque crossed generally otherwise than to a banker, or a cheque crossed specially otherwise than to the banker to whom the same is crossed, or his agent for collection, being a banker, shall be liable to the true owner of the cheque for any loss he may sustain owing to the cheque having been so paid.

Cheque bearing 'not negotiable'

Section 130 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 which the person from whom he took it had.

Example: X is the drawer of a cheque which was drawn in favour of Y. Moreover, X wrote the cheque as non-negotiable. Y will now not be able to endorse the cheque any further, and will have to claim the money on the cheque himself.

Non liability of banker

Section 131 provides that a banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself shall not, in case the title of the cheque proves defective, incur any liability to the true owner of the cheque by reason only of having received such payment.

A banker receives payment of a crossed cheque for a customer within the meaning of this section notwithstanding that he credits his customer's account with the amount of the cheque before receiving payment thereof.

It shall be the duty of the banker who receives payment based on an electronic image of a truncated cheque held with him, to verify the prima facie genuineness of the cheque to be truncated and any fraud, forgery or tampering apparent on the face of the instrument that can be verified with due diligence and ordinary case.

4.2.2 Endorsement

Endorsement means signatures of the person which are generally made at the back of the instrument, for the purpose of transfer of rights to another person.

Section 15 of the Act provides that when the maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negation on the back or face thereof or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as negotiable instrument he is said to indorse the same and is called the 'indorser'.

Therefore, endorsement (indorsement) means writing of a person's name (other than maker) on the face or back of an instrument or on a slip of paper attached thereto for the purpose of negotiation. The person signing the instrument is known as endorser and the person in whose favour it is endorsed is known as endorsee.

Essentials of a valid endorsement

i) It must be on the instrument itself or on a separate slip of paper (called allonge) attached thereto.

ii) For the purpose of negotiation, it must be signed by the endorser.

iii) The instrument may contain in addition to the signature of the endorser, the name of the endorsee also. No particular form of words is necessary for endorsement.

iv) Endorsement is complete when the instrument is delivered to the endorsee with the intention of passing the property in it to the endorsee. Delivery is to be made by the endorser himself or someone on behalf of him.

Who may endorse a bill?

The first endorsement of an instrument can be made by the payee only, however, subsequent endorsement can be made by any person who becomes the holder of the instrument. As per section 15 endorsement cannot be made by the maker or holder of an instrument as maker. Thus, if a bill is drawn payable to the drawer's order the first signature of the drawer as a drawer is not an endorsement, but if he signs the bills second time for the purpose of negotiating it, the second signature would be an endorsement.

It may note that as per section 51 every sole maker, drawer, payee or indorsee or all of several joint makers, drawers, payees or indorsees of a negotiable instrument may endorse and negotiate it.

Types of endorsement:

The endorsement of a negotiable instrument can be:

i) Blank

ii) Full

iii) restrictive endorsement or,

iv) conditional endorsement

As per Section 16 (1), if the endorser signs his name only, the endorsement is said to be "in blank", and if he adds a direction to pay the amount mentioned in the instrument to, or to the order of, a specified person, the endorsement is said to be "in full", and the person so specified is called the "endorsee" of the instrument. Section 49 of the Act provides the mechanism of conversion of a blank endorsement into a full endorsement. As per section 49 the holder of a negotiable instrument indorsed in blank may, without signing his own name, by writing above the endorser's signature a direction to pay to any other person as endorsee, convert the endorsement in full; and the holder does not thereby incur the responsibility of an endorser.

Example 1:

X is a holder of a bill which has been endorsed in blank by Y and delivered to him. If X writes over the signature of Y "Pay to Z or order", X is not liable as a endorser but this operate as full endorsement by Y to Z.

As per section 55 if a negotiable instrument, after having been indorsed in blank, is indorsed in full, the amount of it cannot be claimed from the endorser in full, except by the person to whom it has been indorsed in full, or by one who derives title through such person. As per section 54, subject to the provisions hereinafter (section 55) contained crossed cheques, a negotiable instrument indorsed in blank is payable to the bearer thereof even although originally payable to order.

Example 2:

If A is a payee and holder of a negotiable instrument. He endorses it in blank and delivers it to B who in turn endorse in full" Pay to C or order". C transfers it to D without any formal endorsement. In the instant D as the bearer of the instrument is entitled to payment or to sue drawer, acceptor or A who endorsed the bill in blank but he cannot hold B or C liable. However, C can sue B as he received the bill in full endorsement from B. But if C makes a proper endorsement in favor of D and then delivers to him, D can claim payment from all the prior parties including A and B in addition to C.

As per Section 50 endorsement of a negotiable instrument followed by delivery thereof has the effect of transferring the property in the instrument to the endorsee with a further right to negotiate the Instrument. But the endorser may by express words restrict or exclude such rights in which it will be called a restrictive endorsement. As per section 50 the of a negotiable instrument followed by delivery transfers to the endorsee the property therein with the right of further negotiation; but the endorsement may be express words, restrict or exclude such

right, or may merely constitute the endorsee an agent to indorse the instrument, or to receive its contents for the endorser, or for some other specified person.

The effect of restrictive endorsement is that the endorsee gets the right to full payment of the bill when due for payment and has right to sue any party to the bill but he has no right to transfer this right to any other person unless he expressly authorized to do so. The negotiability of the instrument comes to an end and the last endorsee is the person to sue upon. However, when the restrictive endorsement transfer the right of further endorsement or transfer all the subsequent endorsee get the bill with same right and liabilities as the fires endorsee after the first restrictive endorsement.

As per section 40 if the holder of a negotiable instrument without consent of the endorsee, destroys or impairs the endorser's remedy against a prior party, the endorser is discharged from liability as if the instrument had been paid at maturity.

Quite possible the holder of a negotiable instrument lost the instrument before its date of maturity. In such cases as per section 45 A of the act the holder has right to claim a duplicate copy of the lost bill subject to giving security to the drawer, if required, to indemnify him against all persons whatever in case the bill alleged to have been lost shall be found again. If the drawer on request as aforesaid refuses to give such duplicate bill, he may be compelled to do so as he has no option to give a duplicate copy of the said instrument.

As per section 52 of the Act, the endorser of a negotiable instrument may, by express words in the endorsement, exclude his own liability thereon, or make such liability or the right of the endorsee to receive the amount due thereon depend upon the happening of a specified event, although such event may never happen. This is called conditional endorsement.

Where an endorser so excludes his liability and afterwards becomes the holder of the instrument all intermediate endorsers are liable to him.

Example 3: if the endorser of a negotiable instrument signs his name adding the words "without recourse" upon this endorsement he incurs no liability.

Example 4: X is both holder as well payee of a negotiable instrument. Excluding personal liability by an endorsement "without recourse" he transfers the Instrument to B and B further endorses it to C who endorse it to A. A is not only reinstated in his former rights, but has the rights of an endorsee against B and C.

As clear from the above examples we can say that an endorser can exclude or limit his liability in the following ways:

a) By excluding his liability by making a Sans recourse endorsement. This can be done by adding the words' Sans recourse (Without recourse) to the endorsement. For example, the endorsement can be in the form" Pay A or order without recourse to me" or "pay A or order sans recourse' or 'Pay A or order at his own risk'. In the instant case if the instrument is dishonoured, the subsequent holder or the endorsee cannot look to the endorser for the payment of the same. Where an endorser excludes or limits his liability in this manner and afterwards becomes the holder of the same instrument, all intermediate endorsers continue to be liable to him.

b) Sans Frais endorsement: It may be understood that where the endorser does not want that the endorsee or any other holder to incur any expense on his account, it is called a "sans frais endorsement". In a "Sans Frais' endorsement the endorsee or any other holder does not want to incur any expense on his account This is called without expense endorsement also.

c) By making his liability contingent upon an uncertain event which may never happen as when the uncertain future event is not possible his liability is extinguished. But the endorsee can sue the prior parties before

happening of the event.

Example: The holder of a bill may endorse it "pay A or order on the arrival of the ship 'Vikrant" at Surat or pay A or order on his marriage with B. In all these cases, the liability of the holder as an endorser would arise upon the happening of the event specified.

d) By making right of endorse to receive payment on event which may never happen. In this case endorsee cannot sue prior parties before the happening of the specified event.

e) Partial endorsement: In order to be called a proper and valid endorsement the whole amount of the bill has to be endorsed. A part of the amount of an instrument cannot be endorsed. However, where a part of the amount has been paid or received by the holder, in such endorsement of the remaining unpaid amount can be made.

Example: An instrument is of ₹5,000 however, if any party to the instrument endorsee it for ₹4,000 in favor of any party such endorsement will not be valid. However, where ₹1,000 has been received against that instrument and the fact is recorded in the instrument then the endorsement of balance ₹4,000 is perfectly valid.

f) Facultative endorsement- In case of such an endorsement the endorser abandoned some rights or increases his liability as endorser e.g. "Pay A or order, notice of dishonour waived".

4.2.3 Material Alteration

Any material alteration of a negotiable instrument renders the same void as against anyone who is a party thereto at the time of making such alteration and does not consent thereto, unless it was made in order to carry out the common intention of the original parties:

Alteration by endorsee: And any such alteration, if made by an endorsee, discharges his endorser from all liability to him in respect of the consideration thereof.

It may be noted that to get benefit of this section the alteration must be intentional and not purely accidental. Secondly the alteration must be material. In Lokaram Sethiya vs. Ivon E John (1977) SC defined the term material alteration as follows:

"A material alteration is one which varies the rights, liabilities or legal position of the parties as ascertained by the deeds in its original state or otherwise varies the legal effets of the instruments as originally expressed or which may otherwise prejudice the party bound by the deed as originally executed. Some of the alterations which have been held to be material in various cases are as under:

1. Alteration of an order cheque to a bearer cheque except by or with the consent of the drawer.
2. Alteration by tearing material part of the instrument.
3. Alteration by erasing account paying crossing (J ladies Beauty vs. State Bank of India, AIR 1984 Guj 33)
4. Alteration by affixing stamps without the promisor's knowledge to a note. (Thommer v Union Khan, 1967 Ker LJ 80 N Gowda v B Gowda 1968 1 Myrs LJ 591)
5. Alteration of the date of payment [(A Subha Reddy v Neelapa Reddy Rammana Reddy AIR 1966 AP 267]
6. Alteration of the time of payment. (Long v Moore,1790 3 Esp 155)
7. Alteration of the place of payment (Tidamarsh v Grover 1813 23 LJ QB 261)
8. Alteration of the sum payable (Scholfield v Earl of Londesborough 1896 AC 514)
9. Alteration by adding new party to the instrument (Garner v Walsh 1855 5 ESB 83)

10. Alteration by tearing a material part of the instrument.
11. Alteration of the rate of interest (Seeth Tulsidas Lalchand v Rajagopal 1967 2 MLJ 66)

From the above cases of alteration which have been treated material alteration we can say that any alteration which changes the legal character of the instrument or alters the liabilities of the parties, whether change is prejudicial or beneficial is a material alteration.

Though we have discussed that material alteration discharges the parties to an instrument. But still there are some alterations which do not vitiate the instrument. These are as under:

1. Alteration before the completion of the instrument.
2. Crossing of an open cheque or conversion of general crossing into a special crossing.
3. Making qualified acceptance.
4. Completion of inchoate instrument.
5. Making a blank endorsement into full endorsement.
6. Conversion of a bearer cheque into an order cheque.
7. Alteration with the consent of the party liable on the instrument.
8. Alteration made for the purpose of correcting mistake.
9. Making a blank instrument into a full endorsement

Example: X writes a cheque in favour of Y. Y lost the cheque and Z found the same. Z tried to claim the money by taking it to X's banker. However he changed the name of the payee on the cheque and replaced it with his name. The banker cannot make the payment anymore as the cheque has been materially altered.

Payment of instrument on which alteration is not apparent

So far we have discussed that material alteration on a instrument discharge the parties to it. Still there may be some alteration in an instrument which may not be apparent at the time of payment. As per section 89:

1) Where a promissory note, bill of exchange or cheque has been materially altered but does not appear to have been so altered, or where a cheque is presented for payment which does not at the time of presentation appear to be crossed or to have had a crossing which has been obliterated, payment thereof by a person or banker liable to pay an paying the same according to the apparent tenor thereof at the time of payment and otherwise in due course, shall discharge such person or banker liable to pay and paying the same according to the apparent tenor thereof at the time of payment and otherwise in due course, shall discharge such a person or banker from all liability thereon, and such payment shall not be questioned by reasons of the instrument having been altered, or the cheque crossed.
2) Where the cheque is an electronic image of a truncated cheque, any difference in apparent tenor of such electronic image and the truncated cheque shall be a material alteration and it shall be the duty of the bank or the clearing house, as the case may be, to ensure the exactness of the apparent tenor of electronic image of the truncated cheque while truncating and transmitting the image.
3) Any bank or a clearing house which receives a transmitted electronic image of a truncated cheque, shall verify from the party who transmitted the image to it, that the image so transmitted to it and received by it, is exactly the same.

If a bill of exchange which has been negotiated is, at or after maturity, held by the acceptor in his own right, all rights of action thereon are extinguished. (Section 90)

Acceptance, Assignment and Negotiation

4.3

4.3.1 Acceptance

Only certain types of bills require acceptance. Essentials of a valid acceptance are:

- Must be written on the face of the bill,
- The bill must be signed by drawee or his authorized agent.
- The accepted bill is required to be delivered to the holder of the instrument.

Meaning of 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.

Acceptor

After the drawee has accepted the bill, he is known as the acceptor. It is only the bill of exchange (other than cheque) which requires acceptance. However, acceptance is not necessary to make a valid bill. If a bill is not accepted, it does not become invalid. It only becomes dishonoured by non-acceptance.

Presentation for acceptance may be excused in the following circumstances

a) Where the drawee is dead or insolvent.

b) Where the drawee is a fictitious person or one incapable of contracting.

c) When the drawee can cannot be found with reasonable efforts.

d) When acceptance has been refused on some other grounds.

Acceptance in Case of Bills in Sets

Where a bill is drawn in sets, the acceptance is required to 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 respectively.

When presentation for acceptance is necessary

a) Where the bill is payable at a given time after acceptance or after sight.

b) Where the bill expressly stipulates that it shall be presented for acceptance before presented for payment.

c) Where the bill is made payable at a place other than the place of residence or business of the drawee.

In no other case is presentation for acceptance necessary in order to render liable any party to the bill.

Example: X instructed Y to pay to Z a sum of ₹100. Y accepted to pay the same to Z. Therefore, Y is the acceptor of the bill. However, if Z claims the money after X's death, Y having the knowledge of X's death now will not be able to accept the bill anymore.

Types of Acceptance

Acceptance may be either general or qualified.

General Acceptance: An acceptance is said to be general when the drawee accepts the bill without qualification to the order of the drawer. If the acceptance is not absolute, the holder may treat the bill as dishonoured by non-acceptance

Qualified Acceptance: An acceptance is said to be qualified when the drawee accepts the bill subject to qualification. It may be noted that an acceptance will not be treated as a qualified acceptance unless the qualification is expressed on the bill in the clearest language. The qualification may relate to an event, amount, place, time, etc.

Circumstances indicating Qualified Acceptance

According to Section 86, an acceptance is qualified under the following circumstances:

a) Where it undertakes the payment on the happening of an event therein stated;

b) Where it undertakes the payment of part only of the sum ordered to be paid;

c) Where it undertakes the payment at a specified place of his choice and not otherwise or elsewhere;

d) Where it undertakes the payment at a time other than that at which under the order it would be legally due.

e) Where it is not signed by all drawees who are not partners.

Effect of Qualified Acceptance

a) The holder, may, treat the bill as dishonoured due to non-acceptance and after giving due notice of dishonour, sue the drawer and prior endorsers.

b) If he accepts a qualified acceptance all prior parties whose consent is not obtained are discharged as against the holder and those deriving title from him.

Examples of Qualified Acceptance

a) Accepted payable when in funds.

b) Accepted payable on giving up bill of lading.

c) Accepted payable when a cargo consigned to me is sold.

d) A bill drawn for ₹1,000 accepted for ₹900 only.

e) Accepted payable at Delhi only where no place of payment is specified in the order.

f) Accepted payable at Delhi only where the place of payment specified in the order was Bombay.

g) Accepted payable 4 months after date where the bill drawn as payable 3 months after date.

h) Accepted by A, B and C where drawees were A. B. C and D who not partners.

i) Accepted payable on receiving income tax refund

j) A bill drawn for ₹1,000 but accepted to the extent considered reasonable and just by a common friend of both.

4.3.2 Negotiation

Section 14 defines the term 'negotiation'. When a promissory note, bill of exchange or cheque is transferred to any person, so as to constitute that person the holder thereof, the instrument is said to be negotiated.

Delivery

Section 46 provides that the making, acceptance or indorsement of a promissory note, bill of exchange or cheque is completed by delivery. The delivery is of two types – one is actual delivery and the other is constructive delivery.

As between parties standing in immediate relation, delivery to be effectual must be made by the party making, accepting or indorsing the instrument, or by a person authorized by him in that behalf.

As between such parties and any holder of instrument other than a holder in due course, it may be shown that the instrument was delivered conditionally or for a special purpose only, and not for the purpose of transferring absolutely the property therein.

A promissory note, bill of exchange or cheque payable to bearer is negotiable by the delivery thereof. A promissory note, bill of exchange or cheque payable to order is negotiable by the holder by indorsement and delivery thereof.

In Bhagwati Prasad vs. Pahil Sundari, AIR 1969 Pat 215 it was held where property in a promissory note is transferred by partition, the transferee is entitled to maintain his suit on it; his rights cannot be defeated on the ground of non-endorsement.

In Vaddadi Venkitasami vs. Md. Begum, AIR 1956 AP 9 it was held that in addition to the mode of transfer of a promissory note indicated in Section 46 here are two other modes of its transfer-

- By operation of law; and
- Transfer as a chose-in-action contemplated by Section 130 of the Transfer of Property Act.

The only difference between the two modes is that while transfer by negotiation clothes the transferee with certain rights, assignment as a chose-in-action under Section 130 limits such rights, as the transferor had in the document i.e., the assignee takes only subject to equities in favor of the maker; an assignee of a promissory note otherwise than by indorsement such as transfer by means of writing under Section 130 of the Transfer of Property Act, can sue on the promissory note.

Negotiation is of two types: one is negotiation by delivery and the other is negotiation by indorsement.

Negotiation by delivery

Section 47 provides that subject to the provisions of Section 58 a promissory note, bill of exchange or cheque payable to bearer is negotiable by delivery thereof. There is an exception to this. A promissory note, bill of exchange or cheque delivered on condition that it is not to take effect except in certain event is not negotiable (except in the hands of a holder for value without notice to the condition) unless such event happens.

Examples:

1. A, the holder of a negotiable instrument payable to bearer, delivers it to B's agent to keep for B. The instrument has been negotiated.
2. A, the holder of a negotiable instrument payable to bearer, which is in the hands of A's banker, who is at the time, the bank of B, directs the banker to transfer the instrument to B's credit in the banker's account with B. The banker does so, and accordingly now possess the instrument as B's agent. The instrument has been negotiated, and B has become the holder of it.

Negotiation by endorsement

Section 48 provides that subject to the provisions of Section 58, a promissory note, a bill of exchange or cheque payable to order is negotiable by the holder by endorsement and delivery thereof.

In Chaitram vs. Mohanlal, AIR 1957 Nag. 65 it was held that where a promissory note payable to a particular person does not contain any words prohibiting transfers or indicating that it was not transferable, it would be a negotiable instrument payable to order; it would be negotiable by the holder by endorsement and delivery with the necessary intention to constitute the person in whose favor the endorsement is made as the holder thereof; there must be intention of the endorser to constitute the endorsee as a holder of the pro-note accompanied by delivery; unless this is proved negotiation is not complete.

Conversion of endorsement in blank into endorsement in full

Section 49 provides that the holder of a negotiable instrument indorsed in blank may, without signing his own name, by writing above the indorser's signature a director to pay to any other person as endorsee, convert the endorsement in blank into an endorsement in full and the holder does not there by incur the responsibility of an endorse.

Effect of endorsement

Section 50 provides that the endorsement of a negotiable instrument followed by delivery transfer to the endorsee the property therein with the right of further negotiation, but the endorsement may, by express words, restrict or exclude such right, or may merely constitute the endorsee an agent to endorse the instrument, or to receive its contents for the endorser, or for some other specified person.

Example:

B signs the following indorsements on different negotiable instruments payable to bearer-

a) 'Pay the contents to C only'

b) 'Pay C for my use'

c) 'Pay C for order for the account of B'

d) 'The within must be credited to C.

These indorsements exclude the right of further negotiation by C

e) 'Pay C'

f) 'Pay C value in account with the Oriental bank'

g) 'Pay the contents to C, being part of the consideration in a certain deed of assignment executed by C to the indorser and others'

These indorsements do not exclude the right of further negotiation by C.

In Wasudev vs. National Savings Bank, IR 1953 Bom. 209 it was held that Section 50 deals with what are known as restrictive endorsements which in express words restrict or exclude the rights of endorsees; it does not apply to cases where the endorsee wishes to satisfy the Court by oral evidence that he was endorsee for a particular purpose only.

Who may negotiate?

Section 51 provides that every sole maker, drawer, payee or indorsee, or all of several joint makers, drawers, payees or indorsees, of a negotiable instrument may, if the negotiability of such instrument has not been restricted or excluded as mentioned in Section 50, indorse and negotiate the same.

Nothing in this section enables a maker or drawer to indorse or negotiate an instrument, unless he is in lawful possession or is holder thereof; or enables a payee or indorsee to indorse or negotiate an instrument unless he is holder thereof.

Example: A bill is drawn payable to A or order. A indorses it to B, the indorsement not containing the words 'or order' or any equivalent words. B may negotiate the instrument.

Indorser who excludes his own liability

Section 52 provides that the indorser of a negotiable instrument may, by express words in the indorsement, exclude his own liability thereon, or make such liability or the right of the indorsee to receive the amount due thereon depend upon the happening of a specified event, although such event may never happen. Where an indorser so excludes his liability and after becomes the holder of the instrument, all intermediate indorsers are liable to him.

Holder deriving title from holder in due course

Section 53 provides that a holder of a negotiable instrument who derives title from a holder in due course has the rights thereon of that holder in due course.

Instrument indorsed in blank

Section 54 provides that subject to the provisions contained as to crossed cheques, a negotiable instrument indorsed in blank is payable to the bearer thereof even although originally payable to order.

Claim on the conversion of indorsement of blank into indorsement in full

Section 55 provides that if a negotiable instrument, after having been indorsed in blank, is indorsed in full, the amount of it cannot be claimed from the indorser in full, except by the person to whom it has been indorsed in full, or by one who derives the title through such person.

Indorsement for part of sum due

Section 56 provides that no writing on a negotiable instrument is valid for the purpose of negotiation if such writing purports to transfer only a part of the amount appearing to be due on the instrument where such amount has been partly paid, a note to that effect may be indorsed on the instrument, which may then be negotiated for the balance.

Instrument obtained by unlawful means

Section 57 provides that when a negotiable instrument has been lost, or has been obtained from any maker, acceptor or holder by means of an offence or fraud or for an unlawful consideration, no possessor or indorsee who claims through the person who found or so obtained the instrument is entitled to receive the amount due thereon from such maker, acceptor or holder, or from any party prior to such holder, unless such possessor or indorsee is, or some person through whom he claims was, a holder thereof in due course.

Instrument acquired after dishonour

Section 59 provides that the holder of a negotiable instrument, who has acquired it after dishonour, whether by non-acceptance or nonpayment, with notice thereof, or after maturity, has only, as against the other parties, the rights thereon of his transferor.

Accommodation bill

Any person, who in good faith and for consideration becomes the holder, after maturity, of a promissory note or a bill of exchange made, drawn or accepted without consideration, for the purpose of enabling some party thereto to raise money thereon, may recover the amount or bill from any party.

Example: The acceptor of a bill of exchange, when he accepted it, deposited with the drawer certain goods as a collateral security for the payment of the bill, with power to the drawer to sell the goods and apply the proceeds in discharge of the bill but if it were not paid at maturity. The bill not having been paid at maturity the drawer sold the goods and retained the proceeds but indorsed the bill to A. A's title is subject to the same objection as the drawer's bill.

Instrument negotiable till payment

Section 60 provides that a negotiable instrument may be negotiated, (except by the maker, drawee or acceptor after maturity) until payment or satisfaction by the maker, drawee or acceptor at or after maturity, but not after such payment or satisfaction.

Presentment

Chapter V of the Act provides the procedure of presentment of negotiable instruments.

- Section 61 – Presentment for acceptance;
- Section 62 – Presentment of promissory note at sight;
- Section 63 – Drawee's time for deliberation;
- Section 64 – Presentment for payment;
- Section 65 – Hours for presentment;
- Section 66 – Presentment for payment of instrument payable after the date or sight;
- Section 67 – Present for payment of instrument payable by installments;
- Section 68 – Presentment for payment of instrument payable at specified place and not elsewhere;
- Section 69 – Instrument payable at specified place;
- Section 70 – Presentment where no exclusive place specified;
- Section 71 – Presentment when maker, etc., has no known place of business or residence;
- Section 72 – Presentment of cheque to charge drawer;
- Section 73 – Presentment of cheque to charge any other person;
- Section 74 – Presentment of instrument payable on demand;
- Section 75 – Presentment by or to agent, representative or deceased or assignee of insolvent;

In Jagjivan Mavji vs. Ranchoddas, AIR 1954 SC 553 it was held by the Supreme Court that a bill payable after sight has two distinct stages; firstly, when it is presented for acceptance and later when it is presented for payment. Section 61 deals with the former and Section 64 deals with the later. Presentment for acceptance must always and in every case precede presentment for payment. But when the bill is payable on demand, both stages synchronize; there would be only one presentment, both for acceptance and for payment. When the bill is paid, it involves acceptance; but when not paid, it is really dishonoured for non-acceptance. But whether the bill is payable after sight, or at sight or on demand, acceptance by the drawee is necessary before he can fixed with liability on it. It is acceptance that establishes privity on the instrument between the payee and the drawee.

In Banaras Bank Limited vs. Normusji Pestonji, AIR 1930 All. 648 it was held that Section 64 should be given its plain meaning; the exception to it must be read as more or less an independent rule of law; non presentment of hundis for payment does not exempt the acceptor from his liability; it exempts only other parties to the hundis.

In Nanumal vs. Shibba Mal, AIR 1939 Lah. 18 it was held that where the place of payment is not indicated

by the maker in the instrument, the note or bill has to be presented at the place of business, if any, or at the usual residence of the maker, drawee or acceptor.

In Jayaram vs. Sivaram, AIR 1963 Mad 294 it was held that the term specified place in Section 69 must have been intended to refer to a place indicated with sufficient precision to enable the person, who wants to charge the maker with liability, to resort to him readily, a promissory note which refers to a large city like Madras as the place for presentment does not fall under Section 69 and does not require presentment.

In Gopikisan vs. Jethmal, AIR 1935 Nag.144 it was held that in the absence of any indication in the instrument itself of the place of payment, presentment must be at the place of business of the acceptor or maker or the place where he has his home or residence.

Presentment when not necessary

Section 76 provides that no presentment for payment is necessary in any one of the following cases-

- If the maker, drawee or acceptor intentionally prevents the presentment of the instrument; or
- If the instrument is being payable at his place of business, he closes such place on a business day during the usual business hours; or
- If the instrument being payable at some other specified place, neither he nor any person authorized to pay it attends at such place during the usual business hours; or
- If the instrument not being payable at any specified place, he cannot after due search be found;
- As against any party sought to be charged therewith, if he has engaged to pay notwithstanding non presentment;
- As against any party if, after maturity, with knowledge that the instrument has not been presented he makes a part payment on account of the amount due on the instrument or promises to pay the amount due thereon in whole or in part or otherwise waives his right to take advantage of any default in presentment for the payment

4.3.3 Payment and Interest

Chapter VI deals with the payment of interest. Section 78 provides that the payment should be made to the holder or his accredited agent. Section 79 provides that interest is payable on the amount which has been paid after the due date. The interest is payable from the date of due to the date of realization. Section 80 provides that when no interest rate has been specified in the instrument then the interest shall be calculated at the rate of 18% per annum from the date of due to the date of realization of the amount.

Section 80 provides that any person liable to pay and called upon by the holder to pay the amount due on a negotiable instrument is before payment entitled to have it shown and is on payment entitled to have it delivered up, to him, or if the instrument is lost or cannot be produced to be indemnified against any further claim thereon against him.

4.3.4 Assignment of Negotiation Instruments

Assignment takes place where the holder of an instrument transfers it to another so as to confer a right on the transferee to receive the payment of the instrument. All negotiable instruments are choosing in action and as such are transferable by assignment without endorsement under sections 130-132 of the Transfer of property act. Assignment of a negotiable instrument is effected by writing without endorsement. The main feature of assignment is that the assignee obtains the right of the assignor. Therefore, if the assignor's title is defective assignee's title will also be defective.

Distinction between Negotiation and Assignment

Negotiation	Assignment
Consideration is presumed until contrary is proved.	Consideration must be proved
It transferee is a holder in due course he takes the instrument free from any defects.	Assignee's title is always subject to defenses and equities between the original debtor and assignor.
Notice of transfer is not necessary.	Notice of assignment must be given.
Negotiation is effected by delivery in case of instruments payable to bearer and by delivery and endorsement in case of instrument payable to order.	Assignment is effected only by writing
Transferee can sue the third party in his own name.	Assignee cannot do so.
There are a number of presumptions in favor of holder in due courses.	There are no such presumptions.

Discharge from liability

Chapter VII deals with the discharge from liability on negotiable instruments. Section 82 provides the methods of discharge from liability-

- by cancellation.
- by release; and
- by payment.

Section 83 provides that if the holder allows the drawee more than 48 hours, exclusive of public holidays, to consider whether he will accept the same, all previous parties not consenting to such allowance and thereby discharged them from liability to such holder.

Delay in presentation of cheque

Section 84 provides that where a cheque is not presented for payment within a reasonable time and the drawer at the time when presentment ought to have been made, as between himself and the banker, to have the cheque paid and suffers actual damage through the delay, he discharged to the extent of such damage, that is to say, to the extent to which such drawer is a creditor of the banker to a larger amount that he would have been if such cheque had been paid.

In 'Abdul Majid vs. Ganesh Das Kalooram' – AIR 1954 Ori. 124 it was held that a drawer of a cheque who wants to take advantage of Section 84 must prove two facts-

- He had sufficient money in deposit in the bank in his account to honor the cheque; and
- He had suffered actual damage on account of non-presentment of the cheque within a reasonable time.

Cheque payable to order

Section 85 provides that where a cheque payable to order purports to be indorsed by or on behalf of the payee, the drawee is discharge by the payment in due course. Where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any indorsement whether in full or in blank appearing thereon, and notwithstanding that any such indorsement purports to restrict or exclude further negotiation.

Rights and Liabilities of Parties

4.4

Parties to notes, bills and cheques:

Chapter III of the Act deals with the parties to notes, bills and cheques.

Capacity

Section 26 provides that every person capable of contracting may bind himself and be bound by the making, drawing, acceptance, indorsement, delivery and negotiation of a promissory note, bill of exchange or cheque. A minor may draw, indorse, deliver and negotiate such instrument so as to bind all parties except himself.

Nothing herein contained shall be deemed to empower a corporation to make, indorse or accept such instruments except in cases in which, under the law for the time being in force, they are so empowered.

In 'Sulochana V. Pnaidyan Bank Limited' - AIR 1975 Mad 70 (DB) it was held that when a minor being along with one other executed a promissory note, held, though no liability could be enforced against the minor executants, the other executants, also a party to the document, could not escape his liability.

In 'Orilo Industries Limited v. Bombay Mercantile Bank Limited' – AIR 1961 SC 993 it was held that Section 26 does not purpose to make any provision of substantive or procedural law. The latter part of the section merely brings out that a company cannot claim authority to issue a cheque under its first part. The law in regard to the company's power to issue negotiable instruments has to be found in the relevant provisions of the Companies Act itself.

Agency:

Section 27 provides that every person capable of binding himself or being bound may so bind himself or be bound by a duly authorized agent acting in his name. A general authority to transact business and to receive and discharge debt does not confer upon an agent the power of accepting or indorsing bills of exchange so as to bind his principal. An authority to draw bills of exchange does not itself import an authority to indorse.

In 'M. Rajagopal vs.. K.S. Imam Ali' – AIR 1981 Ker 36 (DB) it was held that in case of conflict between Sections 19 and 22 of the Partnership Act on the one hand and Sections 26, 27 and 28 of the Negotiable Instruments Act on the other, the latter Act should prevail. A claim against a firm based on a written contract by one partner in the course of business and with authority to act is binding on the firm. But when such claim is made on a promissory note or bill of exchange, the Court has to be satisfied that the negotiable instrument disclosed the liability of the firm clearly.

4.4.1 Liability of Agent

Section 28 of the Act provides that an agent who signs his name to a promissory note, bill of exchange or cheque without indicating thereon that he signs as agent, or that he does not intend thereby to incur personal responsibility, is liable personally on the instrument, except to those who induced him to sign upon the belief that the principal only would be held liable.

This section carries an exception to the general law of contract, that the principal, though not disclosed on the instrument may be proceeded against if it is discovered later on that the agent had acted on his behalf as held in

'Ramanathan V.Baldeo Singh'- AIR 1933 Rang.111.

4.4.2 Liability of the representative

Section 29 provides that a legal representative of a deceased person who signs his name to a promissory note, bill of exchange or a cheque is liable personally thereon unless he expressly limits his liability to the extent of the assets received by him as such.

4.4.3 Liability of drawer

Section 30 provides that the drawer of a bill of exchange or cheque is bound, in case of dishonour by the drawee or accepter thereof, to compensate the holder, provided due notice of dishonour has been given to, or received by the drawer as herein provided.

In 'Union Bank of India vs. Swastika Motors' – AIR 1983 Del. 420 it was held that a drawee having dishonoured the hundis, their drawer would be liable to the payee provided he had due notice of dishonour, even if the documents of title, accompanying the hundis, had been delivered to the drawee without valid acceptance.

In 'Silchar Bank vs. Pioneer Bank'- AIR 1951 Assam 127 it was held that if the drawee bank dishonours the cheque after the drawer had stopped payment, the question of notice of dishonour does not arise; the drawer is liable to compensate the holder.

4.4.4 Liability of the drawee of cheque

Section 31 provides that the drawee of a cheque having sufficient funds of the drawer in his hands property applicable to the payment of such cheque must pay the cheque when duly required so to do, and, in default of such payment, must compensate the drawer for any loss or damage caused by such default.

4.4.5 Liability of maker of note and acceptor of bill

Section 32 provides that in the absence of contract to the contrary, the maker of promissory note and the acceptor before maturity of a bill of exchange are bound to pay the amount thereof at maturity according to the apparent tenor of the note or acceptance respectively, and the acceptor of a bill of exchange at or after maturity is bound to pay the amount thereof to the holder of the demand. In default of such payment, such maker or acceptor is bound to compensate any party to the note or bill for any loss or damage sustained by him and caused by such default.

In 'Jagjivan Mavji vs. Ranchoddas' – AIR 1954 SC 554, the Supreme Court held that the drawee of a negotiable instrument is not liable to the payee, unless the drawee has accepted it. Under Section 32 the liability of the drawee arises only when he accepts the bill; there is no provision in the Act that the drawee is as such liable on the instrument, except under Section 31 when the drawee has sufficient funds of the customer in his hands; and even then, the liability is only towards the drawer, not the payee.

In 'M. Ramnarain Private Limited vs. State Trading Corporation of India Limited' – AIR 1988 Bom 45 (DB) it was held that where the payee was the holder of bills but not willing to part with them unless the entire amount covered by the bills had been paid to him, the drawer may sue the acceptor for compensation but only after payment to the payee and his endorsement on the bills in favor of the drawer.

4.4.6 Only drawee can be acceptor except in need or for honor

Section 33 provides that no person except the drawee of the bill of exchange or all or some of several drawees, or a person named therein as a drawee in case of need, or an acceptor for honor can bind him by an acceptance. In 'Manikchand V. Chartered bank' – AIR 1961 Cal. 653 (DB) the High Court narrated the scope of Section 33. Section 33 must not be misread as preventing the drawee from accepting through an agent; under Section 26 and 27 the drawee can accept a bill through his agent.

4.4.7 Acceptance by several drawees not partners

Section 34 provides that where there are several drawees of a bill of exchange who are not partners, each of them can accept it for himself, but none of them can accept it for another without his authority.

4.4.8 Liability of Indorser

Section 35 provides that in the absence of contract to the contrary, whoever indorses and delivers a negotiable instrument before maturity, without, in such indorsement, expressly excluding or making conditional his own liability, is bound thereby to every subsequent holder, in case of dishonour by the drawee, acceptor or maker, to compensate such holder for any loss or damage caused to him by such dishonour, provided due notice of dishonour has been given to, or received by, such indorser as herein after provided.

4.4.9 Liability of prior parties to holder in due course

Section 36 provides every prior party to a negotiable instrument is liable thereon to holder in due course until the instrument is duly satisfied.

Maker, drawer and acceptor principals

Section 37 provides that the maker of a promissory note or a cheque, the drawer of a bill of exchange until acceptance, and the acceptor are, in the absence of a contract to the contrary, respectively liable thereon as principal debtors, and the other parties thereto are liable thereon as sureties for the maker, drawer or acceptor as the case may be.

Prior party a principal in respect of each subsequent party

Section 38 provides that as between the parties the parties so liable as sureties, each prior party is, in the absence of a contract to the contrary, also liable thereon as a principal debtor in respect of each subsequent party.

Example: A draws a bill payable to his own order on B, who accepts. A afterwards indorses the bill to C, C to D and D to E. As between E and B, B is the principal debtors, and A,C and D are his sureties. As between E and A, A is the principal debtors and C and D are his sureties. As between E and C, C the principal debtor and D is his surety.

Suretyship

Section 39 provides that when the holder of an accepted bill of exchange enters into any contract with the acceptor which, under Sections 134 or 135 of the Contract Act, would discharge the other parties, the holder may expressly reserve his right to charge the other parties, and in such case they are not discharged.

4.4.10 Discharger of indorser's liability

Section 40 provides that where the holder of a negotiable instrument, without the consent of the indorser, destroys or impairs the indorser's remedy against a prior party, the indorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity.

Example:

As the holder of a bill of exchange made payable to the order of B, which contains the following indorsements in blank-

- First indorsement – B
- Second indorsement – Peter Williams;
- Third indorsement – Wright and Co;
- Fourth indorsement – John Rozario

This bill A puts in suit against John Rozario and strikes without John Rozario's consent the indorsements by Peter Williams and Wright and Co. A is not entitled to recover anything from Rozario

Acceptor bound, although indorsement forged

Section 41 provides that an acceptor of a bill of exchange already indorsed is not relieved from liability by reason that such indorsement is forged, if he knew or had reason to believe the indorsement to be forged when he accepted the bill.

Acceptance of bill drawn in fictitious name

Section 42 provide 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 course claiming

under an indorsement by the same hand as the drawer's signature, and purporting to be made by the drawer.

Negotiable instrument made without consideration

Section 43 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 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.

Explanation 1 to this section provides that no party for whose accommodation a negotiable instrument has been made, drawn, accepted or indorsed can, if he has paid the amount thereof, recover thereon such amount from any person who became a party to such instrument for his accommodation.

Explanation 2 to this section provides that no party to the instrument who has induced any other party to make, draw, accept, indorse or transfer the same to him for a consideration which he failed to pay or perform in full shall recover thereon an amount exceeding the value of the consideration (if any) which he has actually paid or performed.

In 'Ram Narain V. Ramjiwan' AIR 1937 Nag. 267 it was held that Section 43 must be read subject to Section 59 in all cases in which the latter section applies; the holder, as against other parties, would have only the rights thereon of his transferor.

Partial absence or failure of money consideration

Section 44 provides that when the consideration for which a person signed a promissory note, bill of exchange or cheque consisted or money, and was originally absent in part of has subsequently failed in part, the sum which is a holder standing in immediate relation with such signer is entitled to receive from his is proportionately reduced.

Explanation to this section provides that 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 indorser with the indorsee. Other signers may by agreement stand in immediate relation with the holder.

Example:

A draws a bill on ₹500 payable to the order of A. B accepts the bill, but subsequently dishonours it by non-payment. A sues B on the bill, B proves that it was accepted for value as to ₹400 and as accommodation to the plaintiff as to the residue. A can only recover ₹400.

In 'Tirupagari Tayaramma vs. Sri Ramanjaneya Mercantile Co. Eluru' – AIR 1977 AP 205 it was held that Section 44 would not apply when consideration for the promissory note was a set of obligations, not merely of money.

Partial failure of consideration not consisting of money

Section 45 provides that where a part of the consideration for which a person signed a promissory note, bill of exchange or a cheque, though not consisting of money, is ascertainable in money without collateral enquiry, and there has been a failure of that part, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionately reduced.

Holder's right to duplicate of lost bill

Section 45A provides that where a bill of exchange has been lost before it is overdue the person who was the holder of it may apply to the drawer to give him another bill of the same tenor, giving security to the drawer, if required, to indemnify him against all persons whatever in case the bill alleged to have been lost shall be found again. If the drawer on request refuses to give such duplicate bill, he may be compelled to do so.

Dishonour of a Negotiable Instrument (with special emphasis on Section 138)

4.5

Notice of dishonour

Chapter VIII deals with the notice of dishonour.

When dishonoured?

The dishonour may be due to the following reasons-

- non acceptance; and
- by non-payment

Section 91 provides that a bill of exchange is said to be dishonoured by non-acceptance when the drawee, or one of several drawees, not being partners, makes default in acceptance upon being duly required to accept the bill, or where presentment is excused and the bill is not accepted. When the drawee is incompetent to contract, or the acceptance is qualified the bill may be treated as dishonoured. Section 92 provides that an instrument is said to be dishonoured by non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same.

4.5.1 Notice

Section 93 provides that when an instrument is dishonoured the holder must give notice that the instrument has been dishonoured. In 'Union bank vs.. Dina Nath' – AIR 1953 All. 637 it was held that this section was intended to confine the holder's right of enforcing the liability to only those who are otherwise liable under the law and to whom notice has been given; it was not intended to enlarge the holder's right so as to enable him to claim damages from persons against whom he has no remedy under the Act.

Mode of giving notice

Section 94 provides that the notice may be in writing or oral. If it is in written form it must be sent by post and may be in any form but it must inform the party to whom it is given either in express term or by reasonable intendment that the instrument has been dishonoured and he will be held liable thereon. It must be given within a reasonable time after dishonour at the place of business or at the residence of the party for whom it is intended.

Section 95 provides that any party receiving notice of dishonour must, in order to render any prior party liable to himself, give notice of dishonour to such party within a reasonable time, unless such party otherwise receives due notice.

Section 96 provides that when the instrument is deposited with an agent for presentment, the agent is to issue notice to his principal who is entitled to a further like period to give notice of dishonour.

Section 97 provides that when the party, to whom a notice of dishonour is dispatched, is dead, but the party is not aware of the death, the notice is sufficient.

Notice – when not necessary?

Section 98 provides that in the following circumstances there is no requirement to issue notice

- When it is dispensed with by the party entitled thereto;
- In order to charge the drawer, when he has countermanded payment;
- When the party charged could not suffer damage for want of notice;
- When the party entitled to notice cannot after due search be found; or the party bound to give notice is, for any other reason, unable without any fault of his own to give it;
- To charge the drawers, when the acceptor is also a drawer;
- In the case of a promissory note which is not negotiable;
- When the party entitled to notice, knowing the facts, promises unconditionally to pay the amount due on the instrument.

4.5.2 Noting and Protest

Chapter IX deals with the procedure of noting and protest.

Noting

Section 99 provides that when an instrument is dishonoured for any reason, the holder may cause the dishonour to be noted by a notary public upon the instrument, or upon a paper attached thereto, or partly upon each. The noting must be made within a reasonable time after dishonour. The noting must specify the date of dishonour, the reason assigned for such dishonour or if the instrument has not been expressly dishonoured, the reason the holder treats it as dishonoured and the notary's charges.

Protest

Section 100 provides that when an instrument is dishonoured the holder may cause such dishonour to be noted and certified by a notary public. Such certificate is called a protest. When the acceptor of an instrument becomes insolvent or his credit has been publicly impeached, before maturity of bill, the older may, within a reasonable time, cause a notary public to demand better security of the acceptor and on its being refused may, within a reasonable time, cause such facts to be noted and certified. Such certificate is called a protest for better security.

Contents of the protest

Section 101 provides that a protest must contain-

- either the instrument itself, or a literal transcript of the instrument and of everything written or printed thereupon;
- the name of the person for whom and against whom the instrument has been protested;
- a statement that payment or acceptance or better security, as the case may be, has been demanded of such person by the notary public, or that he could not be found;
- when the note or bill has been dishonoured, the place and time of dishonour and when better security has been refused, the place and time of refusal.
- the subscription of the notary public making the protest;
- in the event of an acceptance for honor or of a payment for honor, the name of the person by whom, of the

person for whom, and the manner in which such acceptance or payment was offered and effected.

Notice of protest

Section 102 provides that notice of protest must be given instead of notice of dishonour in the same manner and subject to the same conditions but the notice may be given by the notary public who makes the protest.

Special Rules of evidence

Chapter XIII deals with this subject. Section 118 what are the presumptions that can be made as to negotiable instruments. Until the contrary is proved the following presumptions shall be made-

- of consideration;
- as to date;
- as to time of acceptance;
- as to time of transfer;
- as to order of indorsement;
- as to stamp;
- that holder is a holder in due course.

It can be presumed that-

- every negotiable instrument was made or drawn for consideration and that every such instrument, when it has been accepted, indorsed, negotiated or transferred, was accepted, indorsed, negotiated or transferred for consideration;
- every negotiable instrument bearing a date was made or drawn on such date;
- every accepted bill of exchange was accepted within a reasonable time after its date and before its maturity;
- every transfer of a negotiable instrument was made before its maturity;
- the indorsement appearing upon a negotiable instrument were made in the order in which they appear thereupon;
- a promissory note, bill of exchange of cheque was duly stamped;
- the holder of a negotiable instrument is a holder in due course.

Onus of holder in due course

Where the instrument has been obtained from its lawful owner, or from any person in lawful custody thereof, by means of an offence or fraud, or has been obtained from the maker or acceptor thereof by means of an offence or fraud, or for unlawful consideration, the burden of proving that the holder is a holder in due course lies upon them.

Presumption on proof of protest

Section 119 provides that in a suit upon an instrument which has been dishonoured, the Court shall, on proof of the protest, presume the fact of dishonour, unless and until such fact is disproved.

Estoppel

Sections 120 to 122 deals with the following types of estoppels-

- estoppel against denying original validity of instrument;
- estoppel against denying capacity of payee to indorse;
- estoppel against denying signature or capacity of prior party.

Section 120 provides that no maker of a promissory note, and no drawer of a bill of exchange or cheque and no acceptor of a bill of exchange for the honor 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 121 provides that no maker of a promissory note and no acceptor of a bill of exchange payable to order shall, in a suit thereon by a holder in due course, be permitted to deny the payee's capacity, at the date of the note or bill, to indorse the same.

Section 122 provides that no indorser of a negotiable instrument shall, in a suit thereon by a subsequent holder, be permitted to deny the signature or capacity to contract of any prior party to the indorsement.

4.5.3 International Law

Chapter XVI deals with the negotiable instrument in international law. Section 134 provides that in the absence of a contract to the contrary, the liability of the maker or drawer of a foreign promissory note, bill of exchange, or cheque is regulated by the law of the place where he made the instrument and the respective liabilities of the acceptor and indorser by the law of the place where the instrument is made payable.

Example: A bill of exchange was drawn by A in California, where the rate of interest is 25% accepted by B, payable in Washington where the rate of interest is 6%. The bill is indorsed in India and is dishonoured. An action on the bill is brought against B in India. He is liable to pay interest at the rate 6% only; but if A is charged as drawer, A is liable to pay interest @25%.

Section 135 provides that where a promissory note, bill of exchange or a cheque is made payable in a different place from that in which it is made or indorsed, the law of the place where it is made payable determines what constitutes dishonour and what notice of dishonour is sufficient.

Example: A bill of exchange is drawn and indorsed in India but accepted payable in France, is dishonoured. The indorsee causes it to be protested for such dishonour and given notice in accordance with the law of France, though not in accordance with the rules herein contained in respect of bill which are not foreign. The notice is sufficient.

Section 136 provides that if an instrument is made, drawn, accepted or indorsed outside India, but in accordance with the law of India, the circumstance that any agreement evidenced by such instrument is invalid according to the law of the country wherein it was entered into does not invalidate any subsequent acceptance or indorsement made thereon within India.

Section 137 provides that the law of any foreign country regarding promissory notes, bill of exchange and cheques shall be presumed to be the same as that of India unless and until the contrary is proved.

4.5.4 Penalties

Section 138 provides penalty for 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 of any money to another person from out of that account for the discharge, in whole or in part, of any 'debt or other liability' (a legally enforceable debt or other liability) is returned by the bank unpaid,-

- either because of the amount of money standing to the credit of that account is insufficient to honor the

cheque; or

- that it exceeds the amount arranged to be paid from that account by an agreement made with that bank, such person shall be deemed to have committed an offence and shall, without prejudice to any other provision of this Act, be punished with imprisonment for a term which may be extended to 2 years or with fine which may extend to twice the amount of the cheque, or with both.

The penal provision in this cheque shall not apply unless-

- the cheque has been presented to the bank within a period of three months (with effect from 01.04.2012, before that it is six months) from the date on which it is drawn or within the period of its validity, whichever is earlier;
- the payee or the holder in due course of the cheque, as the case may be, makes a demand for the payment of the said amount of money by giving a notice in writing to the drawer of the cheque within 30 days of the receipt of information by him from the bank regarding the return of the cheques as unpaid; and
- the drawer of such cheque fails to make the payment of the said amount of money to the payee or as the case may be, to the holder in due course of the cheque within 15 days of the receipt of the said notice.

4.5.5 Conditions precedent

In 'Kusum Ingots & Alloys Limited V. Pennar Peterson Securities Limited' – AIR 2000 SC 954, the Supreme Court held that the ingredients which are to be satisfied for making out a case under Section 138 of the Act, are-

- a person must have drawn a cheque on an account maintained by him in a bank for payment of a certain amount of money to another person from out of that account for discharge of any debt or other liability;
- that cheque has been presented to the bank within a period of six months (now three months) from the date on which it is drawn or within the period its validity whichever is earlier;
- that the cheque is returned by the bank unpaid, either because of the amount of money standing to the credit of the account is insufficient to honor the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with the bank;
- the payee or holder in due course of the cheque makes a demand for the payment of the said amount of money by giving a notice in writing to the drawer of the cheque, within 15 days (now 30 days) of the receipt of information by him from the bank regarding the return of the cheque as unpaid;
- the drawer of such cheque fails to make payment of the said amount of money to the payee or the holder in due course of the cheque within 15 days of the receipt of the said notice.

4.5.6 Presumption in favor of holder

Section 139 provides that it shall be presumed, unless the contrary is proved that the holder of a cheque received the cheque, of the nature referred to in Section 138, for the discharge, in whole or in part, of any debt or other liability.

In 'B. Mohan Krishna V. Union of India' – 1996 CrLJ 683 (AP DB), the Andhra Pradesh High Court Division Bench held that the presumption in Section 139 in favor of the holder of a cheque is not violative of Article 20(3) of the Constitution which incorporates immunity against self incrimination.

Section 140 provides that it shall not be a defence in a prosecution for an offence under Section 138 that the drawer had no reason to believe when he issued the cheque that the cheque may be dishonoured on presentment for the reasons stated in the section.

4.5.7 Offences by companies

Section 141 of the Act provides that a company and every person who was in charge of and responsible to the company for the conduct of the business of the company at the time of offence, the company and such person shall be liable to be proceeded against and punished accordingly. If such person proves that the offence was committed without his knowledge or that he has exercised such due diligence to prevent the commission of the offence he shall not be punishable.

Where a person is nominated as a Director of the company by virtue of his holding any office or employment in the Central Government or State Government or a financial corporation owned or controlled by the Central Government or the State Government as the case may be, he shall not be liable for prosecution under this Chapter. If it is proved that the offence has been committed with the connivance or consent of, it is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such persons shall be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Cognizance of offence

Section 142 provides that no court shall take cognizance of any offence punishable under Section 138 except upon a complaint, in writing, made by the payee or the holder in due course of the cheque. Such complaint shall be made within one month of the date on which the cause of action arises. The cognizance of a complaint may be taken by the Court after the prescribed period, if the complainant satisfies the Court that he has sufficient cause for not making a complaint within such period. No court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the First Class shall try any offence punishable under Section 138.

The offence shall be inquired and tried only by a court within those local jurisdiction-

- if the cheque is delivered for collection through an account, the branch of the bank where the payee or holder in due course maintains the account, is situated; or
- if the cheque is presented for payment by the payee or holder in due course, otherwise through an account, the branch of the drawee bank where the drawer maintains the account is situated.

Where a cheque is delivered for collection at any branch of the bank of the payee or holder in due course, then the cheque shall be deemed to have been delivered to the branch of the bank in which the payee or holder in due course maintains the account.

Summary trial

Section 143 provides that all the offences under this Chapter shall be tried by a Judicial Magistrate of the I class or by a Metropolitan Magistrate. The provisions of Section 262 to 265 of the Code of Criminal Procedure shall apply to such trials.

In case of any conviction in a summary trial it shall be lawful for the Magistrate to pass a sentence of imprisonment for a term not exceeding one year and an amount of fine exceeding ₹5,000.

When at the commencement of, or in the course of, a summary trial under this section, it appears to the Magistrate that the nature of the case is such that a sentence of imprisonment for a term exceeding one year may have to be passed or that it is, for any other reason, undesirable to try the case summarily, the Magistrate shall after hearing the parties, record an order to that effect and thereafter recall any witness who may have been examined and proceed to hear or rehear the case in the manner provided by the Code of Criminal Procedure.

The trial shall be continued from day to day until its conclusion, unless the court finds the adjournment of trial beyond the following day to be necessary for reasons to be recorded in writing. Every trial under this section shall be conducted as expeditiously as possible and an endeavor shall be made to conclude the trial within 6

months from the date of filing of the complaint.

The Act was amended in August 2018. Section 143A has been inserted which empowers the court to direct the drawer to pay interim compensation upto 20% of the cheque value which the drawer pleads "no guilty". In case the drawer files an appeal, the appellate court may direct to the drawer to deposit 20% of the fine or compensation, in addition to what has been paid at trial stage.

Service of summons

Section 144 provides that a Magistrate issuing a summons to an accused or a witness may direct a copy of summons to be served at the place where such accused or witness ordinarily resides or carries on business or personally works for gain, by speed post or such courier services as are approved by a Court of Session.

Where an acknowledgement purporting to be signed by the accused or the witness or an endorsement purported to be made by any person authorized by the postal department or the courier services that the accused or the witness refused to take delivery of summons has been received, the Court issuing the summons may declare that the summons have been duly served.

Evidence on affidavit

Section 145 provides that the evidence of the complainant may be given by him on affidavit and may, subject to all just exceptions be read in evidence in any inquiry, trial or other proceeding under the Code of Criminal Procedure. The Court may, if it thinks fit, and shall, on the application of the prosecution or the accused, summon and examine any person giving evidence on affidavit as to the facts contained therein.

Bank's slip – prima facie evidence

Section 146 provides that the Court shall, in respect of every proceeding, on production of bank's slip or memo having thereon the official mark denoting that the cheque has been dishonoured, presume the fact of dishonour of such cheque, unless and until such fact is disproved.

Compounding

Section 147 of the Act provides that every offence punishable under this Act is compoundable.

In 'M. Rangaswamiah V. R. Shettappa'- 2002 CrLJ 4792 (Karn) the High Court held that there is no prohibition in this Act against compounding of an offence punishable under Section 138. In the absence of any such prohibition therefore, where the Court finds that the parties have settled the matter, where the complainant being present before the Court and submits before the Court that the accused has paid the money covered by the cheque it would be appropriate to allow the parties to compound, rather than negativing such a joint request made by the parties, and proceeding to inflict the sentence on the accused. Particularly when there is no prohibition against compounding, any rejection of request in that regard would not further the cause of the justice, and particularly where the commission of offence is not related to the society at large, but only against a particular person, viz., the complainant to whom certain sum is due under the cheque. Therefore it would be legally permissible for the parties to compound the offence punishable under Section 138 of the Negotiable Instruments Act, 1881.

EXERCISE

⊙ Multiple Choice Question:

1. The Negotiable Instruments Act, 1881 is an Act to define and amend the law relating to:

   a) cheques
   b) bills of exchange
   c) promissory notes,
   d) All of the above

2. "banker" includes:

   a) Any person acting as an employee of any bank and any post office saving bank.
   b) Any person acting as a banker and any post office saving bank
   c) Any person acting as an agent of any bank and any post office saving bank.
   d) Any person acting as a Managing Director of any bank and any post office saving bank

3. Which is NOT an example of "Promissory Note":

   a) "I acknowledge myself to be indebted to B in ₹1,000, to be paid on demand, for value received."
   b) Mr B, I.O.U ₹1,000."
   c) "I promise to pay B or order ₹500"
   d) None of the above

4. In a Promissory Note, how many parties are involved:

   a) One
   b) Two
   c) Three
   d) Four

5. Which is NOT correct about the "Promissory Note":

   a) It contains a conditional undertaking.
   b) It contains the amount mentioned on it.
   c) It is an instrument in writing.
   d) It is signed by the maker

6. The Negotiable Instruments Act, 1881 extends to:

   a) Only to Capital cities of the States.
   b) The whole of India.
   c) The whole of India except the State of Jammu and Kashmir.
   d) The whole of India except the Union Territories.

⊙ State TRUE or FALSE

1. "I acknowledge myself to be indebted to B in ₹1,000, to be paid on demand, for value received." is a promissory note.
2. Section 5 of the NI Act deals with Holders in due course.
3. A 'Cheque' is a Bills of exchange and has been defined under Banking Regulation Act.

4. All offences under Chapter XVII shall be tried by either a Metropolitan Magistrate or a Judicial Magistrate of the first class.
5. Courts that can entertain any offence punishable under section 138 are, Court not inferior to that of a Judicial Magistrate of the first class or Court not inferior to that of a Metropolitan Magistrate.

Fill in the blanks

1. The transaction of negotiable instrument requires at least _____ persons.
2. The person named in the instrument, to who or to whose order the money is by the instrument directed to be paid is, called the _____.
3. Negotiation is of two types, namely, _____,_____.
4. A cheque is a bill of exchange drawn on a specified_____on demand.
5. Clearing house is managed by_____.
6. Draft cannot be drawn on_____.
7. Indorsement is of two types, namely, _____,_____.
8. A negotiable instrument indorsed in blank is payable to the _____.
9. If the amount is paid after due date, the interest is payable at _____when no interest rate has been specified in the instrument.
10. The dishonor of the instrument may be due to_____and_____.

Short Essay Type Questions

1. Discuss about the various types of Instruments.
2. who are the parties to an instrument?
3. Write short notes on-
   (a) Bill of Exchange
   (b) Types of Acceptance
   (c) Holder in due course

Essay Type Questions

1. Discuss briefly the historical background of law of Negotiable Instruments in India.
2. What is the object, scope and applicability of Negotiable Instruments Act? Is it exhaustive on matters relating to Negotiable Instruments?
3. What do you understand by term “Negotiable Instruments”? What are its special characteristics?
4. Define and explain `Promissory Note’. What are its essential features?
5. Define and explain “Bill of Exchange”. What are the essential requisites of Bill of Exchange. What is the distinction between Promissory Note and Bill of Exchange ?

⊙ Unsolved Cases

1. A' signs, as maker, a blank stamped paper and gives it to 'B', and authorises him to fill it as a note for ₹500, to secure an advance which 'C' is to make to 'B'. 'B' fraudulently fills it up as a note for ₹2,000, payable to 'C', who has in good faith advanced ₹2,000. Decide, with reasons, whether 'C' is entitled to recover the amount, and if so, up to what extent?
2. A signs, as the maker, a blank stamped paper and gives it to B and authorises him to fill it as a note for ₹2,000, it being the amount of advances made by B to A. B fraudulently fills it up as a note for ₹3,000 and then, for consideration, endorses it to C. Can C enforce the instrument?

Answer:

Multiple Choice Question

1. d; 2. b; 3. b; 4. b; 5. a; 6.b.

State TRUE or FALSE

1. True; 2. False; 3. False; 4. True; 5. True.

Fill in the blanks

1. 2; 2. Payee; 3. Negotiation by delivery, negotiation by indorsement; 4. Banker; 5. Reserve Bank of India; 6. Private individual; 7. Indorsement in blank, indorsement in full; 8. Bearer; 9. 18%; 10. Non acceptance, nonpayment.

Indian Partnership Act, 1932 5

This Module includes -

5.1 Nature of Partnership

5.2 Rights and Liabilities of Partners

5.3 Formation, Reconstitution and Dissolution of Firms

Indian Partnership Act, 1932

SLOB Mapped against the Module

To acquire the requisite knowledge of kinds of partnerships, their elements, relations between partners and dissolution of partnership firms.

Module Learning Objectives:

After studying this module, the students will be able to -

- To acquire the requisite knowledge of kinds of partnerships, their elements, relations between partners and dissolution of partnership firms
- To develop an understanding about the different rights and liabilities of partners and formation of partnership firms.

Nature of Partnership

5.1

A partnership is a business form wherein two or more persons agree to come together for carrying out a business for economic gains. However, presence of profits is not always a determinative criterion to ascertain if a business form is a partnership. Prior to partnerships being established and legalized by legislation, sole proprietorship used to be carried out by individuals. Even though such business forms still exist, the challenges faced by such business forms led to the emergence of other business forms that could be used to conduct business more efficiently. In sole proprietorship the business is carried out by an individual with limited capital and skills. Due to this paucity of resources, larger businesses could seldom be conceived by such individuals. Therefore, with the emergence of partnerships, a number of partners could now join their resources and skills to carry out bigger businesses.

5.1.1 Definition

Section 4 defines the term 'partnership' as the relationship between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. The term 'partners' is defined as persons, who have entered into partnership with one another are called individually partners. A 'firm' is the collective of the partners. The 'firm name' is the name under which the business is carried on.

The following are the essential ingredients for the constitution of a partnership-

- There should be an agreement between the parties;
- The agreement must be to share the profits of the business; and
- The business must be carried on by all or any of them acting for all;
- The existence of an agency between the concerned persons inter-se
- The agreement need not be in writing. It may be oral. It may be express of implied.

5.1.2 Different types of partnership

There are four types of partnership which are as detailed below-

- General Partnership;
- Limited Partnership;
- Partnership at will;
- Particular Partnership

1. In a **general partnership**, the liability of each partner is unlimited. It means that the firm's creditors can realize their dues in full, from any of the partners by attaching their personal property if the firm's assets are found to be inadequate to pay off its debts. An exception is made in the case of a minor partner whose liability is limited to the amount of his share in the capital and profits of the firm. In India all partnership firms are general partnerships. Each partner of a general partnership is entitled to take active part in the management of the firm, unless otherwise decided by the other partners.

2. A **limited partnership** is a partnership consisting of some partners whose liability is limited to the amount of capital contributed by each. The personal property of a limited partner is not liable for the firm's debts. He cannot take part in the management of the firm. His retirement, insolvency, lunacy or death does not cause dissolution of the firm. There is at least one partner having unlimited liability. A limited partnership must be registered. Limited partnership is now allowed in India under the Limited Liability Partnership Act. In England limited partnership can be formed under the Limited Partnership Act, 1907 and in the USA under the Partnership Act, 1890.

3. Partnership at will is a partnership formed for an indefinite period. The time period or the purpose of the firm is not mentioned at the time of its formation. It can continue for any length of time depending upon the will of the partners. It can be dissolved by any partner by giving a notice to the other partners of his desire to quit the firm.

4. Particular Partnership is a partnership formed for a specific time period or to achieve a specified objective. It is automatically dissolved on the expiry of the specified period or on the completion of the specific purpose for which it was formed.

5.1.3 Different types of partners

The following are the various types of partners-

- Working partner or Active partner;
- Sleeping or dormant partner;
- Secret partner;
- Limited partner;
- Partner in profits only;
- Nominal or ostensible or quasi partner;
- Minor as a partner.

Active partner contributes capital and also takes active part in the management of the firm. He bears an unlimited liability for the firm's debts. He is known to outsiders. He shares profits of the firm. He is a full-fledged partner.

A sleeping or inactive partner simply contributes capital. He does not take active part in the management of the firm. He shares in the profits or losses of the firm. His liability for the firm's debts is unlimited. He is not known to the outside world.

Secret partner contributes capital and takes active part in the management of the firm's business. He shares in the profits and losses of firm and his liability is unlimited. However, his connection with the firm is not known to the outside world.

The liability of such a partner is limited to the extent of his share in the capital and profits of the firm. He is not entitled to take active part in the management of the firm's business. The firm is not dissolved in the event of his death, lunacy or bankruptcy.

Partners in profit only share in the profits of the firm but not in the losses. But his liability for the firm's debts

is unlimited. He is not allowed to take part in the management of the firm. Such a partner is associated for his money and goodwill.

Nominal Partner neither contributes capital nor takes part in the management of business. He does not share in the profits or losses of the firm. He only lends his name and reputation for the benefit of the firm. He represents himself or knowingly allows himself to be represented as a partner. He becomes liable to outsiders for the debts of the firm. A nominal partner can be of two types - Partner by estoppels and partner by holding out. A person who by his words (spoken or written) or conduct represents himself as a partner becomes liable to those who advance money to the firm on the basis of such representation. He cannot avoid the consequences of his previous act. Suppose a rich man, Jalal, is not a partner but he tells Ramu that he is a partner in a firm called Alpha Enterprises. On this impression, Ramu sells good worth ₹20,000 to the firm. Later on the firm is unable to pay the amount. Ramu can recover the amount from Jalal. Here, Jalal is a partner by estoppels. When a person is declared as a partner and he does not deny this even after becoming aware of it, he becomes liable to third parties who lent money or credit to the firm on the basis of such a declaration. Suppose, Alpha tells Ramu in the presence of Jalal that Jalal is a partner in the firm of Alpha Enterprises. Jalal does not deny it. Later on Ramu gives a loan of ₹20,000 to Alpha Enterprises on the basis of the impression that Jalal is a partner in the firm. The firm fails to repay the loan to Ramu. Jalal is s liable to pay ₹20,000 to Ramu. Here, Jalal is a partner by holding out.

5.1.4 Partnership is a creation of contract

Section 5 provides that the relation of partnership arises from contract and not from status. The members of a Hindu Undivided Family carrying on a family business as such, or a Burmese Buddhist husband and wife, carrying on business as such, are not partners in such business.

This section lays down that partnership is not a status, but a creation of contract. The partnership is entirely different from a company, Limited Liability partnership, Hindu Undivided Family.

5.1.5 Difference between a partnership and a company

Basis	Partnership	Company
Legal entity	It is not a separate legal entity.	A company is a separate legal entity.
Liability	The liability of the partners is unlimited.	The liability of the members of the company is limited.
Number of members	Minimum required is two. Maximum number can be 100 subject to some exceptions present Rules provide 50.	Minimum number of members for a private company is 2 and maximum 200. Minimum number of members for a public limited company is 7 and there is no limited for maximum.
Transfer of shares	A partner cannot transfer his share without the consent of other members	Transfer of shares in a public limited company is not a restricted one.
Management	The firm can be run by all or any of the partners.	The Board of Directors has responsibility to run the management
Relationship	The relationship with partners is of that of agency.	No such relationship in the company.

Basis	Partnership	Company
Profit distribution	Profit is distributed according to the agreement entered between partners; if no agreement equal distribution.	No requirement of profit distribution to members. It is at the discretion of the management to declare dividend that too only out of profits.
Remedy to creditors	The creditors of a firm can proceed against the partners jointly and severally.	The creditors can proceed only against the company and not against shareholders.
Audit	Audit is not compulsory for the partnership firm.	Various types of audit are compulsory for the company
Dissolution	Firm can be dissolved on the eve of death of partner, retirement of partner etc., unless otherwise than agreed to in the agreement.	A company can be dissolved only by the winding up process as ordered by the Court.

In 'Gurugubilli Chendran Naidu V. Achanti Pydisetti' – AIR 1985 NOC 135 (AP) it was held that right to share the profits of the partnership in equal shares can arise only when there is no contract between the partners regarding it. But there is no specific provision in the Indian Partnership Act, 1932 to share capital equally.

5.1.6 Difference between partnership and limited liability partnership

Basis	Partnership	Limited Liability Partnership
Legal entity	It is not a separate legal entity	It is a separate legal entity
Liability	The liability of the partners is unlimited.	The liability of the members of the LLP is limited.
Number of members	Minimum required is two. Maximum number is 50 subject to some exceptions	Minimum number of members for a LLP is 2 and no limit for maximum numbers.
Entering into contracts	Partnership is not a separate person and enter into contract on behalf of its partners	LLP is capable of entering into contracts and holding property in its own name
Compliance of law	Lesser compliance	More compliance under LLP Act.
Dissolution	Firm can be dissolved on the eve of death of partner, retirement of partner etc., unless otherwise than agreed to in the agreement.	LLP can be dissolved by complying with the provisions of LLP (Winding up and Dissolution) Rules, 2012.

5.1.7 Differences between the partnership and Hindu Undivided Family

Basis	Partnership	Hindu undivided family
Relationship	Relation subsists between the partners.	It is a single person and it cannot have a partnership by itself.
Management	All of the partners may involve in the management	Karta of HUF is managing the business
Share of profit	Partners can share profit as per the agreement	No such sharing of profits in HUF
Property	The properties even though in the name of partnership firm belongs to all partners	This business is a species of ancestral joint property in which every member of a family acquires
Authority	Each partner is the agent of others	It has implied authority to contract debts and pledge the properties and credit of the family for the ordinary purposes of the family business
Dissolution	Firm can be dissolved on the eve of death of partner, retirement of partner etc., unless otherwise than agreed to in the agreement.	The death of Karta will not lead to the dissolution of the HUF business.

Rights and Liabilities of Partners

5.2

Duties of partners

Section 9 of the Act deals with the general duties of partners. Partners are bound-

- to carry on the business of the firm to the greatest common advantage;
- to be just and faithful to each other; and
- to render true accounts and full information of all things affecting the firm, to any partner or his legal representative.
- Every partner shall indemnify the firm for any loss caused to it by his fraud in the conduct of the business of the firm.

Rights and duties of partners

Section 11(1) provides that the mutual rights and duties of the partners of a firm may be determined by contract entered between the partners. Such contract may be expressed or may be implied by a course of dealing. Such contract may be varied by consent of all partners. Such consent may be expressed or may be implied by a course of dealing.

Agreements in restraint of trade

Section 11(2) of the Act provides that the contracts entered between partners may provide that a partner shall not carry on any business other than that of the firm while he is a partner. Section 36 (2) provides that a partner may make an agreement with his partners on ceasing to be a partner, he will not carry on any business similar to that of the firm within a specified period or within specified local limits. Such agreement shall be valid if the restrictions imposed are reasonable.

Section 54 provides that the partners may, upon or anticipation of the dissolution of the firm, make an agreement that some of them will not carry on a business similar to that of a firm within a specified period or within specified local limits.

Section 55(3) provides that any partner may, upon the sale of the goodwill of a firm, make an agreement with the buyer that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits.

Conduct of business

- Section 12 provides that subject to the contract between the partners-
- every partner has a right to take part in the conduct of the business;
- every partner is bound to attend diligently to his duties in the conduct of the business;

- any difference, arising as to ordinary matters connected with the business, may be decided by a majority of the partners, and every partner shall have the right to express his opinion before the matter is decided, but no change may be made in the nature of the business without the consent of all the partners;
- every partner has a right to have access to, and to inspect and copy, any of the books of the firm; and
- in the event of the death of a partner, his heirs or legal representatives or their duly authorised agents shall have a right of access to and to inspect and copy any of the books of the firm.

In 'Rajnikanth Hasmukhlal Golwala V. Nataraj Theatre, Navsari' – AIR 2000 Guj 80 (88) it was held that Section 12 of the Act gives right to every partner to take part in the conduct of the business. Of course, the right which is enshrined in the Act takes effect subject to any express or implied contract amongstthe partners. This right cannot be fettered by any court unless there is a contract to the contrary arrived at amongst the partners themselves. Further their transferees have no right to do the business sin view of the Section 29 of the Act.

In 'Sasthi Kenker v. Gobinda' – AIR 1919 Pat 419 IC 2 it was held that a partner is not liable for negligence if he can show that used such skill and intelligence as he possessed in the conduct of the business.

Mutual rights and liabilities

Section 13 provides that subject to the contract between the partners-

- a partner is not entitled to receive remuneration for taking part in the conduct of the business;
- the partners are entitled to share equally in the profits earned and shall contribute equally to the losses sustained by the firm;
- where a partner is entitled to interest on the capital subscribed by him, such interest shall be payable only out of profits;
- a partner, making, for the purposes of the business, any payment or advance beyond the amount of capital he has agreed to subscribe, is entitled to interest thereon at 6% per annum;
- the firm shall indemnify a partner in respect of payments made, and liabilities incurred, by him-
  - in the ordinary and proper conduct of the business, and
  - in doing such act, in an emergency, for the purpose of protecting the firm from loss, as would be done by a person of ordinary prudence, in his own case, under similar circumstances; and
- a partner shall indemnify the firm or any loss caused to it by his willful neglect in the conduct of the business of the firm.

When the profits are not shared equally, the losses are, in the absence of the agreement, to be borne in the same proportion as the profits are shares, regardless, whether one partner has put up more capital than other.

In 'Bhagchand v. Kaluram' – AIR 1966 Raj 24 (25) it was held that in the absence of a stipulation in the partnership agreement to the effect that the interest would be paid on all the investments, irrespective of the fact as to whether there was any profit or loss, Section 13 comes into play and interest is, therefore, payable only out of the profits earned by the partnership business.

An advance by a partner to a firm is not treated as an increase of his capital but rather as loan on which interest ought to be paid. An agreement to pay a different rate may be inferred if a different rate is payable by the custom of the particular trade, or has been charged and allowed in the books of the particular partnership. Compound interest may be allowed if there is an agreement, whether express of implied, to that effect as held in 'Chandrika Prasad Ram Swarup V. Commissioner of Income Tax' – AIR 1939 All 341.

In 'Banwari Lal v. Shaikh Shukrullah' – AIR 1940 Pat 2014: 19 it was held that a partner, who is guilty of willful negligence in the conduct of partnership business, is liable to indemnify the firm for any loss, caused to it, by his willful neglect and is not himself entitled to be indemnified by his co-partners.

Section 16 provides that if a partner derives any profit for himself-

- from any transaction of the firm; or
- from the use of the property; or
- business connection of the firm; or
- the firm name

he shall account for that profit and pay it to the firm.

If a partner carries on any business of the same nature as, and competing with, that of the firm, he shall account for and pay, to the firm, all profits made by him in that business.

Rights and duties of partners

Section 17 of the Act provides for the rights and duties of partners. Subject to the contract between the partners-

- where a change occurs in the constitution of a firm, the mutual rights and duties of the partners in the reconstituted firm remain the same as they were immediately before the change, as far as may be;
- where a firm constituted for a fixed term continues to carry on business after the expiry of that term, the mutual rights and duties of the partners remain the same as they were before the expiry, so far as they may be consistent with the incidents of partnership-at-will; and
- where a firm constituted to carry out one or more adventures or undertakings carry out other adventures or undertaking, the mutual rights and duties of the partners in respect of the other adventures or undertakings are the same as those in respect of the original adventures or undertakings.

Partner to be agent of the firm

Section 18 provides that a partner is the agent of the firm for the purpose of the business of the firm.

Implied Authority

Section 22 provides that in order to bind a firm, an act or instrument, done or executed by a partner or other person on behalf of the firm, shall be done or executed in the firm name, or in any other manner expressing or implying an intention to bind the firm.

Section 19 provides that subject to the provisions of Section 22, the act of a partner, which is done to carry on, in the usual way, business of the kind carried on by firm, binds the firm.

The authority of a partner to bind the firm, conferred by this section, is called his 'implied authority'. In the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to-

- submit a dispute relating to the business of the firm to arbitration;
- open a banking account on behalf of the firm in his own name;
- compromise or relinquish any claim or portion of a claim by the firm;
- withdraw a suit or proceeding filed on behalf of the firm;

- admit any liability in a suit or proceeding against the firm;
- acquire immovable property on behalf of the firm;
- transfer immovable property belonging to the firm; or
- enter into partnership on behalf of the firm.

Extension and restriction of implied authority

Section 20 provides that the partners may extend or restrict the implied authority of any partner by contract between the partners. Despite such restrictions, any act done by a partner on behalf of the firm, which falls within his implied authority, binds the firm unless the person, with whom he is dealing, knows of the restriction or does not know or believe that partner to be a partner.

Authority in emergency

Section 21 provides that in case of emergency a partner has authority to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence, in his own case acting under similar circumstances, and such acts bind the firm.

Effect of admission

Section 23 provides that an admission or representation made by a partner about the affairs of the firm is the evidence against the firm, if it is made in the ordinary course of business.

Effect of notice

Section 24 provides that a notice issued to a partner, who habitually acts in the business of the firm, of any matter, relating to the affairs of the firm, will be the notice issued to the firm unless in the case of a fraud on the firm committed by, or with the consent of the partner.

Liability of a partner

Section 25 provides that every partner is liable, jointly with all other partners and also severally, for all acts of the firm done while he is a partner.

Liability of the firm

Section 26 provides that where, by the wrongful act or omission of a partner, acting in the ordinary course of the business of a firm, or with the authority of his partners, loss or injury is caused to any third party, or any penalty is incurred, the firm is liable therefore to the same extent as the partner.

Section 27 provides that the firm is liable for misapplication by partners. If -

- a partner, acting within his apparent authority, receives money or property from a third party and misapplies it; or
- a firm, in the course of its business, receives money or property from a third party and the money or property is misapplied by any of the partners while it is in the custody of the firm, the firm is liable to make good the loss.

Holding out/Deemed Partners

Section 28 provides that any person, who -

- by words spoken or written; or
- by conduct, represents himself; or

- knowingly permits himself

To be represented to be a partner in a firm, is liable as a partner in that firm to anyone who has, on the faith of any such representation, given credit to the firm, whether the person, representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit. Two or more persons doing some activity with common understanding and for gain shall be deemed as partners even when they themselves deny to be partners when they are liable to third parties.

If the business is continued, after the death of a partner, in the old firm name, the continued use of that name, or of the deceased partner's name, as a part thereof, shall not, of itself, make his legal representative, or his estate, liability for any act of the firm done after his death.

Rights of Transferee of a partner's interest

Section 29 deals with the rights of transferee of a partner's interest. This section allows a partner to transfer his interest in the firm, either absolutely or by mortgage or by the creation of a charge on such interest during the continuance of the firm. The transferee who receives such interest in the firm, does not entitled to-

- interfere in the conduct of the business; or
- to require accounts; or
- to inspect the books of the firm

He is entitled to receive the share of profits of the transferring partners and the transferee is to accept the account of profits agreed to by the partners.

If the firm is dissolved or the transferring partner ceases to be a partner, the transferee is entitled to receive the share of the assets of the firm to which the transferring partner is entitled and for the purpose of ascertaining that share, to an account as from the date of dissolution.

Minors as partners

Section 30 of the Indian partnership act provides that though a minor cannot be a partner of a firm, but, with the consent of all the partners for the time being, he may be admitted to the benefits of the partnership by an agreement executed through his guardian with the other partners.

Rights and liability of minor

A minor in a partnership has a right to such share of the property and of the profits of the firm as may be agreed upon. He is having power to have access to and inspect and to get copy, any of the accounts of the firm.

The share of a minor in a partnership firm is liable for the acts of the firm. But he is not personally liable for any such act. When a minor severs his connection with the firm he may not sue the partners for an account or payment of his share of the property or profits of the firm. The account of his share shall be determined by a valuation made, as far as possible.

All the partners of a firm together or any partner entitled to dissolve the firm, upon notice to other partners, may elect to dissolve the firm. The Court shall proceed with the suit as one for dissolutionand for settling accounts between the partners, and the amount of the share of the minor shall be determined along with the shares of the partners.

Election on majority

On attaining majority, or of his obtaining knowledge that he had been admitted to the benefits of partnership whichever date is later, a minor may within six months from such date give public notice that he has elected to

become or that he has elected not to become a partner in the firm. Such notice shall determine his position as regards to the firm. If a minor fail to give such notice, he shall become a partner in the firm on the expiry of the said six months.

If a minor elect to become a partner-

- his rights and liabilities as a minor continue up to the date on which he becomes a partner, but he also becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of the partnership; and
- his share in the property and profits of the firm shall be the share to which he was entitled as a minor.

If a minor does not elect to become a partner-

- his rights and liabilities shall continue to be those of a minor up to the date on which he gives public notice;
- his share shall not be liable for any acts of the firm done after the date of the notice; and
- he shall be entitled to sure the partners for his share of the property. Holding out is not applicable in these cases.

Where any person has been admitted as a minor to the benefits of partnership in a firm, the burden of proving the fact that such person had no knowledge of such admission until a particular date after the expiry of six months of his attaining majority shall lie on the person, asserting the fact.

Rights of outgoing partners

Section 36 provides that an outgoing partner may carry on a business competing with that of the firm.

He may advertise such business, but, subject to contract to the contrary, he may not-

- use the firm name;
- represent himself as carrying on the business of the firm; or
- solicit the custom of persons who were dealing with the firm before he ceased to be a partner.

Section 37 provides that in case where a partner has died or ceased to be a partner, the surviving and continuing partners may carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or the estate of deceased partner. In the absence of a contract to the contrary, the outgoing partner of the representative of the deceased partner is entitled at the option-

- to such share of the profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm; or
- to interest at 6% per annum on the amount his share in the property of the firm.

Where an option is given to surviving or continuing partners to purchase the interest of a deceased or outgoing partner and the same is duly exercised, the estate of the deceased partner or the outgoing partner is not entitled to any further or other share of profits. But if any partner, assuming to act in exercise of the option, does not, in all material respects comply with the terms, he is liable to account under the provisions of this section.

Formation, Reconstitution and Dissolution of Firms

5.3

5.3.1 Determining existence of partnership

Section 6 provides that in order to determine-

- whether a group of persons is or is not a firm; or
- whether a person is or is not a partner in a form

regard shall be had to the real intention between the parties, taking into the facts together.

The sharing of profits or of gross returns arising from property by persons holding a joint or common interest in that property does not make such persons as partners.

The receipt-

- of a share of the profits of a business; or
- of a payment contingent upon the earning of profits; or
- varying with the profits earned by a business,

by a person does not of itself, make him a partner with the persons carrying on the business.

The receipt of such share or payment-

- by a lender of money to persons engaged or about to engage in any business;
- by a servant or agent as remuneration;
- by the widow or child of a deceased partner, as annuity, or
- by a previous owner or part owner of the business as consideration for the sale of the goodwill or share thereof does not make the receiver a partner with the persons carrying on the business.

In 'S.K. Parthasarathy Naidu V. K. Rama Naidu' – AIR 2001 Mad 399 (405) it was held that the legal existence of a partnership is proved by facts to support such a claim. There need not be any particular form of document and in fact, the partnership can even be oral, but, whether a relationship of partners exists or does not exist depends on what was intended by parties.

In 'Shiv Narain & Sons V. Commissioner of Income Tax' – AIR 1935 Lah 896 it was held that a partnership firm is not a 'person', but merely a collective name for the individuals who are members of the partnership, and as such it cannot be a partner in another partnership firm. A partnership is a relationship which subsists between persons. A partnership firm is not a legal entity, is incompetent to enter into a partnership with another partnership firm.

5.3.2 Partnership at will

Section 7 defines the expression 'partnership at will'. According to this section, where no provision is made by contract between the partners for the duration of their partnership, or for the determination of their partnership, the partnership is 'partnership at will'.

Such a partnership could be dissolved by any partner giving notice in writing to all other partners, of his intention to dissolve the firm. On such notice being given, the firm is dissolved from the date mentioned in the notice as the date of dissolution or if not date is so mentioned, as from the date of communication of the notice.

The following are the essential ingredients of a 'partnership-at-will'-

- deed of partnership should contain any provision, whether express of implied as to the duration of partnership; and
- for the determination of the partnership.

If either of the above said provision exists, the partnership would not be a partnership-at-will.

5.3.3 Particular partnership

Section 8 provides that a person may become a partner with another person in particular adventures or undertakings.

5.3.4 Property of the firm

Section 14 provides that subject to contract between the partners, the property of the firm includes all property and rights and interests in property, originally brought into the stock of the firm, or acquired, by purchase or otherwise, by or for the firm, or for the purposes and in the course of the business of the firm and includes also the goodwill of the business.

The property and rights and interests in property acquired with money belonging to the firm are deemed to have been acquired for the firm unless the contrary intention appears.

In 'Arjun Kanaji Tankar v. Shantaram' (1969) 3 SCC 555 a contention was raised that in any event, by virtue of Section 14 of the Partnership Act, all the assets with the aid of which the business was carried on by the plaintiff must be deemed in law to have become the partnership assets under the deed of partnership. It was held that under Section14, the property belonging to a person, in the absence of any agreement to the contrary, does not, on a person entering into a partnership with others, become the property of the partnership merely because it is used for the business of the partnership. It will become the property of the partnership only if there is an agreement, express or implied, that the property was, under the agreement of partnership, to be treated as the property of the partnership.

Section 15 provides that subject to the contract between the partners, the property of the firm shall be held and used by partners exclusively for the purposes of the business.

In 'Reddi Verraju V. Chittori Lakshminarasamma' AIR 1971 AP 266 it was held that no partner can claim an exclusive right in any article of the partnership property. But upon on a dissolution, any part of the partnership property may, by contract of the partners, be converted into the separate individual property of either. It, therefore, follows, so long as there is a partnership in existence, no partner has any right to take any portion of the partnership property or to say that it belongs to him exclusively so as to assign or transfer the partnership property. The right, that he possesses in the partnership property, is as a member of the partnership, and not a right which can claim in his individual capacity.

5.3.5 Formation of a Partnership

Partnership is one of the modes of business. It is governed under the Indian Partnership Act, 1932. For constituting a partnership, the following ingredients are necessary-

- There should be an agreement between the parties;
- The agreement must be to share the profits of the business and the business must be carried on by all or any of them acting for all;
- The existing of an agency between the concerned persons inter-se.

All the above ingredients must exist before a partnership come into existence. Actual starting of business to registration is not a condition precedent.

In 'Meenakshi Achi v. P.S.M. Subramanian Chettiar' – AIR 1957 Mad 8 the High Court held that in determining whether a particular group of persons constitutes a partnership, regard has to be had to the real relationship between the parties as drawn by all relevant facts taken together. However, it is often a difficult question to decide. There are several indicators for testing the existence of a partnership like books of account, existence of other employees of the partnership, proof of business dealing etc., While sharing of profits is an important criterion, it is not conclusive.

The first element relates to the voluntary contractual nature of partnership; the second gives the motive which leads to the formation of firms, i.e., the acquisition of gain; and the third shows that the persons of the group, who conduct the business, do so as agents for the persons in the group and therefore liable to account to all.

If any of the said essential ingredients is lacking there can be no partnership.

Procedure to form a partnership

The first step is to decide the number of partners of a firm. The law provides for minimum 2 number of partners. The upper limit is 10 in case of banking business and 20 in respect of other business.

- First decide to who are the partners of the firm, considering the limit envisaged in the Act;
- The name of the partnership firm is selected subject to the provisions of the partnership Act;
- Select the business to be done by the partnership and object of the business;
- Decide the capital to be brought by each and every partner;
- Prepare the agreement deed of the firm – the deed is the vital and most significant document. The deed shall contain all aspects of the partnership firm. This documents prescribes the 'a to z' of the partnership firm to be formed;
- The agreement should invariably in writing and signed by all partners;
- The provisions contained in the agreement are binding all partners;
- The partnership firm is to be registered. According to the Act the partnership firm may be registered or may not be registered. Unregistered firms have no legal protection and therefore registration of partnership firm is to be preferred.
- Open bank account in the name of the partnership firm;
- In the present scenario obtaining PAN is necessary and get the PAN from the Income Tax Authority;

- Acquire all mandatory licenses from the respective authorities for the conduct of the business;
- Registration with required tax authorities i.e., direct tax as well as indirect tax such as central excise, service tax, VAT etc.,
- The Registration certificate is the conclusive evidence of the formation of the partnership firm.

5.3.6 Reconstitution of Firm

Partnership is an agreement between the members of a firm for sharing the profits of the business carried on by all or any of them acting for all. Any change in this relationship amounts to reconstitution of the partnership firm. Any change in the existing agreement of partnership amounts to reconstitution of a firm. A change in the partnership agreement brings to an end the existing agreement and a new agreement comes into being. This new agreement changes the relationship among the members of the partnership firm. Hence, whenever there is a change in the partnership agreement, the firm continues but it amounts to the reconstitution of the partnership firm.

The reconstitution of a partnership firm may take place in the following occasions-

- Change in profit sharing ratio of the existing partners;
- Admission of a new partner;
- Retirement of existing partner;
- Death of a partner;
- Amalgamation of two partnership firm.

Change in profit sharing ratio

When all the partners of a firm agree to change their profit-sharing ratio, the ratio may be changed. For example, Ram, Mohan and Sohan are partners in the firm sharing profits in the ratio of 3:2:1. With effect from April 1, 2022, they decided to share profits equally. Here, change in the existing profit-sharing ratio results into reconstitution of the firm.

In this case one profit is purchasing a share of partner from another one. In other words, share of one partner may increase and share of another partner may decrease. In case of change in profit sharing ratio, the gaining partner must compensate the sacrificing partner by paying the proportionate amount of goodwill. At the time of change in profit sharing ratio, if there are some reserves or accumulated profits/losses existing in the books of the firm, these should be distributed to partners in their old profit-sharing ratio.

Partners may decide that reserves and accumulated profits/losses will not be affected and remains in the books with same figure. In this case, the gaining partner must compensate the sacrificing partner by the share gained by him.

At the time of change in profit sharing ratio of existing partners' assets and liabilities of a firm must be revalued because actual realizable value of assets and liabilities may be different from their book values. Change in the assets and liabilities to the period prior to change in profit sharing ratio and therefore it must be share in old profit-sharing ratio.

Admission of a new partner

Admission of a partner is one of the modes of reconstitution of a partnership firm. A new partner may be admitted in a partnership firm either for the increase of capital of the firm or to strengthen the management of

the firm. A new partner may be admitted with the consent of all existing partners as per the provisions of the agreement of the firm. For example, Hari and Haqque are partners sharing profit in the ratio of 3:2. On April 1, 2022 they admitted John as a new partner with 1/6th share in the profits of the firm. In this case, with the admission of John the firm is reconstituted.

The new partner is entitled the following rights-

- The right to share in the assets of the partnership firm; and
- The right to share the profits in the business.

The following are to be taken care of while admitting a new partner-

- Computation of new profit sharing ratio and sacrifice ratio;
- Accounting treatment of goodwill;
- Revaluation of assets and liabilities;
- Treatment of undisbursed profits and accumulated losses;
- Adjustment of capital accounts.

Retirement of an existing partner

Retiring of a partner from the firm amounts to reconstitution of the firm. On the retirement of a partner, the existing partnership deed comes to an end. In its place the new partnership deed needs to be framed, i.e. the firm requires reconstitution. The remaining partners shall continue to do their business but on the different terms and conditions. For example, Roy, Ravi and Rao are partners in the firm sharing profit in the ratio of 2:2:1. Ravi retires from the firm on March 31, 2022. Retirement of Ravi from the firm of Roy, Ravi and Rao results into reconstitution of firm.

A partner can retire from the firm in three ways-

- Retirement through mutual consent – A partnership firm may take its shape through mutual consent of partners in the same way. A partner may retire if all the partners agree on the decision of his retirement;
- When there is a provision in the partnership deed for retirement of a partner, in that case the partner may retire from the firm by expressing his intention of leaving the firm through a notice to the other partners of the firm.
- When partnership is at will, a partner may retire by giving notice in writing to all other partners informing them about his intention to retire.

The outgoing partner's account is settled as per the terms of partnership deed i.e., in lump sum immediately or in various installments with or without interest as agreed or partly in cash immediately and partly in installment at the agreed intervals. In the absence of any agreement, Section 37 of the Indian Partnership Act, 1932 is applicable, which states that the outgoing partner has an option to receive either interest @ 6% p.a. till the date of payment or such share of profits which has been earned with his/her money (i.e., based on capital ratio). Hence, the total amount due to the retiring partner which is ascertained after all adjustments have been made is to be paid immediately to the retiring partner. In case the firm is not in a position to make the payment immediately, the amount due is transferred to the retiring Partner's Loan Account, and as and when the amount is paid it is debited to his account.

Liability of a retiring partner

A retiring partner may be discharged from any liability to any third part for acts of the firm done before his

retirement by an agreement made by him with such third party and the partners of the reconstituted firm. Such agreement may be implied by a course of dealing between such third party and the reconstituted firm after he had knowledge of the retirement.

Despite the retirement of a partner of a firm, he and the partners continue to be liable as partners to third parties for any act done by any of them which would have been an act of the firm if done before the retirement, until public notice is given of the retirement. He is not liable to any third party who deals with the firm without knowing that he was a partner. The notice may be given by the retired partner or any partner of the reconstituted firm.

Death of a partner

The death of a partner in partnership firm amounts to reconstitution of the firm since the vacant of one partner arises. For example, X, Y and Z are partners in a firm sharing profits in the ratio 3:2:1. X dies on March 31, 2022. Y and Z decide to carry on the business sharing future profits equally. In this case, continuity of business by Y and Z sharing future profits equally amounts to reconstitution of the firm.

The accounting treatment for disposal of amount due to retiring partner and deceased partner is similar with a difference that in case of death of a partner, the amount credited to him/her is transferred to his Executors' Account and the payment has to be made to him/her. However, there is one major difference that, while the retirement normally takes place at the end of an accounting period, the death of a partner may occur any time. Hence, in case of a partner, his claim shall also include his share of profit or loss, interest on capital, interest on drawings (if any) from the date of the last Balance Sheet to the date of his death of these, the main problem relates to the calculation of profit for the intervening period (i.e., the period from date of the last balance sheet and the date of the partner's death. Since, it is considered cumbersome to close the books and prepare final account, for the period, the deceased partner's share of profit may be calculated on the basis of last year's profit (or average of past few years) or on the basis of sales.

Liability of estate of deceased partner

Section 35 provides that where, under a contract between the partners, the firm is not dissolved by the death of a partner, the estate of a deceased partner is not liable for any act of the firm done after his death.

Expulsion of a partner

Section 33 provides that a partner may not be expelled from a firm by any majority of the partners, save in the exercise, in good faith, of powers conferred by contract between the partners. The provisions of retired partners will be applicable to such expelled partner.

Insolvency of a partner

Section 34 provides that where a partner in a firm is adjudicated an insolvent, he ceases to be a partner on the date on which the order of adjudication is made, whether or not the firm is thereby dissolved.

Where the firm is not dissolved by the adjudication of a partner as an insolvent, the estate of a partner so adjudicated is not liable for any act of the firm and the firm is not liable for any act of the insolvent, done after the date on which the order of adjudication is made.

Revocation of continuing guarantee

Section 38 provides that a continuing guarantee given to a firm or to a third party in respect of the transactions of a firm, is revoked as to future transactions from the date of any change in the constitution of the firm, in the absence of agreement to the contrary.

Amalgamation of two partnership firms

When two or more firms merge into one firm and makes a new firm, then this is called amalgamation of firms.

Example: Rai and Sanjeev are partners in the firm sharing profits in the ratio of 4:1. To avoid competition and bring down administrative expenses their firm was amalgamated with the firm of Sohan and Ashok who are sharing profits in the ratio of 1:2. It was decided that the new profit sharing ratio of Rai, Sanjeev, Sohan and Ashok will be 4:1:1:2. In this case, two firms have amalgamated into one which amounts to reconstitution of the firm of Raj and Sanjeev on the one hand and the firm of Sohan and Ashok on the other hand to form a new reconstituted firm.

When two firm amalgamate with each other, at this time we treat following accounting in the books of old firms so that all doubt solves-

- Revaluation of Assets and Liabilities - All entries same as at the time of admission and retirement;
- Transferring reserve to old partners' capital account into their old ratio;
- Treatment of Good will - the goodwill is evaluated according to the condition of agreement and then goodwill will open with agreed value in the books;
- Treatment of Assets and liabilities not taken by new firm - If assets and liabilities are not taken by new firm, then these item will transfer to the capital accounts of partners of old firm and close these accounts.

The firm, reconstituted by any of the above methods, is required to be get registered with the Registrar of Firms.

5.3.6 Registration of Firms

Exemption from the Act

Section 56 gives power to the State Government to give exemptions either fully or any part thereof the State from the provisions of this Act by means of notification in the Official Gazette.

Registrars of Firms

Section 57 provides that the State Government may appoint Registrars of Firms for the purposes of this Act and may define the areas within which they shall exercise their powers and perform their duties.

Application for registration

Section 58 provides that for the purpose of registration a statement in the prescribed form stating-

- the name of the firm;
- the place, or principal place, of business of the firm;
- the names of any other places where the firm carries on business;
- the date when each partner joined the firm;
- the names, in full, and permanent address of the partners; and
- the duration of the firm.

shall be prepared and duly signed by all partners, or by their agents specifically authorized in this behalf. The prescribed fee is also paid for registration. Each person, signing the statement, shall also verify it in the manner prescribed.

Name of the Firm

A firm name shall not contain any of the following words – Crown, Emperor, Empress, Empire, Imperial, King, Queen, Royal or words expressing or implying the sanction, approval or patronage of Government when the State Government signifies its consent to the use of such words as part of the firm name by order in writing.

Procedure

The registration of a firm may be effected at any time by sending by post or delivering to the Registrar of the area in which any place of business of the firm is situated or proposed to be situated.

Section 59 provides that when the Registrar is satisfied that the provisions of Section 58 have been duly complied with, he shall record an entry of the Statement in a register call the Register of Firms and shall file the statement.

Alteration in firm name or place of business

Section 60 provides that when there is an alteration in firm name or the principal place of business name, a statement may be sent to the Registrar accompanied by the prescribed fee, specifying the alteration and signed and verified in the prescribed manner. When the Registrar is satisfied that the provisions of Section 60 have been duly complied with, he shall amend the entry relating to the firm in the Register of Firms in accordance with the Statement and shall file it along with the statement relating to the firm.

Closing and opening of branches

Section 61 provides that when a registered firm discontinues its business at any place or begins to carry on business at any place, such place not being its principal place of business, any partner or agent of the firm may send intimation to the Registrar. The Registrar shall make a note of such intimation in the entry relating to the firm and file the intimation.

Changes in names and addresses of partners

Section 62 provides that when any partner of a firm alters his name or permanent address an intimation of the alteration may be sent by any partner or agent of the firm to the Registrar, who shall take note of the same in the entry relating to the firm and file the intimation.

Recoding dissolution of a firm

Section 63 provides that when a change occurs in the constitution of a firm, any incoming, continuing or outgoing partner and when a registered firm is dissolved, any person who was a partner immediately before the dissolution may give notice to the Registrar of such change or dissolution, specifying the date of charge or dissolution. The Registrar shall make a record of the notice in the entry relating to the firm in the Register of Firms and shall file the notice along with the statement.

Withdrawal of a minor

When a minor who has been admitted to the benefits of the partnership in a firm, attains majority and elects to become or not to become a partner then he may give notice to the Registrar that he has or has not become a partner. The Registrar shall make a record of the notice in the entry relating to the firm in the Register of Firms and shall file the notice along with the Statement.

Rectification of mistakes

Section 64 provides that the Registrar shall have the power to rectify any mistake at all times to bring the entry in the Register of Firms relating to any firm into conformity with the documents relating to that firm. On application made by all the parties, who have signed any document, the Registrar may rectify any mistake in such document or in the record or note made in the Register of firms.

Amendment by order of Court

Section 65 provides that a Court, deciding any manner, relating to a registered firm, may direct that the Registrar shall make any amendment, in the entry in the Register of Firms, relating to such firm, which is consequential upon its decision and the Registrar shall amend the entry accordingly.

Inspection

Section 66 provides that the Register of Firms shall be open to inspection by any person on payment of such fee as may be prescribed. All statements, notices and intimations, filed shall be open to inspection subject to such conditions and on payment of such fee, as may be prescribed.

Section 67 provides that the Registrar shall, on application, furnish to any person, on payment of such fee, as may be prescribed, a copy, a certified under his hand, of any entry or portion thereof in the Register of Firms.

Rules of evidence

Section 68 provides that any statement, intimation or notice, recorded or noted in the Register of Firms, shall, as against any person, by whom or on whose behalf such statement, intimation or notice was signed, be conclusive proof of any fact therein stated.

Effect of non-registration

Section 69 of the Act place an unregistered firm under some disadvantages as a result of which firms go for compulsory registration. The consequences of non-registration of a firm are as under;

1. No suit to enforce a right arising from a contract or conferred by this Act shall be instituted in any Court by or on behalf of any person suing as a partner in a firm against the firm or any person alleged to be or to have been a partner in the firm unless the firm is registered and the person suing is or has been shown in the Register of Firms as a partner in the firm.
2. No suit to enforce a right arising from a contract shall be instituted in any Court by or on behalf of a firm against any third party unless the firm is registered and the persons suing are or have been shown in the Register of Firms as partners in the firm.
3. The provisions of sub-sections (1) and (2) shall apply also to claim of set- off or other proceeding to enforce a right arising from contract, but shall not affect-
   a) the enforcement of any right to sue for the dissolution of a firm or for accounts of a dissolved firm, or any right or power to realise the property of a dissolved firm, or
   b) the powers of an official assignee, receiver or Court under the Presidency- towns Insolvency

Act, 1909 or the Provincial Insolvency Act, 1920. to realise the property of an insolvent partner.

Penalty

Section 70 provides that any person who signs any statement, amending statement, notice or intimation, containing any particular, which he knows to be false or does not believe to be true, or containing particulars which he knows to be incomplete or does not believe to be complete, shall be punishable with imprisonment which may extend to 3 months or with fine or with both.

Mode of giving public notice

Section 72 provides the mode of giving public notice. A public notice is given-

- if it relates to the retirement or expulsion of a partner from a registered firm, or to the dissolution of a registered firm, or to the election to become or not to become a partner in a registered firm by a person attaining majority who was admitted as a minor to the benefits of partners, by notice to the Registrar of Firms and by publication in the Official Gazette and in at least one vernacular newspaper circulating in the

district where the firm, to which it relates, has its place or principal place of business; and

- in any other case, by publication in the Official Gazette and in at least one vernacular newspaper circulating in the District where the firm, to which it relates, has its place of principal place of business.

5.3.7 Dissolution of a Firm (Section 39-47)

Section 39 provides that the dissolution of partnership between all the partners of a firm is called the 'dissolution of the firm'.

Modes of Dissolution of a firm

1. **Dissolution without the order of the court or voluntary dissolution**

   a) **Dissolution by agreement [Section 40]**

   Section 40 provides that a firm may be dissolved with the consent of all partners or in accordance with a contract between the parties.

   In 'Hakmaji Meghaji V. Punnaji Devichand' – AIR 1938 Bom 453 (456) it was held that mere cessation of business by a partnership does not mean dissolution of partnership.

   A deed of dissolution, signed by five out of six partners cannot amount to a deed of dissolution with the consent of all the partners as designed in Section 40 of the Act. Dissolution and winding up are two different concepts. Realization of the assets is a part of winding up and not of dissolution, unless, perhaps, it was, expressly or by necessary implication, agreed upon by the parties that the life of the partnership should be co-terminus with the collection of the last debt.

   b) **Compulsory dissolution [Section 41]**

   Section 41 provides that a firm is dissolved-

   - By the adjudication of all the partners or of all the partners but one as insolvent; or
   - By the happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership.

   Where more than one separate adventure or undertaking is carried on by the firm, the illegality of one or more shall not cause the dissolution of the firm in respect of its lawful adventures and undertakings.

   c) **Dissolution on the happenings of certain contingencies [Section 42]**

   Section 42 provides that subject to the contract between the partners, a firm is dissolved-

   - if constituted for a fixed term, by the expiry of that term;
   - if constituted to carry out one or more adventures or undertakings, by the completion thereof;
   - by the death of a partner; and
   - by the adjudication of a partner as an insolvent.

   In 'Chainkaram Sidhakaran Oswal vs. Radhakisan Vishwanath Dixit' – AIR 1956 Nag 46 it was held that though there was no direct evidence of an express agreement to the effect that the partnership would not be dissolved on account of death of a partner, the evidence on record established that at the time of death of each of the two partners, the heirs of the deceased partner stepped into his shoes. This course of conduct between the parties was held to be sufficient to raise an inference that there was a contract between them that the partnership was not to be dissolved on the death of a partner.

   d) **Dissolution by notice of partnership at will [Section 43]**

   Section 43 provides that where the partnership is at will, the firm may be dissolved by any partner

giving notice, in writing, to all the other partners, of his intention to dissolve the firm. The firm is dissolved as from the date mentioned in the notice as the date of dissolution or, if no date is mentioned, as from the date of the communication of then notice.

In 'Lilabati Rana V. Lalit Mohan Dey' – AIR 1952 Cal 499 it has been pointed out that the provisions contained in Section 43 of the Partnership Act, do not control the firm dissolved even when no notice in writing has been given as required under Section 43.

2. Dissolution by the court [Section 44]

Section 44 prescribes the grounds on which the Court may direct dissolution of a firm in a suit as discussed below:

- if a partner has become of unsound mind;
- if a partner has become permanently incapable of performing his duties as partner;
- if a partner is guilty of conduct which is likely to affect prejudicially the carrying on of business, regarding being had to the nature of business;
- if a partner willfully or persistently commits breach of agreements relating to-
- the management of the affairs of the firm or the conduct of its business; or
- the conduct of its business; or
- otherwise so conducts himself in matters relating to the business that it is not reasonably practicable for the other partners to carry on the business in partnership with him;
- If a partner has in any way-
- transferred the whole of his interest in the firm to a third party; or
- has allowed his share to be charged; or
- has allowed it to be sold in the recovery of the arrears of land revenue; or
- of any dues recoverable as arrears of land revenue due by the partner;
- the business of the firm cannot be carried on save at a loss; or
- on any other ground which renders it just and equitable that the firm should be dissolved.

In 'Sheoram vs. Prem Chand' – AIR 1943 Nag 13 it was held that to a suit for dissolution of partnership and rendition of accounts, all the partners and legal representatives of the deceased partner/partners are necessary parties. The suit is to be dismissed if a necessary party is not impleaded or is impleaded beyond the period of limitation.

Liability of partners after dissolution

Section 45 provides that the liability of the partners will continue for the acts done before the dissolution, even after the dissolution, until public notice is given of the dissolution. The following partner is not liable for the acts after the date on which he ceases to be a partner-

- a deceased partner;
- a partner who is adjudicated as an insolvent;
- a partner, who not having been known to the person, dealing with the firm, to be a person, retires from the firm

In 'Rajagopala Pillai v. Krishnaswai Chetti' – 8 Mad LJ 261 it was held that the legal representatives of a deceased partner cannot be validly bound by an acknowledgement made by the surviving partner after dissolution

caused by death. Once the partnership is dissolved, even the theory of implied agency disappears. After the jural relationship of partners having been put an end, there can be no question of any partner, acting in any representative capacity, so as to bind the firm.

Right of partners after dissolution

Section 46 provides that on the dissolution of a firm, every partner or his representative is entitled as against all the other partners or their representatives, to have the property of the firm applied in payment of the debts and liabilities of the firm and to have the surplus distributed among the partners or their representatives according to their rights.

Continuing authority of partners

Section 47 provides that after the dissolution of a firm, the authority of each partner to bind the firm and the other mutual rights and obligations of the partners continue, notwithstanding the dissolution, so far as may be necessary to wind up the affairs of the firm and to complete transactions begun but unfinished at the time of the dissolution, but not otherwise.

The firm is, in no case, bound by the acts of a partner who has been adjudicated insolvent. This will not affect the liability of any person who has, after the adjudication, represented himself, or knowingly permitted to be represented as partner of the insolvent.

Mode of settlement

Section 48 provides the mode of settlement of accounts between the partners after the dissolution. In this regard, the following shall be observed, subject to the agreements by the partners-

- losses, including deficiencies of capital, shall be paid first out of profits, next out of capital and lastly if necessary by the partners individually in the proportions in which they were entitled to share profits;
- the assets of the firm, including any sums contributed by the partners to make up deficiencies of
- capital shall be applied in the following manner and order-
  - in paying the debts of the firm to the third parties;
  - in paying to each partner ratably what is due to him from the firm for advances as distinguished
  - from capital;
  - in paying to each partner ratably what is due to him on account of capital; and
  - the residue, if any, shall be divided among the partners in the proportions in which they were entitled to share profits.

Payment of firm debts

Section 49 provides that where there are joint debts due from the firm and also separate debts due from any partner, the property of the firm shall be applied in the first instance in payment of the dues of the firm. If there is any surplus then the share of each partner shall be applied in payment of his separate debts or paid to him. The separate property of any partner shall be applied first in the payment of his separate debts and the surplus, if any, in the payment of the debts of the firm.

Personal profits after dissolution

Section 50 provides that the personal profits earned by any surviving partner or by the representatives of a deceased partner, undertaken after the firm is dissolved on account of the death of a partner and before the affairs have been completely wound up, then such personal profits shall be accounted to the firm. Where any partner or his representative has bought the goodwill of the firm, he shall have right to use the firm name.

Return of premium

Section 51 provides that where a partner has paid a premium on entering into partnership for a fixed term and the firm is dissolved before the expiration of that term otherwise than by the death of the partner, such partner is entitled to repayment of the premium or of such part there of as may be reasonable, regard being had to the terms upon which he became a partner and to the length of time during which he is a partner, unless-

- the dissolution is mainly due to his own misconduct; or
- the dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.

Rescinding of contract

Section 52 provides that where a contract creating partnership is rescinded on the ground of the fraud or misrepresentation of any of the parties, the party entitled to rescind is, without prejudice to any other right, entitled-

- to a lien, or a right of retention of, the surplus of the assets of the firm remaining after the debts of the firm have been paid, for any sum paid by him for the purchase of a share in the firm and for any capital contributed by him;
- to rank as a creditor of the firm in respect of any payment made by him towards the debts of the firm; and
- to be indemnified by the partner or partners guilty of the fraud or misrepresentation against all the debts of the firm.

Restrain to use firm name

Section 53 provides that after a firm is dissolved, every partner or his representative may, in the absence of a contract between the partners to the contrary, restrain any other partner from carrying on a similar business in the firm name, or from using any of the property of the firm for his own benefit, until the affairs of the firm have been completely wound up. Where any partner or his representative has brought the goodwill of the firm he has the right to use the firm name.

In 'Ramesh Kumar V. Smt. Lata Devi' AIR 2007 MP 153 it was held that in order to exercise an option under Section 53, it is necessary to establish that firm has been dissolved and after dissolution of the firm contract has to be seen. In the absence of contract to the contrary there is option available to restrain any other partner or his representative from carrying on the business in the firm name or using any of the property of the firm. The object underlying this section is to restrain a partner from doing anything, while the liquidation proceedings are pending which may prejudice the saleable value or otherwise affect the property of the firm until its use.

Agreements in restraint of trade

Section 54 provides that partners may, upon or in anticipation of the dissolution of the firm, make an agreement that some or all of them will not carry on a business similar to that of them within a specified period of within the specified local limits and notwithstanding anything contained in Section 27 of the Indian Contract Act, 1872, such agreement shall be valid if the restrictions imposed are reasonable.

In 'Premji Damodar V. L.V. Govindji & Co' – AIR 1943 Sind 197 it was held that an agreement between the two separating partners restrained one of them from doing any craft insurance business of any kind whatsoever, directly or indirectly, as agent or as broker, throughout the whole world except at Karachi, and except as broker and except through the other partner. It was held that the said agreement was void under Section 27 of the Contract Act,1872 and not saved by Section 54 because the agreement subjected the partner to a species of slavery as far as the insurance was concerned.

EXERCISE

Multiple Choice Question:

1. An act of a firm means:
   a) Any partner or agent of the firm which gives rise to a right enforceable by or against the firm
   b) Any act by all the partners
   c) Any omission by all the partners
   d) All of the above
2. Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. Does it mean that losses are not shared?
   a) A minor may be admitted in partnership, only for the profits, but he cannot share in losses.
   b) It also depends on the partnership agreement. A person may share the profits but may not share in losses.
   c) Sharing of profits also include losses (negative profits)
   d) All of the above.
3. Where no provision is made by contract between the partners for the duration of their partnership, or for the determination of their partnership, the partnership is called as:
   a) Particular partnership
   b) Partnership for a fixed term
   c) partnership at will
   d) None of the above
4. What information shall be given to the Registrar of Firms by a registered partnership firm:
   a) New opening/closing of the existing branch, if any.
   b) Change in the name of and address of the partner (s)/change in the constitution of the firm.
   c) What there is change in the name of the firm or in location of the principal place of business.
   d) All of the above.
5. Who can inspect the Register and filed documents at the office of the Registrar:
   a) Any Government servant
   b) The Partners of the firm
   c) The partners of the other firms
   d) Any person

6. What are the right of partners after dissolution:

   a) To have the surplus distributed among the partners or their representatives according to their rights.

   b) To have business wound up after dissolution

   c) To have the property of the firm applied in payment of the debts and liabilities of the firm.

   d) All of the above

7. Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm or to interest at the rate of on the amount of his share in the property of the firm:

   a) 9% p.a.

   b) 18% p.a.

   c) 6% p.a.

   d) 12% p.a.

8. The dissolution of partnership means:

   a) It means the dissolution of partnership between all the partners of a firm

   b) It means the change in the relations of the partners

   c) It means the reconstitution of the firm.

   d) None of the above.

9. In what circumstances a partner may retire:

   a) In accordance with an express agreement by the partners

   b) Where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire.

   c) With the consent of all the other partners

   d) All of the above.

10. What would be the position, where a minor elect not to become a partner:

    a) He shall be entitled to sue the partners for his share of the property and profits.

    b) His rights and liabilities shall continue to be those of a minor under this section up to the date on which he gives public notice.

c) His share shall not be liable for any acts of the firm done after the date of the notice.

d) All of the above

State TRUE or FALSE

1. Consideration, which is of essence for the formation of a contract, is essential for the formation of the partnership.
2. The goodwill shall, subject to contract between the partners, be included in the assets and it may be sold either separately or along with other property of the firm.
3. Debts of the firm shall be paid first out of the property of the firm, but in case of private debts of the partners, it shall be paid last after paying of all the dues of the firm.
4. The implied authority of a partner is to carry on the business of the firm, in the usual way.
5. Subject to contract between the partners, the property of the firm includes acquired, by purchase or otherwise, by or for the firm, or for the purposes and in the course of business of the firm, the goodwill of the business and all property and rights and interests in property originally brought into the stock of the firm.

Fill in the blanks

1. The partners in a firm may, by contract between the partners, restrict or extend the _____ authority of any partner.
2. When there is any change in the constitution of the firm, the status of the continuing guarantee given to the firm shall be _____ as to future transactions from the date of any change in the constitution of the firm.
3. The State Government may appoint Registrars of Firms for the purposes of this Act, every Registrar shall be deemed to be a ____within the meaning of section 21 of the Indian Penal Code.
4. A firm may be dissolved by the Court order or in accordance with a _____ between the partners.
5. A person may be deemed as partner by estoppels or holding out when he by his ____ represents himself to be a partner in a firm.

Short Essay Type Questions

1. What are the different types of partnership?
2. Descibe the rights of a partner.

3. Write short notes on-

   (a) Partnership at will

   (b) Liability of a retiring partner

⊙ Essay Type Questions

1. Discuss the duties of a partner in a partnership firm.
2. Discuss the procedure for dissolution of the firm.
3. When can a partnership firm be dissolved?
4. Discuss the concept of implied authority of a partner.
5. Discuss the procedure for registration of a partnership firm.

⊙ Unsolved Cases

1. M/s XYZ is partnership firm and X, Y and Z are the partners. During the course of business travel, partner X recovered a sum of ₹15,000 in cash from the debtor of the firm and credit in his personal bank account. Does the act of X will amount to mis-appropriating the funds of the firm and utilisation of the same for the personal gain.
2. M/s ABC is a partnership firm where Mr. X, Y and Z are partners. Mr. X signs a contract with Coal India Limited for supply of some goods, on behalf of the partnership firm. Can he do so individually or would he require the consent from other two partners?

Answer:

Multiple Choice Question:

1. d; 2. d; 3. c; 4. d; 5. d; 6. d; 7. c; 8. b; 9. d; 10. d.

State whether TRUE or FALSE

1. False; 2. True; 3. True; 4. True; 5. True.

Fill in the blanks

1. implied; 2. revoked; 3. public servant; 4. contract; 5. conduct.

Limited Liability Partnership Act, 2008

6

This Module includes -

6.1 Concept, Formation, Membership, Functioning

6.2 Dissolution

Limited Liability Partnership Act, 2008

SLOB Mapped against the Module

To acquire the requisite knowledge about the business form of limited liability partnership, its essential features, rights and liabilities of the partners, and dissolution of LLPs.

Module Learning Objectives:

After studying this module, the students will be able -

- To acquire the requisite knowledge about the business form of limited liability partnership, its essential features, rights and liabilities of the partners, and dissolution of LLPs.
- To develop an understanding about the different provisions governing a limited liability partnership firm and how it is distinct from a company.

Concept, Formation, Membership and Functioning

6.1

A limited liability partnership is another form of doing business in India under the LLP Act, 2008. The benefit of this business form is that it has the feature of limited liability as can be seen in companies. Despite being a partnership, there are many features that an LLP has which are like that of a company. This business form can continue its existence irrespective of changes in partners, much like a company where membership changes hands. LLPs are capable of entering into contracts and holding property in its own name. The LLP is a separate legal entity, as any incorporated association is and has unlimited liability, but the liability of the partners is limited to their pre-determined contribution in the LLP. Similarly, as in a company, individual partners when acting ultra vires or in an independent manner, would not make other members liable for their acts, despite their being the concept of mutual agency. Unlike a company, where articles of association govern, a limited liability partnership is governed by an agreement between the partners or between the partners and the LLP. An LLP has the characteristics of both the partnership firm and company. It is the most preferred form of organization among entrepreneurs as it incorporates the benefits of both partnership firm and company into a single form. LLPs in India are regulated by the Limited liability Partnership Act, 2008.

Among many features, the advantages of incorporating a limited liability partnership are the low amount of cost and less compliances involved in registering the same. Moreover, the statutory obligations of a company to rotate directors within the board, there is no such provision relating to rotation of partners.

The LLP structure is available in countries like United Kingdom, United States of America, various Gulf countries, Australia and Singapore. In India on the advice of experts who have studied LLP legislations in various countries, the LLP Act is broadly based on UK LLP Act 2000 and Singapore LLP Act 2005. Both these Acts allow creation of LLPs in a body corporate form i.e., as a separate legal entity, separate from its partners/ members.

6.1.1 Concept of LLP

The concept of LLP is explained as below:

- It is an alternative corporate business from that gives the benefit of limited liability of a company and the flexibility of the partnership;
- It can continue its existence irrespective of changes in partners;
- It is capable of entering into contracts and holding property in its own name;
- It is a separate Legal entity and is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP;
- No partner is liable on account of the independent or un-authorized actions of other partners, thus individual partners are shielded from joint liability created by another partner's wrongful business decisions or misconduct;

- Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners or between the partners and the LLP as the case may be.

LLP Act

The Government introduced the 'Limited Liability Partnership Bill, 2006' in the Rajya Sabha on 15.12.2006. The bill was referred to the Department Related Parliamentary Standing Committee on Finance for examination and report. The Committee presented its report on 27.11.2007. The Committee made several recommendations which were examined and considered by the Government. The bill was made an Act in the year 2009. The Act contains 14 chapters with 81 sections and four schedules.

- First Schedule – Provisions regarding matters relating to mutual rights and duties of partners and limited liability partnership and its partners applicable in the absence of any agreement of such matters;
- Second Schedule – Conversion from firm into limited liability partnership;
- Third Schedule – Conversion from private company into limited liability partnership;
- Fourth Schedule – Conversion from unlisted company into limited liability partnership.

To implement the provisions of this Act, the Central Government made 'Limited Liability Partnership Rules, 2009' which came into 01.04.2009 except Rules 32 and 33, Rules 38 to 40 which came into effect from 22.05.2009. For the purpose of winding up of a Limited Liability Partnership, the Central Government made 'The Limited Liability Partnership (Winding up and Dissolution) Rules, 2012.

Limited liability partnership

Section 2(1)(n) defines the expression 'limited liability partnership' as a partnership formed and registered under LLP Act.

Who may be a partner in LLP?

Section 5 provides that any individual or body corporate may be a partner in a LLP. The expression

'body corporate' is defined under Section 2(1)(d) of the Act as a company as defined in Section 3 of the Companies Act, 1956 and includes-

- a limited liability partnership registered under the Act;
- a limited liability partnership incorporated outside India; and
- a company incorporated outside India;

but does not include-

- a corporation sole;
- a co-operative society registered under any law for the time being in force; and
- any other body corporate, not being a company, or a LLP, which the Central Government may, by notification in the Official Gazette, specify in this behalf.

An individual shall not be capable of becoming a partner of LLP, if-

- he has been found to be of unsound mind by a Court of competent jurisdiction and the findings is
- in force.
- he is undischarged insolvent; or
- he has applied to be adjudicated as an insolvent and his application is pending.

Example: X Co. Ltd, is a partner of a partnership firm. The partnership firm already has 5 individual partners in it. X Co. Ltd. by virtue of being a limited liability company, can be the 6th partner.

There have been many amendments to sections of the LLP Act, 2008 through The Limited Liability Partnership (Amendment) Act, 2021. For instance, the following changes have been brought about.

Certain offences have been decriminalised. The Act specifies the manner of operations of LLPs, and provides that violating these requirements will be punishable with a fine ranging between two thousand rupees and five lakh rupees. These requirements include:

i) changes in partners of the LLP,

ii) change of registered office,

iii) filing of statement of account and solvency, and annual return, and

iv) arrangement between an LLP and its creditors or partners, and reconstruction or amalgamation of an LLP. These offences have been decriminalised and a monetary penalty has been imposed. The amendment has also removed some grounds whereby the non-compliance by an LLP of the central government directive to change name of the said LLP, on certain grounds, attracted fines. The amendment now empowers the central government to allot a new name to such an LLP instead of levying a fine. The amendment has also increased the maximum term of imprisonment from two years to five years including a fine between Rs 50,000 and five lakh rupees, in cases of fraudulent activities carried out by an LLP including defrauding its creditors. In such cases the penalty is said to be imposed on every person party to it knowingly.

Under the Act, the central government may compound any offence under the Act which is punishable only with a fine. The amount imposed may be up to the maximum fine prescribed for the offence. The amendment amends this to provide that a regional director (or any officer above his rank), appointed by the central government, may compound such offences.

The amendment allows the central government to establish special courts for ensuring speedy trial of offences under the Act. The special court will consist of:

i) A Sessions Judge or an Additional Sessions Judge, for offences punishable with imprisonment of three years or more; and

ii) A Metropolitan Magistrate or a Judicial Magistrate, for other offences. They will be appointed with the concurrence of the Chief Justice of the High Court. Appeals against orders of these special courts will lie with High Courts. The amendment also contemplates that appeals before NCLAT cannot be made against an orders of NCLT that have been passed with the consent of the parties. Appeals must be filed within 60 days (extendable by another 60 days) of the order. The amendment empowers the central government may prescribe the standards of accounting and auditing for classes of LLPs, in consultation with the National Financial Reporting Authority

6.1.2 Members

Minimum number of members

Section 6 (1) prescribes that every LLP shall have at least two partners.

Reduction in minimum number of members [Section 6(2)]

If at any time the number of partners of a limited liability partnership is reduced below two and the limited liability partnership carries on business for more than six months while the number is so reduced, the person, who is the only partner of the limited liability partnership during the time that it so carries on business after those six months and has the knowledge of the fact that it is carrying on business with him alone, shall be liable

personally for the obligations of the limited liability partnership incurred during that period.

Designated partner

Section 7(1) provides that every LLP shall have at least two designated partners. The designated partners shall be individual and at least one of them shall be a resident of India, who has stayed in India for a period not less 182 days during the preceding one year. In case all the partners of the LLP are bodies corporate or one or more partners are individuals and bodies corporate then at least two individual partners or nominees of bodies corporate shall act as designated partners.

- If the incorporation document specifies who are to be designated partners, such persons shall be designated partners on incorporation;
- If the incorporation document states that each of the partners from time to time of LLP is to be designated partner, every partner shall be a designated partner;
- Any partner may become or cease to be a designated partner in accordance with LLP agreement;

Filing requirement

Section 7(4) provides that-

- An individual shall give his consent to become a designated partner in Form – 9;
- The particulars of an individual who has given his consent to act as designated partner shall be filed in Form No.- 4.
- The individual who has given consent to act as partner or a designated partner shall file consent in Form -2 along with fee.

Disqualification to become designated partner

Rule 9 prescribes that a person shall not be capable of being appointed as a designated partner of a LLP, if he-

- has at any time within the preceding five years been adjudged insolvent; or
- suspends, or has at any time within the preceding five years suspended payment to his creditors and has not any time within the preceding five years made, a composition with them; or
- has been convicted by a Court for any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months; or
- has been convicted by a Court for an offence involving section 30 of the Act.

Liabilities of designated partners

Section 8 provides the liabilities of designated partners. It provides that unless expressly provided otherwise in this Act, a designated partner shall be –

- responsible for the doing of all acts, matters and things as are required to be done by the LLP in respect of compliance of the provisions of the Act including filing of any document, return, statement, report under this Act and as specified in the agreement;
- liable to all penalties imposed on the LLP for any contravention of those provisions.

Vacancy

Section 9 provides that a LLP may appoint a designated partner within 30 days of the vacancy arising for any reason. If no designated partner is appointed, or if at any time there is only one designated partner, each partner shall be deemed to be a designated partner.

Punishment

Section 10(1) provides the LLP contravenes the provisions of Sections 7(1) the LLP and its every partner shall be punishable with fine which shall not be less than ₹10,000/- but which may extend to ₹5 lakhs.

Section 10(2) provides that if the LLP contravenes the provisions of Section 7(4) and (5), Section 8 or Section 9 the LLP and every partner shall be punishable with fine which shall not be less than ₹10,000 but which may extend to ₹1 lakh.

6.1.3 Formation

Incorporation of LLP

The incorporation of an LLP involves the following steps:

- Reservation of name;
- Submission of incorporation documents with Registrar;
- Registration of LLP.

Reservation of name

Section 16 of the Act provides that a person may apply in LLP Form No. 1 along with the payment of fee of ₹200 to the Registrar having jurisdiction where the registered office of the LLP is to be situate. The application shall indicate the name of the proposed LLP. Rule 18 (1) provides that the name of the LLP shall not be one prohibited under the Emblems and Names (Prevention of Improper Use) Act, 1950. Rule 18(2) gives the list of names that are not generally reserved.

Upon receipt of an application along with the fee the Registrar may, if he is satisfied, subject to the rules, that the name to be reserved is not one which may be rejected on any ground, reserve the name. The Registrar shall inform to the applicant for reservation or non-reservation of the changed name or the name with which the proposed LLP is to be registered within seven days of the receipt of the application. The said name shall be available for reservation for a period of three months from the date of intimation by the Registrar.

Rule 19(1) provides that a LLP or a body corporate or any other entity which has already a name which is similar to or which too nearly resembles the name of a LLP incorporated subsequently, may apply to the Registrar in Form 23 to give a direction to that LLP to change its name. The application for this purpose shall state-

- The LLPIN of LLP, or the CIN of the company or the registration number of the other entity as the case may be;
- The name with which the LLP or the company or any other ground was incorporated or registered;
- The grounds of objection to the name of the LLP incorporated subsequently.

The application shall be verified by the person making it. The following documents are to be attached with the application-

- The authority under which he is making such an application;
- A copy of the incorporation certificate of the LLP or the company or the registration certificate of the entity as the case may be.

Submission of incorporation document

Section 11(1) provides that two or more person associated for carrying on a lawful business with a view to profit shall subscribe their names to an incorporation document. The incorporation document shall be in LLP Form No. 2. According to Section 11(2) the incorporation document shall-

- State the name of the LLP;
- State the proposed business of the LLP;
- State the address of the registered office of the LLP;
- State the name and address of each of the persons who are to be partners of the LLP on incorporation;
- State the name and address of the persons who are to be designated partners of the LLP on incorporation;
- Contain such other information as may be prescribed.

The fee payable for registration of LLP is as detailed below:

- LLP whose contribution does not exceed ₹1 lakh – ₹500
- LLP whose contribution exceeds ₹1 lakh but does not exceed ₹5 lakhs – ₹2,000
- LLP whose contribution exceeds ₹5 lakhs but does not exceed ₹10 lakhs – ₹4,000
- LLP whose contribution exceeds ₹10 lakhs – ₹5,000

The Statement in the prescribed form, made by either an Advocate or a Company Secretary or a Chartered Accountant or a Cost Accountant who is engaged in the formation of the LLP and by anyone who subscribed his name to the incorporation document, that all the requirements of this Act and the rules made there under have been complied with, in respect of incorporation and matters precedent and incidental thereto, is also to be furnished.

Section 11(3) provides that if a person makes such a statement which he knows to be false or does not believe to be true, he shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than ₹10,000 but which may extend to ₹5 lakhs.

The incorporation document duly complying with the required provision shall be filed with the Registrar having jurisdiction over the State in which the registered office of the LLP is to be situated.

Incorporation by registration

Section 12(1) provides that when the requirements have been complied, the Registrar shall retain the incorporation document. If the requirements have not been complied with, he shall within a period of 14 days-

- Register the incorporation document; and
- Give a certificate that the LLP is incorporated by the name specified therein.

The Registrar may accept the statement furnished by a Professional engaged in the formation of the LLP, as sufficient evidence that the requirement imposed has been complied with. The Certificate shall be signed by the Registrar and authenticated by his office. This certificate is the conclusive evidence that the LLP is incorporated by the name specified therein.

No LLP shall be registered by a name which, in the opinion of the Central Government is-

- Undesirable; or
- Identical or too nearly resembles to that of any other partnership firm or LLP or body corporate or a registered trademark or a trademark which is subject of an application for registration, of any other person under the Trade Marks Act, 1999.

The Registrar shall maintain a Register of LLP in which the names of LLPs shall be entered in the order in which they are registered. Every LLP so registered shall be assigned a LLP identification Number (LLPIN) in one consecutive series.

Registered Office

Section 13(1) provides that every LLP shall have a registered office to which all communications and notices may be addressed and where they shall be received.

Effect of Registration

Section 14 provides that on registration, a LLP shall, by its name, capable of-

- Suing and being sued;
- Acquiring, owning, holding and developing or disposing of property, whether movable or immovable, tangible or intangible;
- Having a common seal, if it decides to have one; and
- Doing and suffering such other acts and things as bodies corporate may lawfully do and suffer.

Name

Every LLP shall have either the words 'limited liability partnership' or the acronym 'LLP' as the last words of its name. Section 21 provides that every LLP shall ensure that its invoices, official correspondence and publications bear the following-

- The name, address of its registered office and registration number of the LLP; and
- A statement that is registered with LLP.

Any LLP which contravenes the provisions of Section 13 and 21 shall be punishable with fine which shall not be less than ₹2,000 but which may extend to ₹25,000.

Section 20 provides that if any person or persons carry on business under any name or title of which the words 'limited liability partnership' or 'LLP' or any contraction or imitation thereof is or are the last or words, that person of each of those persons shall, unless duly incorporated as LLP, be punishable with fine which shall not be less than ₹50,000 but which may extend to ₹5 lakhs.

Service of documents

Section 13(2) provides that a document may be served on a LLP or a partner or a designated partner by sending it by post under a certificate of posting or by registered post or electronic communication or courier at the registered office and any other address specifically by declared by the LLP for this purpose.

Rule 16 provides that a LLP shall give an address for service of documents within the jurisdiction of the Registrar where its registered office is situate. Such address shall include the PIN code and e-mail address. The LLP may, in addition to the registered office address, declare any other address as its address for service of documents as laid down in the LLP agreement. Where the agreement does not provide for such manner, consent of all partners shall be required for declaring any other address as the address for service of documents.

The intimation of other address for service of document shall be given to the Registrar in Form No. 12 within 30 days of complying with the requirements along with the fee. The effective date for service of documents to LLP at the addressed declared by LLP cannot be prior to the date of filing of the document.

Change of registered office

Section 13(3) provides that a LLP may change the place of its registered office and file the notice of such change with the Registrar by following the procedure as laid down in the LLP agreement. If there is no such agreement, consent of all partners shall be required for changing the place of registered office of a LLP to another place. If the change in place is from one State to another State, the LLP having secured creditors shall also obtain

the consent of such secured creditors.

The notice for change of registered office shall be given to Registrar in Form No. 15, within 30 days of complying with the requirements in case of change of registered office is within the same State and within 30 days of complying in the case of registered office from one State to another State, along with the fee.

If the change in place of registered office is from one State to another State, the LLP shall publish a general notice, not less than 21 days before filing any notice with Registrar, in a daily newspaper published in English and in the principal language of the District in which the registered office of the LLP is situated and circulating in that district giving notice of change of registered office.

If the change is within the State from the jurisdiction of one Registrar to the jurisdiction of another Registrar or from one State to another State the LLP shall file the notice in Form 15 with the Registrar from where the LLP proposes to shift its registered office with a copy thereof for the information to the Registrar under whose jurisdiction the registered office is proposed to be shifted.

Change of name

Rule 20 provides that any LLP may change its name by following the procedure as laid down in the LLP agreement. Where the LLP agreement does not provide such procedure, the consent of all partners shall be required for changing the name of LLP. Notice of change of name shall be given to the Registrar in Form No. 5 within 30 days of complying with the requirement along with the required fee. The Registrar, on being satisfied that the changed name is the one as reserved by him shall issue a fresh certificate of incorporation in the new name and the change name shall be effective from the date of such certificate.

Change of name by Central Government

Section 17 provides that where the Central is satisfied that a LLP has been registered, whether through inadvertence or otherwise and whether originally or by a change of name, under a name which is undesirable or is identical with or too nearly resembles the name of any other LLP or body corporate or other name as to be likely to be mistaken for it, the Central Government may direct such LLP to change its name. The LLP shall comply with the said direction of the Central Government within 3 months after the date of direction or such longer period as the Central Government may allow.

Any LLP which fails to comply with the above direction, shall be punishable with fine which shall not be less than ₹10,000 but which may extend to ₹5 lakhs and the designated partner of such LLP shall be punishable which shall not be less than ₹10,000 but which may extend to `1 lakh.

Partners and their relations

Chapter IV of the Act deals with the partners of LLP and the relations prevailing between them. The LLP is governed by the LLP agreement made between the partners. The persons who subscribed their names to the incorporation document shall be its partners on the incorporation of LLP. Any other person may become partner of LLP in accordance with the LLP agreement. The agreement is a vital document in LLP transactions.

An agreement made in writing before the incorporation of a LLP between the persons who subscribe their names to the incorporation document may impose obligations on the LLP. For this such agreement is to be ratified by all the partners after the incorporation of the LLP. The LLP shall file such information in Form 3 with the Registrar within 30 days of the ratification by all the partners along with the fee.

The mutual rights and duties of the partners of a LLP and the mutual rights and duties of a LLP and its partners shall be governed by the LLP agreement between the partners or between the LLP and its partners, save as otherwise provided by the Act.

Every LLP shall file information with regard to the LLP agreement in Form 3 with the Registrar within 30 days

of the date of incorporation along with the required fee. Any change is made in the LLP agreement the same shall be informed in Form 3 within 30 days of such change along with the fee.

In the absence of agreement as to any matter-

- the mutual rights and duties of the partners; and
- the mutual rights and duties of the LLP and the partners shall be determined by the provisions relating to the matter as set out in the First Schedule which is as follows:
- All the partners of a LLP are entitled to share equally in the capital, profits and losses of the LLP;
- The LLP shall indemnify each partner in respect of payments made and personal liabilities incurred by him-
  - in the ordinary and proper conduct of the business of the LLP; or
  - in or about anything necessarily done for the preservation of the business or property of the LLP;
- Every partner shall indemnify the LLP for any loss caused to it by his fraud in the conduct of the business of the LLP;
- Every partner may take in the management of the LLP;
- No partner shall be entitled to remuneration for acting in the business or management of the LLP;
- No person may be introduced as a partner without the consent of all existing partners;
- Any matter or issue relating to the LLP shall be decided by a resolution passed by a majority in number of the partners. Each partner shall have one vote. However no change may be made in the nature of the business of the LLP without consent of all the partners;
- Every LLP shall ensure that decisions taken by it are recorded in the minutes within 30 days of taking such decisions and are kept and maintained at the registered office of the LLP;
- Each partner shall render true accounts and full information of all things affecting the LLP to any partner or his legal representatives;
- If a partner carries on any business of the same nature as and competing with the LLP without the consent of the LLP, he must account for and pay over to the LLP all profits made by him in that business;
- Every partner shall account to the LLP for any benefit derived by him without the consent of the LLP from any transaction concerning the LLP or from any use by him of the property, name or any business connection of the LLP;
- No majority of the partners can expel any partner unless a power to do so has been conferred by express agreement between the partners;
- All disputes between the partners arising out of the LLP agreement which cannot be resolved in terms of such agreement shall be referred for arbitration as per the provisions of Arbitration and Conciliation Act, 1996.

Cessation of partnership interest

Section 24 provides the circumstances under which the interest of the partnership is ceased. The cessation of a partner of a LLP is in accordance with the agreement entered with the other partners. In the absence of such agreement a partner who intends to resign may give a notice in writing of not less than 30 days to the other partners.

A person shall cease to be a partner of a LLP on the following grounds-

- on his death or dissolution of the LLP; or
- if he is declared to be of unsound mind by a competent court; or
- if he has applied to be adjudged as an insolvent or declared as an insolvent;

Liability of the ceased partner

Section 24(3) provides that where a person has ceased to be a partner of LLP he is to be regarded as still being a partner of the LLP unless-

- the person has notice that the former partner has ceased to be a partner of the LLP;
- notice that the former partner has ceased to be a partner of the LLP has been delivered to the Registrar.

Section 24(4) provides that the cessation of a partner from the LLP does not by itself discharge the partner from any obligation to the LLP or to the other partners or to any other person which he incurred while he is a partner.

Entitlement to the ceased partner

Section 24(5) provides that where a partner of a LLP ceases to be a partner, unless provided in the agreement, he or a person entitled to his share in case of death or insolvency, shall be entitled to receive from the LLP the following-

- an amount equal to the capital contribution of the former partner actually made to the LLP; and
- his right to share in the accumulated profits of the LLP, after the deduction of accumulated losses of LLP, determined as at the date the former partner ceased to be a partner;

Restrictions on ceased partner

Section 24(6) provides that a former partner or a person who is entitled to receive the benefits of the LLP, shall not have any right to interfere in the management of the LLP.

Registration of changes in partners

Section 25 provides the procedure to be followed by the LLP and the partners in case there is a change in partners.

Section 25(1) provides that every partner shall inform the LLP of any change in his name or address within a period of 15 days of such change in Form No. 6. Section 25(5) provides that if any partner contravenes the same he shall be punishable with fine which shall not be less than ₹2,000 but which may extend to ₹25,000.

Section 25(2) provides that a LLP shall file a notice with the Registrar where a person becomes or ceases to be a partner in Form No. 4. Where there is any change in the name or address of a partner, the LLP shall file a notice with the Registrar within 30 days of such change in Form No. 4 along with the fee. The form shall be signed by the designated partner of LLP and authenticated in a manner as may be prescribed. If the change is related to an incoming partner, it shall contain a statement by such partner that he consents to becoming a partner, signed by him and authenticated in the manner as may be prescribed. Form 4 shall be accompanied by a certificate from a Chartered Accountant in practice or Cost Accountant in practice or a Company Secretary in practice that he has verified the particulars from the books and records of the LLP and found them to be true and correct.

Section 25(4) provides that the LLP fails to file notice in Form 4, the LLP and every designated partner of the LLP shall be punishable with fine which shall not be less than ₹2,000 but which may extend to ₹25,000.

Section 25(6) provides that a ceased partner of a LLP may himself file with the Registrar the notice if he has reasonable cause to believe that the LLP may not file the notice with the Registrar. In case of any such notice filed by a partner, the Registrar shall obtain a confirmation to this effect from the LLP unless the LLP has also

filed such notice. If no confirmation is given by the LLP within 15 days the Registrar shall register the notice made by the ceased partner.

Liability of LLP

Section 27, in Chapter V, provides the liabilities of the LLP. The LLP is liable if a partner of a LLP is liable to any person as a result of a wrongful act or omission on his part in the course of the business of LLP or with its authority. An obligation of the LLP whether arising in contract or otherwise, shall be solely the obligation of the LLP.

A LLP is not bound by anything done by a partner in dealing with a person if-

- the partner has no authority to act for the LLP in doing a particular act; and
- the person knows that he has no authority or does not know or believe him to be a partner of the LLP.

Section 29(2) provides that where any credit is received by the LLP as a result of the representation of a person to be a partner of LLP, shall also be liable to the extent of credit received by it or any financial benefit derived thereon.

The liabilities of the LLP shall be met out of the property of the LLP.

Partner as agent

Section 26 provides that every partner of a LLP is the agent of the LLP. He is not the agent of other partners.

Liability of partner

The liabilities of the partner are discussed in detail as below:

- Section 28 provides that a partner is not personally liable solely by reason of being a partner of LLP. But he will be personally liable for his own wrongful act or omission. But he shall not be personally liable for the wrongful act or omission of any other partner of the LLP;
- Section 29 provides that any person, who by words spoken or written or by conduct represents himself, or knowingly permits himself to be represented to be a partner in a LLP is liable to any person, who has on the faith of any such representation given credit to the LLP, whether the person representing himself or represented to be a partner does or does not know that the representatives has reached the person so giving credit.

Unlimited liability

Section 30 provides that any act with intent to defraud creditors of the LLP or any other person, the liability of LLP and partners shall be unlimited for all or any of the debts or other liabilities of the LLP. If such act is carried out by a partner, the LLP is liable to the same extent as the partner unless it is established by the LLP that such act was without the knowledge or the authority of the LLP.

Punishment

Section 30(2) provides that where any business is carried on with such intent to defraud the creditors of LLP, every person who was knowingly a party to the carrying on the business shall be punishable with imprisonment for a term which may extend to 2 years and with fine which shall not be less than ₹ 50,000 but which may extend to ₹ 5 lakhs.

In such cases the LLP or any partner or designated partner or employee shall be liable to pay compensation to any person who has suffered any loss or damage by reason of such conduct.

Section 31 provides for reduction of penalty awarded under Section 30(2). According to Section 31 the Court

or Tribunal may reduce or waive any penalty imposed on any partner or employee of a LLP, if it satisfied that-

- such partner or employee of a LLP has provided useful information during investigation of such LLP;or
- when any information given by any partner or employee leads to LLP or any partner or employee of such LLP being convicted under this Act or any other Act.

No partner or employee of any LLP may discharged, demoted, suspended, threatened, harassed or in any other manner discriminated against the terms and conditions of his LLP or employment merely because of his providing information or causing information to be provided by him.

Contributions

It is the obligation of a partner of LLP to make contribution as per the LLP agreement. A partner may contribute to the LLP-

- tangible or intangible property; or
- moveable or immovable property; or
- other benefit including money, promissory notes, other agreements to contribute cash or property and contracts for services performed or to be performed.

The money value of contribution of each partner shall be accounted for and disclosed in the accounts of the LLP. The same shall be valued by a practicing Chartered Accountant or practicing Cost Accountant or by approved valuer from the panel maintained by the Central Government.

Maintenance of books and accounts

Section 34 requires the LLP to maintain proper books of account relating to its affairs for each year and for filing of an annual Statement of Account and solvency with the Registrar. The accounts of LLP shall be audited. The Central Government is given power to exempt any class or classes of LLP from the requirements of this section.

Rule 24 provides that every LLP shall keep books of accounts which are sufficient to show and explain the LLP's transactions to-

- disclose with reasonable accuracy, at any time, the financial position of the LLP at that time; and
- enable the designated partners to ensure that any Statement of Account and Solvency prepared complies with the requirements of the Act;

Books of accounts

The books account shall contain-

- particulars of all sums of money received and expended by the LLP and the matters in respect of which the receipt and expenditure takes place;
- a record of the assets and liabilities of the LLP;
- statements of cost of goods purchased, inventories, work-in-progress, finished goods and cost of goods sold; and
- any other particulars which the partners may decide.

The books of account of a LLP are required to preserve for 8 years from the date on which they are made.

Statement of Account and Solvency

Every LLP shall file a Statement of Account and Solvency in Form No. 8 with the Registrar, within a period of

30 days from the end of six months of the financial year to which the Statement of Account and Solvency relates, along with the prescribed fee. If a LLP has closed the financial year on 31.03.2011, it shall file the Statement of Account and Solvency in Form No.8 with the Registrar within a period of 60 days from the date of end of 6 months of the financial year to which the Statement of Account and Solvency relates.

The Statement of Account and Solvency of an LLP shall be signed on behalf of the LLP by its designated partners. Each designated partner shall be taken to be a party to its approval unless he shows that he took all reasonable steps to prevent their being approved and signed.

Audit of accounts

Rule 24(8) provides that the accounts of every LLP shall be audited. If the turnover of a LLP does not exceed, in any particular year ₹40 lakhs, or whose contribution does not exceed ₹25 lakhs shall not be required to get its accounts audited. But if the partners of such LLP wants to get the accounts audited the same shall be audited in accordance with the rules. If they decide not to audit, then the Statement of Account and Solvency shall include a statement by the partners to the effect that the partners acknowledge their responsibilities for complying with the requirements of the Act and the Rules with respect to preparation of books of account and a certificate in the Form No.8.

Appointment of auditor

A Chartered Accountant in practice is qualified for appointment as an auditor. The auditor(s) shall be appointed for each financial year of the LLP for auditing its accounts. The designated partners may appoint an auditor(s)-

- at any time for the first financial year but before the end of the first financial year;
- at least 30 days prior to the end of each financial year (other than the first financial year);
- to fill a casual vacancy in the office of auditor, including in the case when the turnover or contribution of LLP exceeds the limits; or
- to fill up the vacancy caused by removal of an auditor.

If the designated partners have failed to appoint auditor(s), the partners may appoint an auditor or auditors. An auditor appointed shall hold office in accordance with the terms of his or their appointment and shall continue to hold such office till the period-

- the new auditors are appointed; or
- they are re-appointed.

Rule 24 (14) provides that where no auditor has been appointed, any auditor in office shall be deemed to be re-appointed unless-

- the LLP agreement requires actual reappointment; or
- the majority of partners have determined that he should be reappointed and have given a notice to this effect to the LLP.

A notice may be in hard copy or electronic form and must be authenticated by the person or persons giving it.

The above shall be applicable to removal and resignation of auditors.

The remuneration of an auditor may be fixed by the designated partners or in accordance with the procedure laid down in the LLP agreement.

Removal of auditor

Rule 24(18) provides that the partners of a LLP may remove an auditor from office at any time by following the

procedure as laid down in the LLP agreement. If the agreement does not provide for the removal of an auditor, consent of all partners shall be required for removal of the auditor from his office.

Resignation of auditor

Rule 24(19) provides that an auditor of an LLP may resign his office by depositing a notice in writing to that effect at the LLP's registered office. If an auditor is not willing to be re-appointed he shall give a notice in writing to the LLP not less than 14 days before the end of the time allowed for appointing the new auditor. The notice is not effective unless it is accompanied by the statement of the circumstances connected with his ceasing to hold office. The auditor's term comes to an end as on the date on which the notice is deposited or on such later date as may be specified in the notice.

Annual return

Section 35 seeks that every LLP shall be required to file with the Registrar an Annual Return duly authenticated every year in Form No. 11 along with the fees. The annual return of an LLP having turnover up to ₹5 crore during the corresponding financial year or contribution up to ₹50 lakhs shall be accompanied with a certificate from a designated partner, other the signatory to the annual return, to the effect that the annual return contains true and correct information. In all other cases, the annual return shall be accompanied with a certificate from a Company Secretary in practice to the effect that he has verified the particulars from the books and records of the LLP and found them to be true and correct.

The Central Government is given power to prescribe, by rules, the contents and manner for filing of such return. If any LLP fails to comply with the filing of Annual Return shall be punishable with fine which shall not be less than ₹10,000 but which may extend to ₹1 lakh.

Inspection of documents

Section 36 provides that the following documents of LLP shall be available with the Registrar for inspection by any person on payment of fee-

- incorporation document;
- names of partners and changes, if any made therein;
- statement of account and solvency; and
- annual return.

Penalty for false statement

Section 37 provides that if in any return, statement or other document required by or for the purposes of any of the provisions of this Act, any person makes a statement-

- which is false in any material particular, knowing it to be false; or
- which omits any material fact knowing it to be material, he shall, save as otherwise expressly provided in the Act, be punishable with imprisonment for a term which may extend to 2 years, and shall also be liable to fine which may extend to ₹5 lakhs but which shall not be less than ₹1 lakh.

Powers of Registrar

Section 38 gives powers to Registrar, to obtain such information, may require any person including any present or former partner or designated partner or employee of a LLP to answer any question or make any declaration or supply any details or particulars in writing to him within a reasonable period. If any person does not answer such question or make such declaration or supply such details or particulars within a reasonable time or time given by the Registrar or when the Registrar is not satisfied with the reply or declaration or details or particulars

provided by such person, the Registrar shall have power to summon that person to appear before him or an inspection or any other public officer whom the Registrar may designate, to answer any such question or make such declaration or supply such details, as the case may be.

Any person who, without lawful excuse, fails to comply with any summons or requisitions of the Registrar shall be punishable with fine which shall not be less than ₹200 but which may extend to ₹25,000.

Compounding of offences

Section 39 provides that the Central Government may compound any offence under this Act which is punishable with fine only, by collecting from a person reasonably suspected of having committed the offence, a sum which may extend to the amount of the maximum fine prescribed for the offence.

Preservation of records

The following records are to be preserved permanently:

a) incorporation document;

b) notice of situation of registered office;

c) information with regard to LLP agreement or any change made therein;

d) notice of other address of any LLP partnership at which documents to be served.

The following documents are to be preserved for 21 years-

- all papers, registers, refund orders and correspondence relating to the LLP liquidation accounts; The following documents are to be preserved for 5 years-
- copies of Government orders relating to LLP;
- registered documents of LLP which have been fully wound up and finally dissolved together with
- the correspondence relating to such LLP;
- papers relating to legal proceedings from the date of disposal of the case and appeal; if any;
- copies of statistical returns furnished to Government;
- all correspondences including correspondences relating to scrutiny of accounts, annual returns, prosecutions, reports to the Central Government and the Tribunal and the correspondences relating to complaints;
- Statement of compliance with the requirements of the Act by an Advocate or Company Secretary or Chartered Accountant or Cost Accountant in while time practice and by any person who subscribed his name to the incorporation document;'
- Notice of a person ceasing to be a partner and any change in the name or address of a partner;
- Registered documents relating to LLP struck off under Section 75 together with correspondence or copy of the order of restoration of the LLP into the register;
- Annual Return of a LLP;
- Consent of candidate to act as designated partner to be filed with the Registrar;
- Consent to act as a partner;
- Statement by all the partners of firm containing particulars of firm along with application for its conversion into LLP;
- Statement by all shareholders containing particulars of private company/unlisted company along with the

application for its conversion into LLP;

- Certified copy of the order(s) of the Tribunal under Section 60/61/62;
- Copy of the order of dissolution of LLP by Tribunal;
- Statement of Account and Solvency;

In case of prosecution matter, the date is to be recorded from the date of disposal of the case appeal, if any.

The following records to be preserved for three years-

- All books, records and papers, other than those specified above;
- Routine correspondence regarding payment of fees, additional filing fees and correspondences about the return of documents.

Destruction of old records

Rule 27 provides that subject to previous orders of the Registrar, the records in the office of the Registrar may be destroyed after the expiry of the period of their preservation as discussed above. The Registrar shall maintain a Register of destroyed documents in two parts wherein he shall center brief particulars of the records destroyed and shall certify therein the date and mode of destructions.

6.1.4 Conversion to LLP

Chapter X of the Act deals with the conversion to LLP from other r types of business types. The Act allows the following conversion-

- Conversion from firm into LLP;
- Conversion from private company into LLP;
- Conversion from unlisted company into LLP.

The second schedule deals with the procedure of conversion of firm into LLP. The third schedule deals with the procedure of conversion from private company into LLP. The fourth schedule deals with the procedure of conversion from unlisted public company into LLP.

6.1.4.1 Conversion of firm into LLP

Para 1(a) of the second schedule defines the term 'firm' as a firm as defined in Section 4 of the Indian Partnership Act, 1932. Para 1(b) defines the term 'convert' in relation to a firm converting into a LLP as a transfer of the property, assets, interests, rights, privileges, liabilities, obligations and the undertaking of the firm to LLP.

A firm may convert into a LLP on the condition that the partners of the firm shall be bound by the provisions of the second schedule that are applicable to them. A firm may apply to convert into a LLP if and only if the partners of the LLP into which the firm is to be converted, comprise, all the partners of the firm. Except the partners in the partnership no other person will be allowed to be a partner in LLP after its conversion.

A firm may apply to the Registrar by filing-

- A statement by all of its partners in Form No. 17 and accompanied by fee containing the following particulars-
- the name and registration number, if applicable, of the firm; and
- the date on which the firm was registered under the Indian Partnership Act, 1932 or under any other law, if applicable; and
- Incorporation document and statement.

On receipt of the above said documents, the Registrar shall register the documents and issue a certificate of registration in Form No. 19 as the Registrar may determine stating that the LLP is, on and from the date specified in the certificate, registered under the Act. The Registrar may require the documents to be verified in such manner, as he considers fit. The LLP shall within 15 days of the date of the registration, inform the concerned Registrar of Firms with which it was registered under the provisions of Indian Partnership Act about the conversion and the particulars of the LLP.

The Registrar may refuse registration if he is not satisfied with the particulars or other information furnished. In such cases appeal may be filed before the Tribunal.

6.1.4.2 Conversion from private limited company into LLP

Para 1(b) of the third schedule defines the term 'convert' in relation to a private company converting into a LLP, as a transfer of the property, assets, interests, rights, privileges, liabilities, obligations and the undertaking of the private company to the LLP in accordance with the third schedule.

A company may apply to convert itself into a LLP if and only if-

- there is no security interest in its assets subsisting or in force at the time of application; and
- the partners of the LLP to which it converts comprise all the shareholders of the company and no one else.

Upon the conversion of a private company into an LLP, the company and its shareholders, the LLP and the partners of the LLP shall be bound by the provisions of this schedule that are applicable to them.

The company has to apply with the Registrar by filing the following documents:

- A statement by all its shareholders in Form No. 18 and fees containing the following particulars-
  - The name and registration number of the company;
  - The date on which the company was incorporated; and
- Incorporation document and statement;

On the receipt of the above said documents, the Registrar shall register the documents subject to the provisions of the Act and the rules made there under. The Registrar may require the documents to be verified as he considers fit. The Registrar shall issue a certificate of registration in Form No. 19 as the Registrar may determine stating that the LLP is, on and from the date specified in the certificate.

The LLP shall inform the concerned Registrar of Companies within 15 days of the date of registration about the conversion and of the particulars of LLP in Form along with the fees.

If the Registrar is not satisfied with the particulars or other information furnished the Registrar may refused to register. Against this order appeal may be made before the Tribunal.

6.1.4.3 Conversion from unlisted public company into LLP

Para 1(b) of the fourth schedule defines the term 'convert' in relation to a company converting into a LLP, as a transfer of the property, assets, interests, rights, privileges, liabilities, obligations and the undertaking of the company to the LLP in accordance with the provisions of the schedule.

Para 1(c) defines the term 'listed company' as defined in SEBI (Disclosure and Investor Protection) Guidelines, 2000 issued by SEBI under Section 11 of the SEBI Act, 1992 which defines as a company which has any of its securities offered through an offer document listed on a recognized stock exchange and also includes Public Sector Undertakings whose securities are listed on a recognized stock exchange.

Para 1(d) defines the term 'unlisted company' as a company which is not a listed company.

A company may apply to convert into a LLP if and only if-

- there is no security interest in its assets subsisting or in force at the time of application; and
- the partners of the LLP to which it converts comprise all the shareholders of the company and no one else.

A company is also to file the following documents-

- A statement by all its shareholders in Form No.18 along with fee containing the following particulars-
  - the name and registration number of the company;
  - the date of which the company was incorporated; and
- Incorporation document and statement;

On receipt of the above statements the Registrar shall register the documents, subject to the provisions of the Act and the rules made there under. The Registrar may require the documents to be verified as he considers fit. The Registrar shall issue a certificate of registration in Form No. 19 as the Registrar may determine stating that the LLP is, on and from the date specified in the certificate, registered under the Act.

The LLP shall inform the concerned Registrar of Companies within 15 days of the date of registration about the conversion and the particulars of the LLP in Form

The Registrar, if is he is not satisfied with the particulars or other information furnished, may refuse to register. Against this order an appeal may be filed before the Tribunal.

6.1.4.4 Effect of registration

On registration of conversion from a partnership firm into a LLP, a private company into a LLP and an unlisted public company into a LLP the following will be the effects-

- There shall be a LLP by the name specified in the certificate of registration registered under this Act;
- All tangible and intangible property vested in the company, all assets, interests, rights, privileges, liabilities, obligations relating to the company and the whole of the undertaking of the company shall be transferred to and shall vest in the LLP without further assurance, act or deed; and
- The partnership firm/private limited company/unlisted public company shall be deemed to be dissolved and removed from the records of the Registrar of firms/Registrar of Companies.

Registration in relation to property

If any property is registered with any authority, the LLP shall, as soon as practicable, after the date of registration, take all necessary steps as required by the relevant authority to notify the authority of the conversion and of the particulars of the LLP in such form and manner as the authority may determine.

Pending proceedings

All proceedings by or against the partnership firm/company which was pending before any Court or Tribunal or before an authority on the date of registration may be continued, completed and enforced by or against the LLP.

Continuance of conviction, ruling, order of judgment

Any conviction, ruling, order or judgment of any Court, Tribunal or other authority in favor of or against the firm/company may be enforced by or against the LLP.

Existing agreements

Every agreement to which the firm/company was a party immediately before the date of registration, whether

or not of such nature that the rights and the liabilities could be assigned shall have the effect as from that date as if-

- the LLP were a party to such an agreement instead of the company; and
- for any reference to the firm/company, there were substituted in respect of anything to be done on or after the date of registration a reference to the LLP.

Existing contracts

All deeds, contracts, schemes, bonds, agreements, applications, instruments and arrangements subsisting immediately before the date of registration relating to the company or to which the company is a party shall continue in force on and after that date as if they relate to the LLP and shall be enforceable by or against the LLP as if the LLP were named therein or were a party thereto instead of the firm/company.

Continuance of employment

Every contract of employment shall continue in force on or after the date of registration as if the LLP were the employer there under instead of the firm/company.

Existing appointment, authority or power

Every appointment of the company in role or capacity which is in force immediately before the date of registration shall take effect and operate from that date as if the LLP were appointed. Any authority or power conferred on the company which is in force immediately before the date of registration shall take effect and operate from that date as if it were conferred on the LLP

The above shall apply to any approval, permit or license issued to the company under any other Act which is in force immediately before the date of registration of the LLP, subject to the provisions of such other Act under which such approval, permit or license has been issued.

Notice of conversion in correspondence

The LLP shall ensure that for a period of 12 months commencing not later than 14 days after the date of registration, every official correspondence of the LLP bears the following-

- A statement that it was, as from the date of registration, converted from a company into a LLP; and
- The name and registration number of the company from which it was converted.

Any LLP which contravenes the above shall be punishable with fine which shall not be less than ₹10,000 but which may extend to ₹1 lakh and with a further fine which shall not be less than ₹50 but which may extend to ₹500 for every day after the first day after which the default continues.

6.1.5 Foreign LLP

Chapter XI deals with foreign LLP. The term 'foreign LLP' is defined under Section 2(m) of the Act as a LLP formed, incorporated or registered outside India which establishes a place of business within India.

Rule 34(1) provides that a foreign LLP shall file with the Registrar in Form No. 27 within 30 days of establishing a place of business in India-

- a copy of the certificate of incorporation or registration and other instrument(s) constituting or defining the constitution of the LLP;
- the full address of the registered or principal office of the LLP in the country of its incorporation;
- the full address of the LLP in India which is to be deemed as its principal place of business in India; and
- list of partners and designated partners, if any, and the names and addresses of two or more persons resident

in India, authorized to accept on behalf of the LLP, service of process and any notices or other documents required to be served on the LLP.

Rule 34(2)(i) provides that if the LLP is incorporated in any country which is a part of the commonwealth, the copies of the documents mentioned in Section 34(1) shall be certified as true copies-

- by an official of the Government to whose custody the original is committed; or
- by a Notary (Public) in that Part of the Commonwealth; or
- by an officer of the LLP, on oath before a person having authority to administer an oath in that part of the Commonwealth.

Rule 34(2)(ii) provides that if the LLP is incorporated in a country falls outside the Commonwealth but is a party to The Hague Apostille Convention, 1961-

- the copies of the document mentioned in Section 34(1) shall be certified by an official of the Government to whose custody the original is committed and be duly apostilled in accordance with the Hague Convention;
- a list of partners and designated partners of the LLP, if any, the name and address of persons resident in India, authorized to accept notice on behalf of the LLP shall be duly notarized and be apostilled in the country of their own in accordance with Hague Convention.

Rule 34(2)(iii) provides that if the LLP is incorporated in a country outside the Commonwealth and is not a party to the Hague Convention, the copy of the incorporation document shall be certified-

- by an official of the Government to whose custody the original is committed; or
- a Notary (Public) of such country; or
- by an officer of the LLP.

Rule 34(2) (iv) provides that the signature or seal of the official or the certificate of Notary shall be authenticated by a Diplomatic or Consular Officer empowered in this behalf under Section 3 of the Diplomatic and Consular Officers (Oaths and Fees) Act, 1948 or where there is no such officer, by any of the officials mentioned in Section 6 of the Commissioners of Oaths Act, 1889 or in any Act amending the same.

Rule 34(2)(v) provides that the certificate of the officer shall be signed before a person having authority to administer an oath provided under Section 3 of the Diplomatic and Consular Officers (Oaths and Fees) Act, 1948 or as the case may be, by Section 3 of the Commissioners of Oaths Act, 1889 the status of the person administering the oath in the latter case being authenticated by any official specified in Section 6 of the Commissioners of Oaths Act, 1889 or in any Act amending the same.

Alteration

Rule 34(3) provides that if any alteration is made or occurs in-

- the instrument constituting or defining the constitution of a LLP incorporated or registered outside India;
- the registered or principal office of a LLP incorporated or registered outside India; or
- the partner or designated partner, if any, of a LLP incorporated or registered outside India

the foreign LLP shall file in Form No. 28 such alterations with the Registrar within 60 days of the close of the financial year.

If any alteration is made or occurs in-

- the certificate of incorporation or registration of LLP incorporated or registered outside India;

- the name or address of any of the persons authorized to accept service on behalf of a foreign LLP in India; or
- the principal place of business of foreign LLP in India, the foreign LLP shall file in Form 29 such alterations with the Registrar within 30 days from the date on which the alteration was made or occurred.

Translated document

Rule 34(5) provides if any document mentioned above is not in the English language, there shall be annexed to it a certified translation thereof. Where the translation is made outside India, it shall be authenticated. If such translation is made within India, it shall be authenticated-

- by an Advocate, Chartered Accountant, Company Secretary or Cost Accountant; or
- by an affidavit of a person who, in the opinion of the Registrar has adequate knowledge of the language of the original and of English.

Filing with Registrar

Rule 34(4) provides that every foreign LLP shall file with the Registrar the Statement of Account and Solvency in Form 8 duly signed by the authorized representatives within a period of 30 days from the end of six months of the financial year.

Rule 34(5)(ii) provides that the translation of documents into English are required to be filed with the Registrar or shall be certified to be correct.

Name to be made known

Rule 34(6) provides that every foreign LLP shall cause the name of the foreign LLP and of the country in which the LLP is incorporated, to be stated in the legible English characters in all invoices, official correspondence and publications of the LLP.

Service of document

Rule 34(7) provides that where any foreign LLP makes default in delivering to the Registrar the name and addresses of persons resident in India who are authorized to accept on behalf of the LLP service of process, notices or other documents; or if at any time all the persons whose names and addresses have been so delivered are dead or have ceased so to reside, or refuse to accept service on behalf of the LLP or for any reason, cannot be served, a document may be served on the LLP by leaving it at or sending it by post to, any place of business established by the LLP in India.

Registration

Rule 34(10) provides that the Registrar shall, on registration of Form 27, issue a certificate for establishment of place of business in India by the foreign LLP in Form No. 30.

Cessation

Rule 34(8) provides that if any foreign LLP ceases to have a place of business in India, it shall give notice to the Registrar in Form 29 within 30 days of its intention to close the place of business and as from the date on which notice is so given, the obligation of the LLP to file any document to the Registrar shall cease, provided it has no other place of business in India and it has filed all the documents due for filing as on the date of the notice.

6.1.6 Compromise or arrangement

Section 60(1) provides that a compromise or arrangement may be proposed-

- between a LLP and its creditors; or

- between a LLP and its partners.

The following may apply before the Tribunal for compromise, rearrangement-

- the LLP; or
- any creditor of the LLP; or
- any partner of the LLP; or
- in the case of a LLP which is being wound up, of the liquidator.

The application shall be supported by an affidavit. A copy of the proposed compromise or arrangement shall be annexed to the affidavit in Form 20.

Where the LLP is not the applicant a copy of the summons and of the affidavit shall be served on the LLP or where the LLP is being wound up it shall be served on liquidator. This shall be served not less than 14 days before the date fixed for the hearing of the summons. The summons shall be in Form 21.

Upon the hearing of the summons or any adjourned hearing, the Tribunal shall give such directions as it may think necessary in respect of the following matters-

- determining the creditors and/or of partners whose meeting is have to be held for considering the proposed compromise or arrangement;fixing the time and place of meeting;
- appointing a Chairman for the meeting to be held;
- fixing the quorum and the procedure to be followed at the meeting including voting by proxy;
- determining the values of the creditors and/or of the partners, whose meetings have to be held;
- notice to be given of the meeting and the advertisement, if any of such notice;
- the time within which the Chairman of the meeting is to report to the Tribunal the result of the meeting; and
- such other matters as the Tribunal may deem necessary.

6.1.7 Procedure of meeting of creditors/partners

- The notice of the meeting is to be given to the creditors and/or partners individually by the Chairman or by the LLP, if the Tribunal or any other person as the Tribunal may direct;
- The notice shall be sent by post under certificate of posting to their last known address not less than 21 clear days before the date fixed for the meeting;
- The notice shall be accompanied by a copy of the proposed compromise or arrangement along with statement material interest of the designated partners, if any, and a form of proxy in Form No. 26;
- The notice of the meeting shall be advertised, if so decided by the Tribunal, in such newspapers and in such manner as the Tribunal may direct;
- Every creditor or partner entitled to attend the meeting shall be furnished by the LLP, free of charge, within 48 hours of a requisition made for the same, with a copy of the proposed compromise or arrangement;
- The Chairman shall file an affidavit not less than 7 days before the date fixed for the holding of the meeting showing that the directions regarding the issue of notices and the advertisement have been duly complied with;
- In default the summons shall be posted before the Tribunal for such orders as the Tribunal may think fit to make.

- The proxy shall be signed by the person entitled to attend and vote at the meeting shall be filed with the LLP at its registered office not later than 48 hours before the meeting;
- A body corporate may authorize any person to act as its representative at the meeting. A copy of authorization of such person to act as its representative at the meeting and certified to be a true copy by a designated partner or other authorized officer of such body corporate shall be lodged with LLP at its registered office not later than 48 hours before the meeting;
- The Chairman of the meeting shall, within the time fixed by the Tribunal or where no time has been fixed, within 7 days after the conclusion of the meeting, report the result of the meeting to the Tribunal;
- The report shall state accurately the number of creditors or the partners, who were present and who voted at the meeting either in person or by proxy, their individual values and the way they voted;
- Where the proposed compromise or arrangement is agreed to with or without modification by the creditors/partners three fourth of its value, the LLP or liquidator shall present a petition to the Tribunal for confirmation of the compromise or arrangement within 7 days of the filing of the report by the Chairman to the Tribunal;
- Where a compromise or arrangement is proposed for the purposes a scheme for reconstruction of any LLP or the amalgamation of any two or more LLP, the petitioner shall pray for appropriate orders and directions of the Tribunal;
- If the LLP fails to present the petition for confirmation of the compromise or arrangement, it shall be open to any creditor or partner, with the leave of the Tribunal to present the petition for confirmation and LLP shall be liable for the costs thereof;
- Where no petition for confirmation is presented to or where the compromise or arrangement has not been approved by the requisite majority the report of the Chairman shall be placed for consideration before the Tribunal for such orders as may be necessary;
- If the Tribunal is satisfied that the LLP or any other person by whom an application has been made, has disclosed to the Tribunal, by affidavit or otherwise, all material facts relating to the LLP including its latest financial position and the pendency of any investigation proceedings in relation to the LLP the Tribunal may sanction the scheme;
- The order of the Tribunal is binding on all the creditors or of all the partners and also on LLP; or in the case of LLP which is being wound up, binding on the liquidator and contributories of the LLP;
- An order may be the Tribunal shall be filed by the LLP with the Registrar within 30 days of making such an order in Form 22 along with the fee. In computing the period of 30 days from the date of order the requisite time for obtaining a certified copy of the order shall be excluded;
- An order shall have effect only after it is filed with the Registrar.;
- The Tribunal may, at any time after an application has been made stay the commencement or continuation of any suit or proceeding against the LLP on such terms as the Tribunal thinks fit until the application is disposed of;

6.1.8 Penalty

Section 60(4) provides that if default is made in complying with filing of order of Tribunal with Registrar, the LLP and every designated partner shall be punishable with fine which may extend to ₹1 lakh.

Power of the Tribunal

Section 61 provides that where the Tribunal makes an order sanctioning a scheme or an arrangement in respect of a LLP it shall have power to supervise the carrying out the compromise or an arrangement and may, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement, as it may consider necessary, for the proper working of the compromise or arrangement. If the Tribunal is satisfied that a compromise or arrangement sanctioned cannot be worked satisfactorily, it may make an order for winding up of the LLP.

6.1.9 Reconstruction or amalgamation

Rule 12(i) provides that an arrangement for revival and rehabilitation of any LLP may be proposed –

- Where on a demand by the creditors of the LLP representing 50% or more of its outstanding amount of debt, the LLP has failed to pay the debt, within 30 days of the service of the notice of demand or to secure or compound it to the reasonable satisfaction of the creditors; or
- Where a petition for winding up of a LLP is pending before the Tribunal, in terms of the directions given by the Tribunal on the winding up petition; or
- Where the liquidator has failed his report before the Tribunal, in terms of directions given by the Tribunal on the report of the liquidator.

The LLP or any creditor or partner of the LLP, or in the case of LLP which is being wound up, the Liquidator may make application for sanction of the arrangement for revival and rehabilitation before the Tribunal.

Application before Tribunal

Rule 35 (13) provides that an application shall be accompanied by-

- Statement of account and solvency of LLP for the immediately preceding financial year;
- Particulars and documents relevant to the scheme, proposed restructuring or rescheduling of the debts or any undertaking or undertaking, in case from bank or financial institution through a letter or any other case through an affidavit of concerned party or parties or in any other form as may be directed by the Tribunal;
- Proposed scheme of revival and rehabilitation of the LLP including proposal for appointment of an LLP Administrator.

The application is to be made to the Tribunal within 90 days from the date of expiry of demand notice or from the date of direction of the Tribunal. The Tribunal may hear all the parties concerned within 60 days of receipt of application. The Tribunal may admit or dismiss the application. If the Tribunal admits the application, it may make provisions for all or any of the following matters-

- Holding of meetings of the creditors for approval of scheme proposed for revival and rehabilitation of LLP;
- Procedure to be followed by the LLP Administrator proposed in the scheme in connection with holding of the meeting including the appointment of Chairman for such meeting;
- Any other direction as may be considered necessary.

LLP Administrator

Rule 35(17) provides that the LLP Administrator shall be appointed from a panel maintained by the Central Government for winding up and dissolution of LLPs. The terms and conditions of the appointment including the fee of LLP Administrator shall be such as may be ordered by the Tribunal. The Tribunal may, on a reasonable cause being shown and for reasons to be recorded in writing, remove the LLP Administrator and may appoint another LLP Administrator. In case of removal, death or incapacity of the LLP Administrator, the Tribunal may

appoint another LLP Administrator.

Report of LLP Administrator

The LLP Administrator shall submit his preliminary report including the decision of the meeting to the Tribunal within 60 days of order by the Tribunal. On consideration of his report and other materials available, if the Tribunal is satisfied that the creditors representing three fourths in value of the amount outstanding against that LLP have, with or without modification of the scheme, resolved that it is not possible to revive and rehabilitate the LLP, the Tribunal may, within 60 days of the receipt of such report, order-

- that the proceedings for the winding up of the LLP be initiated; or
- the LLP be wound up, or the liquidator to continue; or
- sanction for arrangement for revival and rehabilitation of LLP as approved by such creditors with such modifications considered necessary by the Tribunal and make orders for continuation of the LLP Administrator or appointment of a new LLP Administrator.

The Tribunal may consider for its approval including the appointment of any other LLP Administrator if the arrangement is approved by three fourth majorities, in value of creditors.

Order of Tribunal

The order of sanction of the arrangement by the Tribunal may make provisions for all or any of the following-

- powers and functions of the LLP Administrator;
- the time period within which various actions proposed in the arrangement to be completed;
- any such direction to the LLP or its officers or to the creditors, or to the LLP Administrator or to any other person, as may be considered necessary, for the purpose of implementation of the arrangement of revival and rehabilitation; and
- any other order or orders as may be considered necessary.

The LLP Administrator shall complete all the actions relating to the implementation of the scheme and submit his final report before the Tribunal within such time directed by the Tribuna but not exceeding

180 days of the order. The LLP Administrator shall, within 30 days of the making or order or orders cause certified copy to be filed with the Registrar concerned in Form 22 along with the fee.

Section 62 provides that where an application is made to the Tribunal for sanctioning of a compromise or arrangement which relates to reconstruction of LLP or the amalgamation of two or more LLPs and under a scheme the whole or any part of the undertaking, property or liabilities of any LLP in the scheme is to be transferred to another LLP, the Tribunal may, either by the order sanctioning the compromise or arrangement or by a subsequent order, make provisions for matters like transfer to the transferee LLP of the whole or any part of the undertaking, property or liabilities of any transferor LLP, the continuation by or against the transferee LLP of any legal proceedings pending by or against any transferor LLP. The dissolution without winding of any transferor LLP, the provisions to be made for any person who, within such time and in such manner as the Tribunal directs, dissent from the compromise or arrangement and such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out. It also provides that if default is made in complying with provisions relating to filing of such order of Tribunal with the Registrar, the LLP and every designated partner of the LLP shall be punishable with fine which may extend to ₹50,000.

Enforcement of duty to make returns etc.

Section 41 provides that in case any LLP is in default in complying with the provisions relating to filing with the Registrar of any return, account or other document or giving of any notice to him, the Registrar may make an application before the Tribunal for making an order for directions in order to make good the default within a time frame.

Assignment and transfer of partnership rights

Section 42 provides that the rights of a partner to a share of the profits and losses of the LLP and to receive distributions shall be transferable in accordance with the LLP agreement. Such transfer shall not by itself cause the disassociation of the partner or a dissolution and winding up of the LLP. Such transfer would not entitle the transferee to participate in the management of LLP.

Investigation

Chapter IX of the Act deals with the investigation procedure against LLPs. The Central Government is to appoint inspectors to cause investigations against the LLPs. The investigation is of two types – one is on the order of Court or Tribunal and the other is by the Central Government itself.

Investigation on orders of Court or Tribunal

Section 43(1) provides that the Central Government shall appoint one or more Inspectors to investigate the affairs of a LLP if-

- the Tribunal, either *suo motu* or on an application received from not less than one fifth of the total number of partners of LLP, by order, declares that the affairs of the LLP ought to be investigated; or
- any Court, by order, declares that the affairs of a LLP ought to be investigated.

Investigation by Central Government

Section 43(2) provides that the Central Government may appoint one or more Inspectors to investigate the affairs of a LLP and to report on them in such manner as it may direct. Such appointment may be made-

- if not less than one fifth of the total number of partners of LLP make an application with supporting evidence and security amount as may be prescribed; or
- if the LLP makes an application that the affairs of the LLP ought to be investigated; or
- if, in the opinion of the Central Government, there are circumstances suggesting-
  - that the business of the LLP is being or has been conducted-
    - with an intent to defraud its creditors, partners or any other person; or
    - for a fraudulent purpose; or
    - unlawful purpose; or
    - in a manner oppressive; or
    - unfairly prejudicial to some or any of its partners; or
    - the LLP was formed for any fraudulent or unlawful purpose; or
- that the affairs of the LLP are not being conducted in accordance with the provisions of this Act; or
- that, on receipt of a report of the Registrar or any other investigating or regulatory agency, there are sufficient reasons that the affairs of the LLP ought to be investigated.

Inspectors and their powers

No firm, body corporate or other association shall be appointed as an Inspector. The Inspector shall have the power to carry out investigation into the affairs of related entities and shall report on the affairs of the other entity or partner or designated partner, so far as he thinks that the results of his investigation are relevant to the investigation of the affairs of the LLP. For that the Inspector has to get the prior approval of the Central Government. Before according approval the Central Government shall give the entity or partner or designated partner a reasonable opportunity to show cause why such approval should not be accorded.

The Inspector may require any entity to furnish such information to, or produce such books and papers before him or any person authorized by him in this behalf, if the production of such books and papers is relevant or necessary for the purposes of his investigation.

An Inspector may examine on oath-

- any of the entity, partner, designated partner etc.;
- the affairs of the LLP or any other entity; and
- may administer an oath accordingly and for that purpose he may require any of the persons to appear before him personally.

In the course of investigation, if the Inspector has reasonable ground to believe that the books and papers of or relating to the LLP or other entity or partner or designated partner of such LLP may be destroyed, mutilated, altered, falsified or secreted, the Inspector may make an application to the Judicial Magistrate for an order for the seizure of such books and papers. The Magistrate may, by order, authorize the Inspector-

- to enter, with such assistance, the place or places where such books and papers are kept;
- to search that place or those places in the manner specified in the order; and
- to seize books and papers which the Inspector considers it necessary for the purposes of his investigation.

Inspector's report

Section 49 provides that the Inspectors shall make interim reports to the government and on the conclusion of the investigation shall make a final report to the Central Government in the mode as directed by the Government. The Central Government shall forward a copy of any report to the LLP and to any person at their request.

Prosecution

Section 50 provides that the Central Government based on the report of the Inspection if it appears to it that any person in relation to the LLP or in relation to any other entity has been guilty of any offence for which he is liable, the Central Government may prosecute such person for the offence. It shall be the duty of all partners, designated partners and other employees and agents of the LLP or other entity to give the Central Government all assistance in connection with the prosecution which they are reasonable able to give.

Section 51 provides that if it appears to the Central Government from the report made by an Inspector that it is expedient to do so by reason that the business of the LLP is being conducted with an intent to defraud its creditors, partners or any other person, or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive or unfairly prejudicial to some or any of its partners, or that the LLP are not being conducted in accordance with the provisions of the Act may take action for the winding up of the LLP.

Recovery of damages

Section 51 provides that the Central Government may bring an action against the LLP for the recovery of-

- damages in respect of any fraud, misfeasance or other misconduct in connection with the promotion or formation or the management of the affairs; or
- any property of such LLP which has been misapplied or wrongfully retained.

Expenses of investigation

Section 52 provides that the expenses of and incidental to an investigation by an Inspector appointed by the Central Government shall be defrayed by the Central Government in the first instance and reimbursed from the concerned LLP or entity. Any amount for which a LLP or other entity is liable, shall be a first charge on the sums or property recovered by such LLP or other entity during investigation. The amount to be recoverable from LLP and other persons may be recovered as arrears of land revenue

Inspector's report to be evidence

Section 54 provides that a copy of any report of any Inspector or Inspectors appointed shall be admissible in any legal proceeding as evidence in relation to any matter contained in the report.

Striking off name of defunct LLP

Rule 37 provides that where a LLP is not carrying on any business of operation for a period of 2 years or more and the Registrar has reasonable cause to believe the same, *suo motu* action for striking of the name of the LLP. In this case the Registrar shall send a notice to the LLP and all its partners intimating his intention to strike off the name the LLP from the register and requesting them to send their representation along with relevant copies of documents within a period of one month from the date of receipt of notice.

If the LLP is regulated under a special law, the notice shall be accompanied by approval of regulatory body under that law. The notice and its contents shall also be displayed in the web site of Ministry of Corporate Affairs for the information of general public for a period of one month.

On the expiry of the notice period, the Registrar may, by an order, unless cause to the contrary is shown by the LLP, or the Registrar is satisfied that the name should not be struck off the register, and shall publish notice in the Official Gazette. On this the LLP shall stand dissolved. The Registrar before passing such order, shall, where he has sufficient cause to believe that the LLP has any asset or liability, satisfy himself that sufficient provision has been made for the realization of all amount due to the LLP and for the payment or discharge of its liabilities and obligations of the LLP within a reasonable time and if necessary obtain necessary undertakings from the designated partner or partner of other persons in charge of the management of the LLP.

The liability of every designated partner of the LLP dissolved, shall continue and may be enforced as if the LLP had not been dissolved.

Where a LLP is not carrying on any business of operator for a period of one year or more the LLP in Form 24 may apply to the Registrar, with the consent of all partners, for striking off its name from the register. For this no notice is required to be issued to the LLP and the partners. The other procedure as discussed will be applicable.

Dissolution

6.2

Winding up of Limited Liability Partnership

Chapter XIII of Limited Liability Partnership Act provides for winding up and dissolution. Section 65 gives powers to the Central Government to make rules for the provisions in relation to winding up and dissolution of LLP. The Central Government made Limited Liability Partnership (Winding up and Dissolution) Rules, 2010. In suppression of this rules, in exercise of the powers conferred by Section 6t read with Section 79 of the Act, the Central Government made the rules called as 'Limited Liability Partnership (Winding up and Dissolution) Rules, 2012 vide Notification No. GSR 550 (E), dated 10.07.2012. These Rules came into effect from 10.07.2012.

Modes of winding up

Rule 4 provides that the winding up of an LLP may be either voluntary or by the Tribunal. The Tribunal means the National Company Law Tribunal constituted under the Companies Act.

Voluntary winding up

Part III of the Rules deals with the procedure for voluntary winding up. The LLP may be wound up voluntarily if the LLP passes a resolution to wind up the LLP with the approval of at least three fourths of the total number of its partners. If the LLP has creditors, whether secured or unsecured, the approval of such creditors is to be obtained for the voluntary winding up. A copy of the resolution shall be filed with the Registrar within 30 days of passing resolution in Form No. 1.

Commencement of voluntary winding up

Rule 6 provides that a voluntary winding up shall be deemed to commence on the date of passing of the resolution for voluntary winding up.

Declaration of solvency

Rule 7 provides that in case of voluntary winding up the majority of its designated partners, not being less than two, shall make a declaration in Form No. 2 verified by an affidavit to the effect that the LLP has no debt or that it will be able to pay its debts in full within such period as may be specified in the declaration, but not exceeding one year from the commencement of the winding up.

The declaration shall be delivered to the Registrar in Form No. 3 within 15 days immediately preceding the date of passing of the resolution for winding up of LLP. The declaration shall be accompanied by a statement of assets and liabilities inform No. 4 for the period commencing from the date up to which the last account was prepared and ending with the latest practicable date immediately before the making of the declaration duly attested by at least two designated partners. The declaration shall also be accompanied by a report of the valuation of the assets of the LLP prepared by a valuer, if there are any assets.

Meeting of creditors

The meeting of creditors shall be convened for seeking approval of such creditors. The notice shall be sent by registered or speed post or any other mode prescribed. Where the two thirds in value of creditors give their consent that the winding up in the interest of all partners and creditors, the LLP shall within 14 days thereafter, file an application before the Tribunal for winding up. Notice of any decision of creditors shall be given to the Registrar in Form No. 5 within 15 days from the date of receipt of consent of creditors.

Publication

The LLP shall within 14 days of the receipt of the creditors' consent, give notice of the resolution by advertisement in a newspaper circulating in the district where the registered office or the principal office of the LLP is situated.

Appoint of LLP liquidator

The term 'LLP Liquidator' is defined in Section 2(a)(i) as a liquidator appointed in connection with voluntary winding up of a LLP from the panel maintained by the Central Government consisting of the names of practicing Chartered Accountants, Advocates, practicing Company Secretaries, practicing Cost Accountants or forms or bodies corporate having Chartered Accountants, Advocates, Company Secretaries, Cost Accountants and such other professionals as may be notified by the Central Government.

The LLP shall within 30 days of passing of resolution of voluntary winding up shall appoint a voluntary liquidator as LLP liquidator and this would be effective only after it is approved by two thirds of the creditors in value of the LLP. If the creditors do not approve this appointment, the creditors shall appoint another LLP liquidator and fix the remuneration to be paid to him. The liquidator appointed by the creditor shall be LLP liquidator. If no liquidator is appointed the Tribunal may appoint an LLP liquidator on such remuneration as may be determined by it.

The LLP liquidator shall file a declaration in Form No. 6 disclosing conflict of interest or lack of independence in respect of his appoint, if any, with the LLP or the creditors, as the case may be, and such obligation shall continue throughout the term of his or its appointment.

Removal of LLP liquidator

The Tribunal may, on cause being shown, remove an LLP liquidator and appoint any another LLP liquidator in his place. The Tribunal may also appoint or remove an LLP liquidator on an application made by the Registrar in this behalf. Before removal the liquidator shall be given a reasonable opportunity of being heard.

The LLP liquidator may also be removed by the partners of the LLP or creditors where such appointment is approved by the partners, as the case may be, the creditors. The liquidator shall be given notice and given a reasonable opportunity of being heard.

Duties of LLP liquidator

Rule 13 provides that on appointment of a LLP liquidator, all the powers of the designated partner and other partner, if any, shall cease, except for the purpose of giving notice of such appointment of the LLP liquidator to the Registrar. Rule 14 prescribes the following duties-

He shall settle the list of creditors or partners, which shall prima facie evidence of the liability of the persons therein to the creditors or partner;

- He shall obtain approval pf partners or creditors for any purpose he may consider necessary;
- He shall maintain register and proper books of accounts in the form and manner as specified;

- He shall the debts of the LLP and shall adjust the rights of the partners among themselves;
- He shall observe due care and diligence in the discharge of duties.

Audit of LLP liquidator's account

Rule 15 provides that the accounts of the LLP liquidator shall be audited.

Supervision of winding up

Rule 16 provides that the partners or the creditors may appoint such committees as they consider appropriate to supervise the voluntary winding up and assist the LLP liquidator in discharging the functions.

The LLP liquidator shall report quarterly on the progress of the winding up of the LLP in Form No. 8 to the partners or creditors which shall be made before the end of the following quarter. Where the fraud is reported against any person other than a partner or designated partner, the LLP liquidator, before sending a report to the Tribunal, may intimate it to the partners or designated partners and include their views in the report.

The Tribunal is having power to make any order to transfer the winding up proceedings from voluntary winding up to compulsory winding up by Tribunal.

Dissolution of LLP

Rule 19 provides that as soon as the affairs of a LLP are fully wound up, the LLP liquidator shall prepare a report stating the manner in which the winding up has been conducted and property has been disposed off, final winding up accounts and explanations, in Form No.9, showing that the property and assets of the LLP have been disposed of and its debts fully discharged to the satisfaction of the creditors and thereafter seek the approval of the partners or the creditors on the said report and the final winding up accounts and explanation in the meeting of partners or creditors.

If two thirds of total number of partners or two thirds in value of creditors, as the case may be, after considering the report, accounts and explanations of the LLP liquidator are satisfied that the LLP shall be wound up, they shall pass a resolution, within 30 days of receipt of such report, winding up accounts and explanations for its dissolution.

Within 15 days after the resolution passed, the LLP liquidator shall-

- send to the Registrar a copy of the final winding up accounts, explanations and report in Form No. 10; and
- file an application with the Tribunal along with a copy of the final winding up accounts, explanations and report, for passing an order of dissolution of the LLP.

If the Tribunal is satisfied that the process of winding up has been duly followed, the Tribunal may pass an order, within 60 days of the receipt of such application the LLP stands dissolved. The LLP liquidator shall file a copy of the order with the Registrar within 30 days in Form No. 11. The Registrar shall forthwith public a notice in the Official Gazette that the LLP stands dissolved.

If the affairs of the LLP are not fully wound up within a period of one year from the date of commencement of voluntary winding up, the LLP liquidator shall file an application before the Tribunal explaining the reasons thereof and seek appropriate directions.

Distribution of property of LLP

Rule 21 provides that the assets of an LLP shall, on its winding up, be applied in satisfaction of its liabilities *pari passu* and, subject to such application, shall, unless the LLP Agreements otherwise provides, be distributed

among the partners according to their rights and interests in the LLP.

Costs of voluntary winding up

Rule 24 provides that all costs, charges and expenses properly incurred in the winding up, including the fee of the LLP liquidator, shall, subject to the rights of secured creditors, if any, and workmen, be payable out of the assets of the LLP in priority to all other claims.

Winding up by Tribunal

Petition for winding up Rule 26 provides that an application to the Tribunal for the winding up of an LLP shall be by a petition presented by-

- the LLP or any of its partner or partners;
- any secured creditor or creditors, including any contingent or prospective creditor or creditors;
- the Registrar; or
- any person authorized by the Central Government in this behalf;
- the Central Government, in a case falling under Section 64(d).

A petition filed by the LLP or any of its partner or partners for winding up before the Tribunal shall be admitted only if accompanied by a statement of affairs of the LLP on the date of petition and a resolution of three fourths of the total number of partners.

The Registrar shall not a present a petition on the ground that the LLP is unable to pay its debts unless it appears to him either from the financial condition of the LLP as disclosed in its Statement of Accounts and Solvency or from the report of an Inspector that the LLP is unable to pay its debts. Further the Registrar shall obtain the previous sanction of the Central Government to the presentation of a petition. The Central Government shall not accord its sanction for the presentation of the petition unless the LLP concerned has been given a reasonable opportunity of making representations, if any.

Inability to pay debts

Rule 25 provides an LLP shall be deemed to be unable to pay its debts-

- if a creditor, to whom the LLP is indebted for an amount exceeding ₹1 lakh then due, has served on the LLP, by causing it to be delivered at its registered office, by registered post or otherwise, a demand requiring the LLP to pay the amount so due and the LLP has failed to pay the such amount within 21 days after the receipt of such demand or to provide adequate security or re-structure or compound the debt to the reasonable satisfaction of the creditor;
- if any execution or other process issued on a decree or order of any Court or Tribunal in favor of a creditor of the LLP is returned unsatisfied in whole or in part; or
- if it is proved to the satisfaction of the Tribunal that the LLP is unable to pay its debts, and, in contingent and prospective liabilities of the LLP.

Powers of Tribunal

- dismiss it, with or without costs;
- make any interim order, as it thinks fit;
- direct the action for revival or rehabilitation of the LLP in accordance with the procedure laid down in Section 60 to 62 of the LLP Act;

- appoint a liquidator as provisional liquidator of the LLP till the making of a winding up order;
- make an order for the winding up of the LLP with or without costs;
- any other orders or orders as may be considered fit.

Directions for filing statement of affairs

Rule 28 provides that the Tribunal, where a petition for winding up is filed by any person other than the LLP, if satisfied that a prima facie case for winding up is made out, by an order direct the LLP to file its objections along with a statement of its affairs within the time specified in the order. The Tribunal may direct the petitioner to deposit such security for costs as it may consider reasonable as a precondition to issue directions to the LLP. If the LLP fails to file, the statement of affairs the LLP lose the change to oppose the petition.

Appointment of liquidators

Rule 29 provides that the Tribunal may appoint a liquidator who may be called by either an official liquidator or a liquidator appointed by an order of the Tribunal from the panel maintained by the Central Government. In the absence of such order the Official Liquidator shall act as liquidator or provisional liquidator.

Every liquidator appointed from the panel, shall, before entering upon his duties as a liquidator of the LLP, furnish security of such sum and in such manner as the Tribunal may direct.

Winding up order to be communicated

Rule 31 provides that where the Tribunal makes an order for the winding up of a LLP, it shall within a period of not exceeding 15 days from the date of passing of the order, cause intimation thereof to be sent to the Liquidator and the Registrar in Form No. 12. On receipt of the intimation, the Registrar shall make an endorsement to that effect in his records relating to the LLP and notify in the Official Gazette that such order has been made.

On receipt of intimation, the Liquidator shall send notice to the registered office of the LLP, its partners, designated partners, officers, employees including Chief Executive Officer, Chief Financial Officer and auditors and secured creditors, if any, within 15 days of the receipt of the intimation for the purpose of custody of the property, assets, effects, actionable claims, books of accounts or other documents.

The winding up order shall be deemed to be a notice of discharge to the officers, employees and workmen of the LLP except when the business of the LLP is continued. An order of winding up of an LLP shall operate in favor of all creditors and all the partners.

Jurisdiction of Tribunal

Rule 32 provides that the Tribunal shall, notwithstanding anything contained in any other law for the time being in force, have jurisdiction to entertain, or dispose of-

- any suit or proceeding by or against the LLP;
- any claim made by or against the LLP, including claims by or against any of its branches in India;
- any application made under Sections 60 to 62 of the Act;
- any scheme submitted under the Act or any other law, for the time being in force, for revival or rehabilitation of LLP;
- any question of priorities or any other question whatsoever, whether of law or fact, which may relate to or arise in the course of winding up of the LLP, whether such suit or proceeding has been instituted or such claim or question has arises or arises or such application is made or has been made or such scheme is submitted or has been submitted, before or during the pendency of winding up petition or after the winding up order is made.

Report by Liquidator

Rule 34 provides that where the Tribunal has made a winding up order, the Liquidator shall, within 60 days from the date of winding up of the order, submit to the Tribunal, a report containing the following particulars-

- the nature and details of the assets, cash balance in hand and in bank, if any and the marketable securities, if any held by the LLP;
- amount of contribution received and outstanding from partners;
- the existing and contingent liabilities of LLP;
- debts due to the LLP;
- guarantees given by the LLP;
- list of partners and dues if any payable by them and details of any outstanding contributions;
- details of intangible assets;
- details of subsisting contracts, joint ventures and collaborations, if any;
- details of other LLPs or companies in which LLP has any stake;
- details of legal cases filed by or against the LLP;
- details of the properties, assets, books or records and other documents taken under the custody of the Liquidator;
- scheme of revival or rehabilitation of LLP, if any; and
- any other information which the Tribunal may direct or the Liquidator may consider necessary to include.

The Liquidator may make in the report, the viability of the business of the LLP or the steps which, in his opinion, are necessary for maximizing the value of the assets of the LLP.

Directions of Tribunal on the report

Rule 35 provides that the Tribunal shall, on consideration of the report, fix a time limit within which the entire proceedings shall be completed and the LLP dissolved. The Tribunal may, at any stage of the proceedings, if it considers that it will not be advantageous or economical to continue the proceedings, reduce the time limit within which the entire proceedings shall be completed and the LLP dissolved. If it is in the opinion of the Liquidator that the proceedings could not be completed within the time allowed by the Tribunal, the Tribunal after satisfying itself on an application of the Liquidator, may extend the time, but not exceeding further 30 days.

Sale of LLP

The Tribunal may, on an examination of the reports of the Liquidator and after hearing the liquidator, creditors, partners, order the sale of the LLP as going concern or its assets or part thereof. The Tribunal may appoint a Sale Committee consisting of such creditors, partners and officers or employees of the LLP to assist the Liquidator in this regard.

Revival or rehabilitation of LLP

If the Tribunal is of the opinion that an LLP can be revived or rehabilitated, it may, direct that an action for revival or rehabilitation may be taken in accordance with Sections 60 to 62 of the Act.

Fraud

Where a report of the liquidator indicates the fraud committed in respect of the LLP, the Tribunal shall, without prejudice to the process of winding up, order for investigation and on consideration of the report of such investigation it may pass order and give such directions as it may think appropriate.

Custody of LLP's properties

Rule 36 provides that where a winding up order has been made or where a provisional liquidator has been appointed, the liquidator on the order of the Tribunal, forthwith take into his custody or under his control all the property, assets, effects and actionable claims to which the LLP is or appears to be entitled to and take such steps and measures, to protect and preserve the properties of LLP.

On the order of the Tribunal, any partner, trustee, receiver, banker, agent etc., are required to pay, deliver, surrender or transfer to the liquidator the money, property or books and papers in their custody within the time specified by the Tribunal.

Application of assets

The assets of the LLP shall be applied first for the payment of cost including expenses, charges or fees and remuneration of the Liquidator incurred in the winding up of the LLP and thereafter be applied for the discharge of its liability *pari passu* with the provisions of the Act and the rules.

Committee of Inspection

Rule 39 provides that the Tribunal may, at the time of making an order for the winding up of an LLP or any time thereafter, direct that there shall be appointed a committee of inspection to act with the liquidator. The committee shall consist of such number of members not exceeding 12. The Committee shall meet at such times as it may from time to time appoint and the Liquidator or any member of the Committee may also call a meeting of the committee as and when he thinks necessary. As soon as possible after the holding of the meetings of the Committee, the Liquidator shall report the result to the Tribunal for further directions.

Periodical reports

Rule 40 provides that the Liquidator shall report quarterly on the progress of winding up of the LLP in Form No. 13 to the Tribunal which shall be made before the end of the following quarter. The Tribunal may review any order made by it and make such modifications as it thinks fit with or without any further directions.

Assistance to Liquidator

Rule 42 provides that the Liquidator may, with the sanction of the Tribunal, appoint one or more practicing Chartered Accountants or practicing Company Secretaries or practicing Cost Accountants or legal practitioners entitled to appear before the Tribunal or such other professions or experts or valuers or agency as he considers necessary to assist him in the performance of his duties and functions under the Act or the rules.

Appeal against the decision of Liquidator

Rule 43(5) provides that any person aggrieved by any act or decision of the Liquidator may apply to the Tribunal. The Tribunal may confirm, reverse or modify the act or decision complained of and make such further order as it thins just in the circumstances.

Books of accounts

Rule 44 provides that the liquidator shall keep proper books of accounts in the manner prescribed in which he

shall cause entries or minutes to be made or proceedings of the meetings. The accounts of the liquidator shall be audited in the form and manner specified in Rule 56. The liquidator shall cause the statement of accounts when audited or a summary thereof to be printed and shall send a printed copy of the statement of accounts or summary thereof by post to every creditor and every partner.

Control of Central Government over liquidator

Rule 48 provides that the Central Government shall take cognizance of the conduct of the Official Liquidators of LLPs which are being wound up by the Tribunal and if a Tribunal does not faithfully perform his duties and duly observe all the requirements imposed on him by the Act and Rules with respect to performance of his duties or if any complaint is made to the Central Government by any creditor or partner in regard thereto, the Central Government shall inquire into the matter and take such action thereon as it may thin expedient. The Central Government may also direct a investigation to be made of the books and vouchers of such liquidators.

Provisions applicable to every mode of winding up

Part V of the Rules provides the provisions that are applicable to all type of winding up.

Powers of liquidator

Rule 51 provides that the LLP liquidator, with the sanction of the Tribunal in case of winding up by the Tribunal or with the sanction of a resolution by three fourths of total number of partners, in case of voluntary winding up, has the following powers-

- pay any class of creditors in full;
- make any compromise or arrangements with creditors;
- compromise any money due from partners including outstanding, unrealized or unrecovered contribution etc.,

Proof of debts

Rule 50 provides that all debts payable on a contingency and all claims against the LLP, present or future, certain or contingent, ascertained or sounding only in damages, shall be admissible to proof against the LLP.

Evidence

Rule 53 provides that all books and papers of the LLP, LLP liquidator and Liquidator shall, as between the partners of the LLP, be prima facie evidence of the truth of all matters purporting to be recorded therein.

Inspection of books and papers

Rule 54 provides that at any time after making of an order for the winding up of a LLP by the Tribunal any creditor or partner of the LLP may inspect the books and papers of the LLP subject to conditions specified. The conditions are not applicable on the Central Government or a State Government or any authority or officer of the Government.

Disposal of records

Rule 55 provides that when the affairs of a LLP have been completely wound up and it is about to be dissolved, its books and papers and those of the LLP liquidator may be disposed of as follows-

- in case of winding up by the Tribunal, in such manner as the Tribunal directs; and
- in case of voluntary winding up, in such manner as the LLP approves it by three fourths of the total number of partners with the prior approval of the secured creditors.

After expiry of five years from the dissolution of LLP, no responsibility shall devolve on the LLP, the LLP liquidator or the liquidator on the books and papers of the LLP, the liquidator. The Central Government may, by notification direct for such period not exceeding five years from the dissolution of the LLPs for the prevention of the destruction of the books and papers of a LLP which has been wound up and of its LLP Liquidator or Liquidator.

Remittance of money

Rule 57 provides that every liquidator shall pay the moneys received by him as Liquidator of any LLP into the public account of India in the RBI or any scheduled bank. If the Tribunal considers that it is advantageous for the creditors or partners of the LLP, it may permit the account to be opened in such other bank specified by it.

The liquidator shall not deposit any money received by him in his capacity into any private account. The liquidator can retain at any time for more than ten days a sum of ₹ 50,000 on the authorization of the Tribunal. For this the liquidator is to make application and explains the retention to the satisfaction of the Tribunal. If the liquidator fails he is liable to pay interest and also penalty.

Filing returns

Rule 62 provides that every liquidator shall file, deliver or make any report, statement of accounts or any other document or give any notice which is required to be filed, delivered or made or given, as the case may be, pursuant to any rule, within the time specified in such rule. The Central Government may also specify any other report, statement of accounts or other documents to be filed within the time specified.

Dissolution void

Rule 64 provides that the where an LLP has been dissolved the Tribunal may at any time within two years of the date of the dissolution, on application by the Liquidator or by any other person, make an order, upon such terms as the Tribunal may think fit, declaring the dissolution to be void, and thereupon such proceedings may be taken as if the LLP has not been dissolved. The copy of the said order is to be filed within 30 days with the Registrar in Form No. 11, who shall register the same.

Computing period of limitation

Rule 66 provides that in computing the period of limitation specified for suit or application in the name and on behalf of a LLP which is being wound up by the Tribunal, the period from the date of commencement of the winding up of the LLP to a period of one year immediately following the date of winding up order shall be excluded.

Filing with Registrar and filing fee

Rule 67 provides that a notice, document, form, resolution etc., or notification required to be filed with the Registrar shall be filed in electronic form along with the fee specified. In case of winding up by the Tribunal, the Central Government may waive the fee, if it deems fit. No fee shall be payable if any LLP under liquidation by the order of the Tribunal does not have funds and the liquidator submits a certificate that the LLP does not have any fund.

Proceedings and general procedures

Part VI of the rules provides for the proceedings and general procedures of the winding up. The following is the procedure enumerated in Part VI of the Rules-

- All proceedings shall be instituted before the Bench of the Tribunal having jurisdiction as may be notified by the Central Government;

- All petitions, applications, affidavits etc., shall be written, typewritten or printed neatly and legibly on substantial paper of foolscap size in duplicate and separate sheets shall be stitched together;
- The contents shall be divided into separate paragraphs, which are numbered serially;
- The general hearing in all proceedings before the Tribunal and in all advertisements and notices shall be in Form No. 16;
- Fees on applications as specified shall be paid;
- The proceedings shall be in English or Hindi;
- No documents other than in English or Hindi, unless translated into Hindi or English shall be accepted;
- No rules shall be deemed to limit or otherwise affect the inherent powers of the Tribunal to make such orders as may necessary for the ends of justice or to prevent abuse of the process of the Tribunal;
- The Tribunal shall have the power to dispense with the requirements of any of these rules subject to such terms and conditions and for the reasons recorded to be in writing;
- Where any particular number of days is specified, the same shall be reckoned exclusively of the first day and inclusively of the last day, unless the last day shall happen to fall on a day on which the offices of the Tribunal are closed, in which case the time shall be reckoned exclusively of that day also and of any succeeding day or days on which the offices of the Tribunal continued to be closed;
- The Tribunal shall keep the following registers in physical or digital format or both the format, relating to the proceedings under the Act and the Rules-
  - LLP Petitioner's Register;
  - LLP Applications' Register;
  - Liquidation Registers;
  - LLP Document Registers;
  - Appearance of the person before the Tribunal;
- Every application or petition shall bear its distinctive serial number.;
- Every petition shall be verified by an affidavit by the petitioner and such affidavit shall be in Form No. 18 and shall be filed along with the petition;
- Every application/petition shall be accompanied by the documents required to be annexed;
- Where a petition is filed, an application shall be made by along with summons in Form No. 19 to the Member for directions as to the advertisement of the petition, the notices to be served and the proceedings to be taken;
- Where any petition is required to be advertised, be advertised not less than 7 days before the date fixed for hearing in one issue each of a daily newspaper in English language and a daily newspaper in regional language circulating in the State or the Union territory concerned as may be fixed by the Member;
- The advertisement shall be in Form No. 20 and shall include the required information;
- Every petition shall be served on the respondent;
- Notice of every petition required to be served upon any person shall be in Form No. 21 not less than 7 days before the date of hearing;

- The petitioner shall be responsible for the service of all notices, summons and other processes for the advertisement and publication of notices, required to be effected by these rules or by order of Tribunal;
- An affidavit of service on a LLP or its liquidator shall be in Form No. 22 or 23 as the case may be;
- Every person who intends to appear the hearing of a petition, whether to support or oppose the petition, shall serve on the petitioner or his advocate, notice of his intention at the address given in the advertisement;
- The petitioner or his advocate or authorized representative shall prepare a list of the names and addresses of the persons who have given notice of their intention to appear at the hearing of the petition in the form No. 25 and shall be filed in Tribunal before the hearing of the petition;
- At the time of hearing the Member may either dispose of the petition finally or give such directions as may be deemed necessary for filing of counter affidavit and reply affidavits;
- All adjournments and postings will be subject to time schedule prescribed under the Act or the rules;
- It shall not be necessary give notice of the adjourned hearing to any person;
- The date of order shall be the date on which it was actually made notwithstanding that it is drawn up and issued on a later date;
- The costs should be awarded for every adjournment on the party seeking adjournment at the time of granting adjournment except in cases of serious illness and such similar circumstance;
- Where costs are awarded to a party in any proceeding, the order shall direct that the party liable to pay the costs shall pay the same.

Inspection and copies of proceedings

Rule 79 provides that records of every proceedings pending before the Tribunal will be available for the inspection of the parties or their authorized representatives on making an application in writing and on payment of a fee as specified. A person who is not a party to the proceedings is not entitled for inspection of records or proceedings except with the consent of the parties by whom they were presented or produced or under the orders of the Tribunal on payment of fee. A person not a party to the proceedings on which final orders have been passed can obtain copy of the orders on payment of such fee specified.

Petition for winding up

The following is the procedure for winding up-

- A petition for winding up an LLP shall be in Form No. 26 or 27 or 28 as the case may be, with such variations as the circumstances may require;
- The petition shall be in duplicate;
- Where the petition is filed by the LLP the petition shall be accompanied with the Statement of affairs of LLP on the date of petition;
- The Registrar shall note on the petition the date of its presentation;
- The petition shall be posted before the Member in chambers for admission and to fix hearing date;
- The member may direct notice to be given to LLP before advertisement;
- The petition by a contingent or prospective creditor may be presented accompanying an application for the leave of the Tribunal for the admission of the petition;

- Every partner or creditor of the LLP shall be entitled a copy of petition within 24 hours on payment of the charges as specified;
- The advertisement shall be in Form No. 29 and advertised within the time and in the manner provided;
- A petition shall not be withdrawn after presentation without the leave of the Tribunal;
- The Tribunal may substitute creditor or partner for original petitioner;
- An affidavit intended to be used in opposition shall be filed not less than 5 days before the date fixed for the hearing of the petition;
- A copy of the affidavit shall be served on the petitioner; the statement of affairs of the LLP shall also be filed;
- An affidavit intended to be used in reply to the affidavit filed in opposition to the petition shall be filed not less than 2 days before the day fixed for the hearing of the petition and a copy of the affidavit shall be served on the other party;
- After the admission of the petition, the Tribunal, if it thinks fit, and upon such terms and conditions may appoint the liquidator to be the provisional liquidator pending final orders on the winding up petition;
- The order appointing the provisional liquidator shall be set out the restrictions and limitations, if any, on his powers and imposed by the Tribunal in Form No. 30;
- All costs and charges and expenses properly incurred by the Liquidator shall be paid out of the assets of the LLP;
- The Registrar of the Tribunal shall forthwith send to the liquidator appointed by the Tribunal notice of the order under the seal of the Tribunal in duplicate in Form No. 31 or 32 together with a copy of the petition;
- The order shall be in Form No. 33 with such variations as may be necessary;
- The liquidator shall make out a report for direction with regard to the performance by the liquidator of all or any of the duties or any other matter requiring the directions of the Tribunal;
- The Tribunal may give such directions as it thinks fit in regard to various matters including fixing of time before which the various matter shall be completed;
- The Tribunal shall, at the time of making the winding up order or at any time thereafter, give directions as to the advertisement of the order and the persons if any on whom the order shall be served;
- Every order for the winding up shall within 14 days of the date of making the order, be advertised by the petitioner in Form No. 34;
- An application for stay of proceedings in the winding up shall be made to the Tribunal upon notice to the parties to the winding up petition;
- If stay order is granted the applicant shall within 15 days file a certified copy of the order with the Registrar in Form No. 10;
- An application for leave of the Tribunal to commence or continue any suit proceedings against the LLP shall be made to the Tribunal upon notice to liquidator and other parties to the suit or proceedings sought to be commenced or continued;
- An application for transfer to the Tribunal of any suit or proceeding by or against the LLP pending in court, other than High court and Supreme Court, or any Tribunal shall be made upon the notice to the liquidator

and to the parties to the suit or proceedings sought to be transferred;

- A notice by the liquidator to any person to submit and verify a statement of affairs of LLP, shall be in Form 35 after the order of winding up;
- The Statement of Affairs shall be in Form No. 37 and shall be made out in duplicate, one copy of which shall be verified by affidavit;
- An affidavit of concurrence in the statement of affairs shall be in Form No. 38;
- The liquidator shall verify the Statement of Affairs and affidavit of concurrence and submit one copy to the Tribunal and retain the duplicate copy;
- Partners and other officers of LLP shall attend before the Liquidator and furnish the required information;
- The report shall be submitted by the Liquidator in Form No. 40 and the same shall contain the required information;
- Further report is to be filed by the liquidator in case fraud has been detected;
- On consideration of the Report the Tribunal may pass such orders and give such directions as it may think fit including directions of examination of designated partners, partners, officers and employees past and present of the LLP.

Settlement of list of creditors

The procedure for settlement of creditors is as follows-

- The liquidator, in any mode of winding up, shall issue notice not less than 14 days before the date of hearing to the creditors of the LLP to prove their debts or claims and to establish any title for they may have to priority under preferential payments or to be excluded from the benefit of any distribution made before such debts or claims are proved, or, as the case may be, from objecting to such distribution;
- The liquidator shall give not less than 14 days of notice so fixed by advertisement which shall be released within 30 days from the date of confirmation of sale and in Form No. 41;
- If the number of creditors does not exceed 100, individual notice may be given within 30 days from the date of confirmation of sale;
- The liquidator shall also give not less than 14 days notice of the date fixed, to every person mentioned in the Statement of Affairs in Form No. 42 or 43;
- Every creditor shall prove his debt, unless the Member in any particular case directs that any creditors or class of creditors shall be admissible without proof;
- An affidavit proving a debt shall contain a statement of accounts showing the particulars of the debt and shall specify the vouchers or bills or contracts or any other material documents, by which the same can be substantiated and shall state whether the creditor is a secured creditor, or a preferential creditor and if so, shall set out the particulars of the security or the preferential claims and the affidavit shall be in Form No. 44;
- Claims for workmen may be in Form No. 45. Such proof shall have a schedule annexed thereto setting forth the names of the workmen and others and the amounts severally due to them;
- A creditor is also to prove the future debts;
- The liquidator shall examine every proof lodged with himself and the grounds of the debt; if it requires

further evidence the liquidator shall send notice in Form No. 46 to produce further evidence;

- The liquidator is having power to summon any person in connection with the investigation;
- Unless otherwise ordered by the Member, a creditor shall bear the costs of proving his debt;
- The notice of admission of the proof shall be in Form No. 48;
- The notice of rejection of the proof shall be in Form No. 47;
- Any creditor, aggrieved against the order of the Liquidator, may file appeal before the Tribunal;
- The liquidator is not personally liable for costs in relation to an appeal from his decision rejecting any proof wholly or in part;
- The liquidator shall, within two months from the last date for proving the debts, file in Tribunal a certificate in Form No. 49 containing a list of creditors who submitted proofs of their claims, the amount of claims etc.;
- In the event of there being a surplus after payment in full of all the claims admitted to proof, creditors whose proofs have been admitted shall be paid interest from the date of winding up order up to the date of final distributable sum at a rate not exceeding the prime lending rate fixed by the RBI;
- In the event of there being a surplus after payment to creditors in full the partners are entitled for return of asset; for this purpose the liquidator shall give a provisional list of partners of the LLP with their names and addresses, the amount of contribution in Form No. 50;
- The liquidator then send notice to every person included in the provisional list in Form No. 51 not later than one month from the date of filing of the provisional list;
- On the hearing date the liquidator hears any objections if any;
- The liquidator then shall prepare the final list for settlement;
- Within 7 days after the settlement of the list, the liquidator shall file in Tribunal a certificate of the list of partners as finally settled by him in Form No. 52;
- The liquidator then issue notice to every person placed on list of partners as finally settled, stating the amount of contribution in Form No. 53;
- The liquidator may vary the final list and file application for rectification and the Tribunal may rectify or vary the list as it may think fit;
- An order varying such a list of partners shall be in Form No.54.

Meeting of creditors or partners in a winding up

- The procedure for meeting of creditors or partners in a winding up by Tribunal and of creditors in a voluntary winding up is as follows-
- The liquidator shall summon all meeting of creditors or partners by giving not less than 14 days notice of the time of meeting;
- The notice of the meeting shall be advertised in the newspapers;
- The notices shall be in such Form No. 55, 55A, 55B, 55C and 55D as may be appropriate;
- The place of the meeting shall be at the convenient of the most of the creditors;
- Different times or places or both may, if thought fit, be appointed for the meetings of creditors and the

meetings of partners;

- If any officer fails to attend the liquidator, the liquidator may report such failure to the Tribunal in form No. 56;
- The liquidator shall file affidavit for proof of notice in Form No. 57;
- The cost of call meetings at the instance of creditor or partner shall be borne by the applicant;
- If the meeting is summoned by the liquidator, he or some person nominated by him shall be the Chairman of the meeting; the nomination shall be in form No. 58;
- In case of voluntary winding up the Chairman shall be such person as the meeting by resolution appoint;
- At a meeting of creditors, a resolution shall be deemed to be passed, when a majority in value of creditors present personally or by proxy and voting on the resolution has voted in favor of the resolution;
- At a meeting of partners, a resolution shall be deemed to be passed when a majority of the partners present personally or by proxy and voting on the resolution have voted in favor of the resolution;
- The liquidator shall file in Tribunal a copy of every resolution certified by him;
- The Chairman may, with the consent of the partners or creditors present in the meeting adjourn it from time to time;
- The quorum for the meeting is at least two creditors entitled to vote if there are more than 2 or in case of a meeting of partners at least two partners;
- If there is no quorum, the meeting shall be adjourned to the same day in the following week at the same time and same place, or to such other day, or time or place as the Chairman may appoint, but the day appointed shall be not less than 7 days or more than 14 days;
- The Chairman shall have power to admit or reject a proof for the purpose of voting, but his decision shall be subject to appeal to the Tribunal;
- The Chairman shall within 7 days of the conclusion of the meeting, report the result thereof to the Tribunal and such report shall be in Form No. 59;
- The Chairman shall cause minutes of the proceedings at the meeting to be drawn up and fairly entered in the boom and the minutes shall be signed by him or by the Chairman of the next meeting;
- A list of creditors or partners present at every meeting shall be made and kept as in Form No. 60;

Collection and distribution of assets in a winding up by Tribunal

Rule 203 provides that the duties imposed on the Tribunal with regard to the collection of assets of the LLP and the application of the assets in discharge of LLP's liabilities shall be discharged by the liquidator as an officer of the Tribunal subject to the control of the Tribunal.

The liquidator shall, for the purpose of acquiring and retaining possession of the property of the LLP, be in the same position as if he were a Receiver of the property appointed by the Tribunal and the Tribunal may on his application enforce such acquisition or retention accordingly.

Where the person who is required to pay, deliver, convey, surrender or transfer to or into the hands of the liquidator any money, property, documents, books or papers which happened to be in his hand for the time being, the Liquidator may apply to the Tribunal for appropriate orders and the notice shall be in form No. 62;

Rule 206 provides that the liquidator is to realize unrealized contribution etc.,

Compromise or abandonment of claims

Rule 235 provides that no claim by the LLP against any person shall be compromised or abandoned by the Liquidator without the sanction of the Tribunal upon notice to such person as the Tribunal may direct.

Rule 236 provides that every application for sanction of a compromise or arrangement with any person shall be accompanied by a copy of the proposed compromise or arrangement and shall be supported by an affidavit of the liquidator stating that for the reasons set out in the affidavit, he is satisfied that the proposed compromise or arrangement is beneficial to the LLP and the Tribunal may, if it thinks fit, direct notice of the application to be given to the Committee of Inspection, if there is one, and to such other person as it may think fit.

Sales by the liquidators

Rule 237 provides that no property belonging to LLP shall be sold by the liquidator without previous sanction of the Tribunal and every sale shall be subject to confirmation by the Tribunal and such order of confirmation may be passed within 60 days of the filing of the report by the Liquidator.

Rule 238 provides that every sale shall be held by the liquidator by an agent or an auctioneer approved by the Tribunal and subject to the terms and conditions, if any, as may be approved by the Tribunal. All sales shall be made by public auction or by inviting sealed tenders or in such manner as the Member may direct.

Rule 239 provides that the gross proceeds shall, unless the Tribunal otherwise orders, be paid over to the Liquidator by such auctioneer or agent and the charges and expenses connected with the sale shall afterwards be paid to such auctioneer or agent in accordance with the scales, if any fixed by the Tribunal or as approved by the Tribunal.

Distributable sum and returns of assets

Rule 240 provides that no distributable sum to creditor or return of assets to partners shall be declared by the liquidator without the sanction of the Tribunal. No payment shall be made to the creditors which would be deemed to distributable sum without filing list of creditors and sanctioned by Tribunal as distributable sum and no payment shall be made to the partners without filing final settlement of the list of settlement of partners and sanctioned by the Tribunal.

Rule 241 provides that liquidator shall give notice of the declaration of distributable sum not less than one month prior to the date fixed for payment. The advertisement shall be in form No. 82. The notice to the creditor shall be in Form No. 83.

Rule 242 provides that a person to whom distributable sum is payable may lodge with the liquidator an authority in writing to pay such distributable sum to another person named therein in Form No.84.

Rule 243 provides that distributable sum may, at the request and risks of the persons to whom they are payable, be transmitted to him by registered post or any other mode as approved by the Tribunal, by cheques or demand drafts or any other manner a s may be appropriate or as approved by the Tribunals within 45 days from the date of filing the list of creditors before the Tribunal.

Rule 244 provides that every order by which the liquidator is authorized to make a return to partners of the LLP, shall, unless Tribunal otherwise directs, contain or have appended there to a list setting out in a tabular form the name, amount etc., and interest which have been made or the variations in the list of partners which have arisen since the date of settlement of the list of partners and such other information as may be necessary to enable the return to be made. This list is in Form No. 85. The liquidator shall send a notice of return to each partner by ordinary post in Form No. 86. The payment may be sent by registered post or any other mode as may

be appropriate or as approved by the Tribunal at the risk of the partners.

Rule 245 provides that where a claim made in respect of a distributable sum due to a deceased creditor or a return of contribution due to a deceased partner is Rs.500 or less, the liquidator may, upon satisfying himself as tp the claimant's right and title to receive the distributable sum or the return, apply to the Tribunal for sanctioning the payment of such distributable sum or the return without production of a succession certificate or like authority and where the Tribunal sanctions the payment, the liquidator shall make the payment upon obtaining a personal indemnity from the payee.

Termination of winding up

Rule 246 provides that as soon as the affairs of the LLP have been fully wound up, the liquidator shall file his final account with the Tribunal in Form No. 89 and apply for orders as to the dissolution of the LLP. The application shall not be heard until the accounts are audited.

Rule 247 provides that upon hearing the application, the Tribunal may, after hearing the liquidator and any other person to whom notice may have been ordered by the Tribunal, order for the dissolution of the LLP.

Rule 248 provides that upon the order of dissolution being made, the liquidator shall forthwith pay into the LLP's Liquidation Account in the public account of India any unclaimed or unpaid distributable sum payable to the creditors or undistributed or unpaid assets refundable to partners in his hands on the date of order of dissolution, and such other balance in his hands as he has been directed by the Tribunal to deposit into the LLPs Liquidation Account.

A copy of the order of dissolution shall, within 30 days from the date of order, be forwarded to the liquidator in Form No. 11 who shall make in his books a minute of the dissolution of LLP. A copy of the same shall be filed with the Registrar along with a Statement signed by him that the directions of the Tribunal regarding the application of the balance as per his final account have been duly complied with.

Conclusion of winding up

Rule 249 provides that the winding up of a LLP shall be deemed to be concluded, in the case of-

- An LLP wound up by order of the Tribunal, at the date on which the order dissolving the LLP has been reported by the Liquidator to the Registrar;
- An LLP wound up voluntarily, at the date of dissolution of the LLP, unless at such date any fund or assets of the LLP remain unclaimed or undistributed in the hands or under the control of LLP liquidator, or any person who has acted as liquidator, in which case the winding up shall not be deemed to be concluded until such funds or assets have either been distributed or paid into the LLP Liquidation Account.

Application to declare dissolution void

Rule 250 provides that an application shall be made upon notice to the Central Government and the Registrar. Where the Tribunal declares the dissolution to have been void, the applicant shall file a certified copy of the order with the Registrar not later than 30 days from the date of order.

Appeal from order of Tribunal to NCLAT

Rule 301 provides that any aggrieved person may prefer an appeal against the order or decision of the Tribunal to the National Company Law Appellate Tribunal within a period of 45 days from the date on which the order is delivered in such manner as may be provided by that Appellate Tribunal.

EXERCISE

⊙ Multiple Choice Question:

1. Which of the following is true about a Limited Liability Partnership?

   a) A Limited Liability Partnership is not a distinct entity from its partners

   b) A Limited Liability Partnership is a legal entity separate from its partners

   c) A Limited Liability Partnership is a body corporate

   d) Both b and c are correct

2. Which of the following is true about the number of designated partners required in a Limited Liability Partnership?

   a) A Limited Liability Partnership can have at least two designated partners

   b) A Limited Liability Partnership can have at least three designated partners

   c) A Limited Liability Partnership can have at least seven designated partners

   d) A Limited Liability Partnership can have at least four designated partners

3. What is the exact time limit under which a Limited Liability Partnership must file its annual return with the registrar?

   a) A Limited Liability Partnership must file its annual return within 30 days from the closing of its financial year

   b) A Limited Liability Partnership must file its annual return within 45 days from the closing of its financial year

   c) A Limited Liability Partnership must file its annual return within 15 days from the closing of its financial year

   d) A Limited Liability Partnership must file its annual return within 60 days from the closing of its financial year

4. Every Limited Liability Partnership must maintain its books of accounts diligently. Those books of accounts should maintain _____.

   a) Particulars of the receipts and expenditures at the Limited Liability Partnership with the details of those transactions

   b) An inventory of the cost of goods purchased, work in progress, inventories, finished goods as well as the cost of goods sold

   c) A complete record of the assets and liabilities of the Limited Liability Partnership

   d) All of the above

5. As per Sale of Goods Act, this is not included:

   a) A Limited Liability Partnership should maintain its accounts at the branch office

   b) A Limited Liability Partnership should maintain its accounts at the corporate office

   c) A Limited Liability Partnership should maintain its accounts at the head office

   d) A Limited Liability Partnership should maintain its accounts at the registered office

6. As per Sale of Goods Act, this is not included:

   a) A Limited Liability Partnership should maintain its books of accounts on the accrual basis
   b) A Limited Liability Partnership should maintain its books of accounts on the cash basis
   c) A Limited Liability Partnership should maintain its books of accounts based on the double-entry system of accounting
   d) All of the above

Fill in the blanks

1. Section 2 (d) of the LLP Act, 2008, defines ____.
2. "Foreign limited liability partnership" means a limited liability partnership formed, incorporated or registered _____ India which establishes a place of business within India.
3. A limited liability partnership is a _____ formed and incorporated under this Act and is a legal entity separate from that of its partners.
4. An individual shall not be capable of becoming a partner of a limited liability partnership, if he has been found to be of _____ by a Court of competent jurisdiction and the finding is in force.
5. Every limited liability partnership shall have at least ____ partners.
6. When the requirements imposed by clauses (b) and (c) of sub-section (1) of section 11 have been complied with, the ____ shall retain the incorporation document.

Short Essay Type Questions

1. Who may be a partner in LLP?
2. Discuss the power of the Registrar?
3. Write short notes on -
   (a) Compounding of offences
   (b) Report by Liquidator

Essay Type Questions

1. How does LLP differ from Traditional Partnership and Company?
2. What are the essential documents required for LLP Registration?
3. What are the advantages of an LLP.
4. Discuss the difference between LLP & a Company.

Unsolved Cases

1. XYZ company was appointed as the partner for a Limited Liability Partnership. The company was also appointed as the designated partner for the partnership. The regulatory and legal compliances were not completed in full and therefore, the designated partners were held liable. Is this justified?
2. Mr. A was appointed as a partner of an LLP but just after 2 months he was declared as an undischarged insolvent. Can he continue as a partner as he was appointed when he was solvent?

Answer:

Multiple Choice Question:

1. d; 2. a; 3. a; 4. d; 5. b; 6. d.

Fill in the blanks

1. Body Corporate; 2. Outside; 3. Body Corporate; 4. Unsound; 5. Two; 6. Registrar.

SECTION - B

INDUSTRIAL LAWS

Factories Act, 1948 7

SLOB Mapped against the Module

To acquire the requisite knowledge of the aim and object of the Act to safeguard the interests of workers, prevent their exploitation and obligations, duties and responsibilities of a factory owner and also on the factory manager.

Module Learning Objectives:

After studying this module, the students will be able -

- To acquire the requisite knowledge of the aim and object of the Act to safeguard the interests of workers, prevent their exploitation and obligations, duties and responsibilities of a factory owner and also on the factory manager.
- To develop an understanding about the different provisions relating to health, safety welfare, and annual leaves of workers in factory.

Factories Act, 1948

7

There are several legislations which regulate the conditions of employment, work environment and other welfare requirements of certain specific industries. The Factories Act, 1948 enacted to regulate the working conditions in factories.

In the case of Ravi Shankar Sharma v. State of Rajasthan, AIR 1993 Raj 117, and Court held that Factories Act is a social legislation and it provides for the health, safety, welfare and other aspects of the workers in the factories. In short, the Act is meant to provide protection to the workers from being exploited by the greedy business establishments and it also provides for the improvement of working conditions within the factory premises.

The main object of the Factories Act, 1948 is to ensure adequate safety measures and to promote the health and welfare of the workers employed in factories. The Act also makes provisions regarding employment of women and young persons (including children and adolescents), annual leave with wages etc.

The Act extends to whole of India including Jammu & Kashmir and covers all manufacturing processes and establishments falling within the definition of 'factory' as defined under Section 2(m) of the Act. Unless otherwise provided it is also applicable to factories belonging to Central/State Governments. (Section 116)

The Factories Act, 1948 extend to whole of India and came into effect from 01.04.1949.

Important Definitions

Competent person

Section 2(ca) defines the expression 'competent person' in relation to any provision of this Act, means a person or an institution recognized as such by the Chief Inspector for the purposes of carrying out tests, examinations and inspections required to be done in a factory under the provisions of this Act having regard to-

- the qualifications and experience of the person and facilities available at his disposal; or
- the qualifications and experience of the persons employed in such institution and facilities available therein, with regard to the conduct of such tests, examinations and inspections, and more than one person or institution can be recognized as a competent person in relation to a factory;

Hazardous Process

Section 2(cb) defines the expression 'hazardous process' as any process or activity in relation to an industry specified in the First Schedule where, unless special care is taken, raw materials used therein or

the intermediate or finished products, bye-products, wastes, or effluents thereof would-

- cause material impairment to the health of the persons engaged in or connected therewith, or
- result in the pollution of the general environment.

The State Government may, by notification in the Official Gazette, amend the First Schedule by way of

addition, omission or variation of any industry, specified in the said Schedule;

Manufacturing process

Section 2(k) defines the expression 'manufacturing process' as 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, or
- pumping oil, water, sewage or any other substance; or
- generating, transforming or transmitting power; or
- composing types for printing, printing by letter press, lithography, photogravure or other similar process or book binding; or
- constructing, reconstructing, repairing, refitting, finishing or breaking up ships or vessels; or
- preserving or storing any article in cold storage.

In 'M/s Qazi Noorul Hasan Hamid Hussain Petrol Pump V. Deputy Director, Employees' State Insurance Corporation' – 2003 LLR 476 it was held that the definition 'manufacturing process' does not depend upon and is not correlated with any end product being manufactured out of a manufacturing process. It includes even repair, finishing, oiling or cleaning process with view to its use, sale, transport, delivery or disposal. It cannot be restricted an activity which may result into manufacturing something or production of a commercially different article. The 'manufacturing process' cannot be interpreted in a narrow sense in respect of an act which is meant for the purpose connected with the social welfare.

Worker

Section 2(l) defines the term 'worker' as a person employed, directly or by or through any agency (including a contractor) with or without the knowledge of the principal employer, whether for remuneration or not, in any manufacturing process, or in cleaning any part of the machinery or premises used for a manufacturing process, or in any other kind of work incidental to, or connected with, the manufacturing process, or the subject of the manufacturing process but does not include any member of the armed forces of the Union.

In 'Lal Mohammed V. Indian Railway Construction Co. Limited' – AIR 1999 SC 355 it was held that all the workers employed by a construction company would squarely attract the definition of the term

'workman' as found in Section 2(l) of the Act as they are working for remuneration in a manufacturing process carried out by the project.

Factory

Section 2(m) defines the term 'factory' as any premises including the precincts thereof-

- whereon ten or more workers are working, or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on with the aid of power, or is ordinarily so carried on, or
- whereon twenty or more workers are working, or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on without the aid of power, or is ordinarily so carried on,-
- but does not include a mine subject to the operation of the Mines Act, 1952 or a mobile unit belonging to

the armed forces of the Union, a railway running shed or a hotel, restaurant or eating place.

- For computing the number of workers for the purposes of this clause all the workers in different groups and relays in a day shall be taken into account;
- For the purposes of this clause, the mere fact that an Electronic Data Processing Unit or a Computer Unit is installed in any premises or part thereof, shall not be construed to make it a factory if no manufacturing process is being carried on in such premises or part thereof.

In 'Seelan Raj V. Presiding Officer, I Additional Labor Court, Chennai' – 2001 LLR 418 it was held that under Section 2(m), 'Factory' means any premises including the precincts thereof in which a manufacturing process is carried on Explanation II of Section 2(m) sets out that the mere fact that an electronic data processing unit or a computer unit is installed in any premises or part thereof would not render a unit into a factory if no manufacturing process is carried on in such premises or part thereof.

The State Government may make rules relating to approval, licensing and registration of factories and no factory can run without such license or approval. Power to de-license and deregister is also with the State Government.

Occupier

Section 2(n) defines the term 'occupier' of a factory as the person who has **ultimate control** over the affairs of the factory.

- in the case of a firm or other association of individuals, any one of the individual partners or members thereof shall be deemed to be the occupier;
- in the case of a company, any one of the directors shall be deemed to be the occupier;
- in the case of a factory owned or controlled by the Central Government or any State Government, or any local authority, the person or persons appointed to manage the affairs of the factory by the Central Government, the State Government or the local authority, as the case may be, shall be deemed to be the occupier;
- in the case of a ship which is being repaired, or on which maintenance work is being carried out, in a dry dock which is available for hire,-
- the owner of the dock shall be deemed to be the occupier for the purposes of any matter provided for by or under-
  - section 6, section 7, section 7A, section 7B, section 11 or section 12;
  - section 17, in so far as it relates to the providing and maintenance of sufficient and suitable lighting in or around the dock;
  - section 18, section 19, section 42, section 46, section 47 or section 49, in relation to the workers employed on such repair or maintenance;
- the owner of the ship or his agent or master or other office-in-charge of the ship or any person who contracts with such owner, agent or master or other officer-in-charge to carry out the repair or maintenance work shall be deemed to be the occupier for the purposes of any matter provided for by or under section 13, section 14, section 16 or section 17 (save as otherwise provided in this proviso) or Chapter IV (except section 27) or section 43, section 44, or section 45, Chapter VI, Chapter VII, Chapter VIII or Chapter IX or section 108, section 109 or section 110, in relation to-

- the workers employed directly by him, or by or through any agency; and
- the machinery, plant or premises in use for the purpose of carrying out such repair or maintenance work by such owner, agent, master or other officer-in-charge or person.

In 'Container Corporation of India Limited v. Lt. Governor, Delhi' – 2002 LLR 1068 it was held that in the case of a company, which owns a factory, it is only one of the directors of the company who can be notified as the occupier of the factory for the purpose of the Act and the company cannot nominate any other employee to be the occupier of the factory.

In 'Indian Oil Corporation V. Labor Commissioner' –AIR 1998 SC 2456 it was held that for the purpose of Section 2(n) what is to be seen is who has the 'ultimate control' over the affairs of the factory. Relevant provisions regarding establishment of the Indian Oil Corporation Limited and its working, leave no doubt that the ultimate control over all the affairs of the Corporation, including opening and running of the factories, is with the Central Government. Acting through the Corporation is only a method employed by the Central Government for running its petroleum industry. In the context of Section 2(n) it will have to be held that the all the activities of the Corporation are really carried on by the Central Government with a corporate mask.

Notice by occupier

Section 7 provides that the occupier shall, at least 15 days before he begins to occupy or use any premises as a factory, send to the Chief Inspector, a written notice containing the name and situation of the factory, the name and address of the occupier, the nature of manufacturing process, the details of workers etc., Whenever a new manager is appointed, the occupier shall send to the Inspector a written notice and to the Chief Inspector a copy thereof within seven days from the date on which such person takes over charge.

Duties of occupier

Section 7A prescribes the general duties of occupier. Every occupier shall ensure, so far as is reasonably practicable, the health, safety and welfare of all workers while they are at work in the factory.

Inspector

Section 8 provides that the State Government may appoint such persons as possess the prescribed qualification to be Inspectors for the purpose of this Act and may assign to them such local limits as it may think fit. Section 9 prescribes the powers of the Inspector as detailed below-

- to enter into any place which is used, or which he has reason to believe is used as a factory;
- make examination of the premises, plant, machinery, article or substance;
- inquire into any accident or dangerous occurrence, whether resulting in bodily injury, disability or not and take on the sport statements of any person which he may consider necessary for such inquiry;
- require the production of any document relating to factory;
- seize or take copies of any register, record or other documents of any portion thereof as he may consider necessary;
- to take possession of any article or substance or part thereof and detain it for so long as is necessary for such examination;
- to exercise such other powers as may be prescribed.

Certified surgeons

Section 10 provides that the State Government may appoint qualified medical practitioners to be certifying surgeons for the purposes of this Act within such local limits or for such factory or class or description of factories as it may assign to them respectively.The duties of certified surgeons are as follows-

- the examination and certification of young persons;
- the examination of person engaged in factories in such dangerous occupations or processes as may be prescribed;
- the exercising of such medical supervision as may be prescribed for any factory or class or description of factories, where-
  - cases of illness have occurred which it is reasonable to believe are due to the nature of the manufacturing process carried on, or other conditions of work prevailing, therein;
  - by reason of any change in the manufacturing process carried on or in the substances used therein or by reason of the adoption of any new manufacturing process or of any new substance for use in a manufacturing process, there is a likelihood of injury to the health of workers employed in that manufacturing process;
  - young persons are, or are about to be, employed in any work which is likely to cause injury to their health.

Welfare measures

The Factories Act takes care of the workers in the following aspects-

- health of the workers in the working environment;
- safety of the workers including in the hazardous process;
- welfare of the workers;
- working hours of adults;
- employment of young persons;
- Annual leave with wages;

Health

Chapter III of the Act deals with measures to be taken considering the health aspects of the workers. The following are to be taken care of by the occupier of the factory:

- cleanliness;
- disposal of waste and effluents;
- ventilation and temperature;
- dust and fume;
- artificial humidification;
- overcrowding;
- lighting;

- drinking water;
- latrines and urinals;
- spittoons

Cleanliness

Section 11 of the Act provides every factory shall be kept clean and free from effluvia arising from any drain, privy or other nuisance, and in particular-

- removal of accumulated dirt and refuse on floors, benches of workroom, stair cases and passages and effective disposal of the same;
- cleaning of the floor of every workroom – once in every week by washing with disinfectant or by some other effective method;
- providing effective drainage for removing water to the extent possible;
- to ensure that interior walls and roofs etc., are kept clean the following is to be complied with-
  - white wash or color wash should be carried out at least once in every period of 14 months;
  - where surface has been painted or varnished, repair or revarnish should be carried out once in every five years, if washable then once in every period of six months;
  - where they are painted or varnished or where they have smooth impervious surface, it should be cleaned once in e very period of 14 months by such method as may be prescribed.
- all doors, windows and other framework which are of wooden or metallic shall be kept painted or varnished at least once in every period of five years;

The dates on which such processes are carried out shall be entered in the prescribed register.

Disposal of wastes and effluents

Section 12 provides that effective arrangements shall be made in every factory for the treatment of wastes and effluents due to the manufacturing process carried on therein, so as to render them innocuous, and for their disposal.

Ventilation and temperature

Section 13 provides that effective and suitable provision shall be made in every factory for securing and maintaining every workroom with adequate ventilation by the circulation of fresh air and such a temperature as will secure to workers therein reasonable conditions of comfort and prevent to health. In case of the work involves the production excessively high temperatures, adequate measures shall be taken to protect the workers by separating their process which produces such high temperatures from the workroom by insulating the hot parts or by other effective means.

Dust and fume

Section 14 provides that in every factory if there is given off any dust or fume or other impurity of such nature in the process of manufacturing and it is likely to be injurious or offensive to the workers employed, any dust in substantial quantities, offensive to the workers, effective measures shall be taken to prevent its inhalation and accumulation in any work room. Exhaust appliance shall be applied as near as possible to the point of origin of dust, fume or other impurity and such points shall be enclosed so far as possible.

Artificial humidification

Section15 provides that if the humidity of the air is artificially increased, the State Government may make rules-

- prescribing standards of humidification;
- regulating the methods used for artificially increasing the humidity of the air;
- directing prescribed tests for determining the humidity of the air to be correctly carried out and recorded;
- prescribing methods to be adopted for securing adequate ventilation and cooling of the air in the workrooms.

Overcrowding

Section16 provides that no room in any factory shall be overcrowded to an extent injurious to the health of the workers employed therein. There shall be in every workroom in a factory at least14.2 cubic meters of space for every worker employed therein.

Lighting

Section 17 provides that in every part of a factory where workers are working or passing there shall be provided and maintained sufficient and suitable lighting, nature or artificial or both. All glazed windows and skylights used for the lighting shall be kept clean on both the inner and outer surfaces and free from obstruction. Effective provisions shall be made for the prevention of glare, either directly from a source of light or by reflection from a smooth or polished surface and the formation of shadows to such an extent as to cause eye strain or the risk of accident to any worker.

Drinking water

Section 18 provides that effective arrangements shall be made to provide and maintain at suitable points conveniently situated for all workers employed a sufficient supply of wholesome drinking water. Where more than 250 workers are employed provision shall be made for cool drinking water during hot weather. The water points shall be away six meters from any washing place, urinal, latrine, spittoon, open drain carrying sullage or effluent or any other source of contamination.

Latrines and urinals

Section 19 provides that in every factory-

- sufficient latrine and urinal accommodation of prescribed types shall be provided conveniently situated and accessible to workers at all times while they are at factory;
- separate enclosed accommodation shall be provided for male and female workers;
- they shall be adequately lighted and ventilated;
- they shall be maintained in a clear and sanitary conditions at all times;
- sweepers shall be employed to keep clean latrines, urinals and washing places.

If there are more than 250 workers are employed all latrine and urinal accommodation shall be of prescribed types. The flows and internal walls and the sanitary blocks shall be laid in glazed tiles to provide a smooth polished impervious surface. The latrines and urinals shall be washed and cleaned at least once in every seven days with suitable detergents or disinfectants or with both.

Spittoons

Section 20 provides that there shall be provided a sufficient number of spittoons in convenient places and they shall be maintained in a clean and hygienic condition.

Safety

Chapter IV of the Act prescribes the procedures to be adopted on the safety of the working place in a factory. The factory is to take safety measures in respect of the following-

- Fencing of machinery;
- Work on or near machinery in motion;
- Employment of young persons on dangerous machines;
- Striking gear and devices for cutting off power;
- Self acting machines;
- Casing of a new machinery;
- Prohibition of employment of women and children near cotton openers;
- Lifting machines, chains, ropes and lifting tackles;
- Revolving machinery;
- Floors, stairs and means of access;
- Pits, sumps openings in floors etc.,;
- Excessive weights;
- Protection of eyes;
- Precaution against dangerous fumes, gases, etc.,
- Precautions regarding the use of portable electric light;
- Explosive or inflammable dust, gas etc.,
- Precaution in case of fire;
- Safety on buildings and machinery;
- Maintenance of buildings;
- Appointment of safety officers.

Hazardous Processes

Chapter IVA provides for making provisions relating to hazardous process.The State Government may, for purposes of advising it to consider applications for grant of permission for the initial location of a factory involving a hazardous process or for the expansion of any such factory, appoint a Site Appraisal Committee. The Site Appraisal Committee shall examine an application for the establishment of a factory involving hazardous process and make its recommendation to the State Government within 90 days of the receipt of such application. The Committee has the power to call for any information from the person making an application.When the application is got approved by the State Government, it shall not be necessary to obtain a further approval from the Central Board of the State Board of pollution authorities.

Responsibility of the occupier

The occupier has to follow the procedure-

- to lay down a detailed policy with respect to the health and safety of the workers;
- to disclose all the information regarding dangers including health hazards and the measures to overcome such hazards arising from the exposure to or handling of the materials or substances in the manufacture, transportation, storage and other processes to the workers employed in the factory;
- to draw up an onsite emergency plan and detailed disaster control measures for the factory and make known to the workers and to the general public living in the vicinity of the factory, the safety measures required to be taken in the event of accident taking place.
- to lay down measures for the handling usage, transportation and storage of hazardous substances inside the factory premises and the disposal of such substances outside the factory premises and publicize them in the manner prescribed among the workers and the general public living in the vicinity.

Section 41C provides that the occupier is having specific responsibilities in relation to hazardous processes. He has to maintain the health records of the employees. He is to appoint experienced persons who possess specified qualifications in handling hazardous substances and competent to supervise such handling within the factory.

Powers of the Central Government

Section 41D provides that the Central Government is having power to inquire to the standards of health and safety observed in a factory. Section 41E provides to provide emergency standards in respect of a factory. Section 41F provides for fixing the maximum permissible threshold limits of exposure of chemical and toxic substances in manufacturing process in any factory. Section 41G provides that the occupier shall set up a Safety Committee consisting of equal number of representations of workers and management to promote co-operation between the workers and the management in maintaining proper safety and health at work and to review periodically the measures taken in that effect. Section 41H provides that the workers have reasonable apprehension that there is a likelihood of imminent danger to their lives or health due to accident, they may bring the same to the notice of his occupier, agent, manager or any other person who is in charge of the factory or the process. Immediate action shall be taken and a report to the Inspector having jurisdiction.

Welfare

Chapter V provides the welfare measures to be taken in a factory for the workmen employed in the factory. The following are the welfare measures prescribed in the Act to be provided by the factory to their workmen-

- washing facilities;
- facilities for storing and drying clothing;
- facilities for sitting;
- first aid appliances;
- canteens;
- shelters, rest rooms and lunch rooms;
- crèches;
- appointment of welfare officers.

Washing facilities

Section 42 provides that in every factory adequate and suitable facilities for washing shall be provided and maintained for the use of the workers.Separate and adequately screened facilities shall be provided for the use of male and female workers.The washing facility shall be conveniently accessible and shall be kept clean.

Facilities for storing and drying clothing

Section 43 provides that the State Government may, in respect of any factory or class or description of factories, make rules requiring the provision therein of suitable places for keeping clothing not worn during working hours and for the drying of wet clothing.

Facilities for sitting

Section 44 provides that suitable arrangements for sitting shall be provided and maintained for all workers obliged to work in a standing position, in order that they make take advantage of any opportunities for rest which may occur in the course of their work.

First aid appliances

Section 45 provides that first aid appliances shall be provided and maintained so as to be readily accessible during all working hours or cupboards equipped with the prescribed contents and the number of such boxes or cupboards to be provided and maintained shall not be less than for every

150 workers at any one time in the factory.Each first aid box or cupboard shall be kept in charge of a separate reasonable person who holds a certificate in the first aid treatment recognized by the State Government and he should always be readily available during the working hours of the factor.

In a factory where more than 500 workers are employed an ambulance of the prescribed size containing the prescribed equipment, nursing staff etc., shall be provided and made readily available at all times.

Canteens

Section 46 provides that if more than 250 workers are employed in a factory a canteen or canteens shall be provided and maintained by the occupier for the user of the workers.The items of expenditure in the running of the canteen which are not to be taken into account in fixing the cost of foodstuffs shall be borne by the employer.

In 'Ferro Alloys Corporation Limited V. Government of Andhra Pradesh Labor Employment and Technical Education (Labor II) Department' – 2003 (96) FLR 160 it was held that there is nothing in Section 46 of the Factories Act, which provides for the mode in which the specified establishment must set up a canteen where it is left to the discretion of the concerned establishment to discharge its obligation of setting up a canteen either by way of direct equipment or by employment of contractor, it cannot be postulated that in the latter event, the persons working in the canteen would be the employees of the establishment.

Shelters, rest rooms and lunch rooms

Section 47 provides that if more than 150 workers are employed adequate and suitable shelters or rest rooms and a suitable lunch room with provision for drinking water shall be provided and maintained for the use of the workers.The same shall be sufficiently lighted and ventilated and shall be maintained in a cool and clean condition.

Crèches

Section 48 provides that if more than 30 women workers are employed there shall be provided and maintained a suitable room for the use of children under the age of 6 years of such women.The same shall be adequately

ventilated and shall be maintained in clear and sanitary conditions and under the charge of women trained in the care of children and infants.

Welfare Officers

Section 49 provides that if 500 or more than workers are employed in a factory, the occupier shall employ in the factory such number of welfare officers as may be prescribed. In 'Shyam Vinyals Limited V. T. Prasad' – (1993) 83 FJR 18 (SC) it was held that an Assistant Personnel Officer cannot be held that he was in fact appointed asa Labor Welfare Officer simply because as a Assistant and Personnel Officer he was looking after the problems of the laborers and the welfare of the laborers.

Working hours of adults

Working hours

Chapter VI of the Act provides for the working hours of adults.This chapter provides for working hours in a day, weekly working hours,weekly holidays, intervals for rest. Spread over of duty, night shift etc.,

Section 54 provides that no adult worker shall be required or allowed to work in factory for more than nine hours in any day.

Section 55 provides that the periods of work of adult workers in a factory each day shall be so fixed that no period shall exceed five hours and that the worker shall work for more than five hours before he has had an interval for rest of at least half an hour.

Section 56 provides that the periods of work of an adult worker in a factory shall be so arranged that inclusive of his intervals for rest, they shall not spread over more than ten and half hours in any day.

Section 51 provides that no adult worker shall be required or allowed to work in a factory for more than

48 hours in any week.In 'Richa & Company V. Shri Suresh Chand' – 2009 LLR 333 (SN) (Del HC) it was held that increase of 15 minutes working will not be violative of Section 51 of the Act.

Weekly holidays

Section 52 provides that no adult worker shall be required or allowed to work in a factory on the first day of the week unless-

- he has or will have a holiday for a whole day on one of the three days immediately before or after the said day; and
- the manager of the factory, has, before the said day or the substituted day whichever is earlier-
  - delivered a notice at the office of the Inspector of his intention to require the worker to work on the said day and of the day which is to be substituted; and
  - displayed a notice to that effect in the factory.

In 'Motor and Machinery Manufacturers Limited V. State of West Bengal' – 1964 (2) LLJ 562 it was held that the primary object of the Section 52 is to provide weekly holiday for the workers and such day was fixed to be the first day of the week i.e., Sunday. But for any special reasons, it becomes necessary to make Sunday the working day, a substitutional holiday is made compulsory. But the intendment of the section is not that the employers will at their sweet convert successive on all the Sundays primarily intended to be holidays as working days and make any other working day of the week a holiday instead of Sunday.

Compensatory holidays

Section 53 provides that if a worker is deprived of any of the weekly holidays he shall be allowed within the month in which the holidays were due to him or within two months immediately following that month, compensatory holidays of equal number to the holidays so lost shall be given.

Shift duty

Section 57 provides that where a worker in a factory works on a shift which extends beyond midnight-

- for the purposes of Section 52 and 53, a holiday for a whole day shall mean in his case a period of 24 consecutive hours beginning when his shift ends;
- the following day for him shall be deemed to be the period of 24 hours beginning when such shift ends, and the hours he has worked after midnight shall be counted in the previous day.

Section 58 provides that the work shall not be carried on in any factory by means of a system of shifts so arranged that more than one relay of workers is engaged in work of the same kind at the same time.

Overtime

Section 59 provides that where a worker works in a factory for more than 9 hours in any day or for more than 48 hours in any week, he shall, in respect of the overtime work, be entitled to wages at the rate of twice his ordinary rate of wages.

The term 'ordinary rate of wages' is defined as the basic wages plus such allowances, including the cash equivalent of the advantage accruing through the concessional sale to workers of food grains and other articles, as the worker is for the time being entitled to, but does not include a bonus and wages for overtime work.Where any workers are paid on a piece rate basis, the time rate shall be deemed to be equivalent to the daily average of their full time earnings for the days on which they actually worked on the same or identical job during the month immediately preceding the calendar month during which the overtime work was done and such time rates shall be deemed to be ordinary rate of wages of those workers.

In 'National Textiles Corporation (D.P.&R) Limited Unit- Mahalakshmi Mills, Beawar V. Labor Court, Jaipur'

– 1997 LLR 518 it was held that Section 59 creates an obligation on the employer to pay extra wages for overtime if a worker works for more than 9 hours in any day or for more than 48 hours in any week.

Double employment

Section 60 imposes restriction that no adult worker shall be required or allowed to work in any factory on any day on which he has already been working in any other factory, save in such circumstances as may be prescribed.

Register of adult workers

Section 62 provides that a register of adult workers shall be maintained, showing-

- the name of each adult worker in the factory;
- the nature of the work;
- the group, if any, in which he is included;
- where his group works on shifts, the relay to which he is allotted;
- such other particulars as may be prescribed.

Employment of women

Section 66 provides that the provisions of this Chapter shall, in their application to women in factories,

be supplemented by the following further restrictions-

- no exemption from the provisions of Section 54 may be granted in respect of any woman;
- no woman shall be required or allowed to work in any factory except between the hours of 6 a.m. and 7 p.m.;
- the State Government may authorize the employment of any women between the hours of 10 p.m. and 5 a.m.;
- there shall be no change of shifts except after a weekly holiday or any other holiday.

Employment of young persons

Chapter VII of the Act deals with the employment of young persons.

Prohibition of employment of young children

Section 67 provides that no child who has not completed his 14th year shall be required or allowed to work in any factory.

Adolescent worker

Section 68 provides that a child who has completed his 14th year or an adolescent shall not be allowed to work in any factory unless-

- a certificate of fitness granted is in the custody of the manager of the factory; and
- such child or adolescent carries while he is at work a token giving a reference to such certificate.

Certificate of fitness

Section 69(1) provides that a certifying surgeon shall, on the application of any young person or his parent or guardian accompanied by a document signed by the Manager of a factory that such person will be employed therein if certified to be fit for work in a factory, or on the application of the Manager of the factory in which any young person wishes to work, examine such person and ascertain his fitness for work in a factory.

Section 69(2) provides that the certifying surgeon, after examination, may grant to such young person, in the prescribed form or may renew-

- a certificate of fitness to work in a factory as a child, if he is satisfied that the young person has completed his 14th year, that he has attained the prescribed physical standards and that he is fit for such work;
- a certificate of fitness to work in a factory as an adult, if he is satisfied that the young person has completed his 15th year and is fit for a full day's work in a factory.

The certificate granted by the certifying surgeon shall be valid for a period 12 months from the date thereof. He shall revoke any certificate granted or renewed if in his opinion the holder of it is no longer fit to work in capacity stated therein in a factory. In case the certifying surgeon refuses to give certificate, he has to give reasons for the same. If a certificate is given under certain conditions, the young person shall not be allowed in any factory except in accordance with those conditions. The occupier is to pay the fee for getting the certificate from the certifying surgeon and the same shall not be recovered from the young person, his parents or guardian.

Working hours for children

Section 71 provide that no child shall be employed or permitted to work in any factory for more than four and a half hours in any day and during night. The period of work of all children employed in a factory shall be limited to two shifts which shall not overlap or spread over more than five hours each. Each child shall be employed in only one of the relays which shall not, except with the previous permission. No female child shall be allowed to work in any factory except between 8 a.m. and 7 p.m.

Register of child workers

Section 73 provides that the Manager of every factor in which children are employed shall maintain a register of child workers showing-

- the name of each child worker in the factory;
- the nature of his work;
- the group, if any, in which he is included;
- where his group works on shifts, the relay to which he is allotted; and
- the number of his certificate of fitness granted under Section 69.

Annual Leave with wages

Chapter VIII of the Act deals with annual leave granted workers with wages.

Annual leave

Section 79 provides that every worker who has worked for a period 240 days or more in a factory during a calendar year shall be allowed leave with wages for a number days calculated at the rate of-

- if an adult, one day for every 20 days of work performed by him during the previous calendar year;
- if a child, one day for every 15 days of work performed by him during the previous calendar year.

The following shall be deemed to be days on which the worker has worked for the purpose of computation of the period of 240 days or more-

- any days of lay off, by agreement or contract or as permissible under the standing orders;
- in the case of a female worker, maternity leave for any number of days not exceeding 12 weeks; and
- the leave earned in the year prior to that in which the leave is enjoyed

but the above shall not be entitled for a worker to earn leave. The leave admissible shall be exclusive of all holidays whether occurring during or at either end of the period of leave.

In calculating the leave fraction of leave of half a day or more shall be treated as one full day's leave and fraction of less than half a day shall be omitted.

Carry forward of leave

If a worker does not in any calendar year take the whole of the lave allowed to him any leave not taken by him shall be carried over to the succeeding year. The total number of leave that may be carried forward shall not exceed 30 days in the case of an adult or 40 in the case of a child. A worker, who has applied for leave with wages but has not been granted, shall be entitled to carry forward the leave refused without any limit.

Availing of leave

A worker may, at any time, apply in writing to the Manager not less than 15 days before the date on which he wishes his leave to begin, to take all the leave or any portion thereof allowable to him during the calendar year. Such application shall be made not less than 30 days before the date on which he wishes his leave to begin, if he is employed in a public utility service. An application for leave shall not be refused unless refusal is in accordance with the scheme for the time being in operation.

Wages during leave period

Section 80 provides that a worker shall be entitled to wages at a rate equal to the daily average of his total full time earnings for the days on which he actually worked during the month immediately preceding his leave, exclusive of any over time and bonus but inclusive of dearness allowance and the cash equivalent of the advantage accruing through the concessional sale to the worker of food grains and other articles. In case of a worker who has not worked on any day during the calendar month immediately preceding his leave, he shall be paid at a rate equal to the daily average of the total full time earnings for the days on which he actually worked during the last calendar month preceding his leave, in which he actually worked.

Advance payment

Section 81 provides that a worker who has been allowed leave for not less than four days, in case of an adult, and five days, in the case of a child, shall, before his leave begins be paid the wages due for the period of the leave allowed.

Encashment of leave

Section 79(3) provides that if a worker is discharged or dismissed from services or quits his employment or is superannuated or dies while in service, during the course of the calendar year, he or his heir or nominee, shall be entitled to the wages in lieu of the quantum of leave to which he was entitled immediately before such termination of his services. Such payment shall be made before the expiry of the second working day from the date of discharge, dismissal or quitting and where the worker is superannuated or dies while in service, before the expiry of two months from the date of such superannuation or death.

Penalties

Section 92 provides that there is any contravention of any of the provisions of this Act or of any rules made there under or of any order in writing given, the occupier and manager of the factory shall each be guilty of an offence and punishable with imprisonment for a term which may extend to 2 years or with fine which may extend to ₹ 1 lakh or with both. If the contravention is continued after conviction, with a further fine which may extend to ₹ 1,000 for each day on which the contravention so continued.

If the contravention resulted in an accident causing death or serious bodily injury, the fine shall not be less than ₹ 25,000 in the case of an accident causing death, and ₹ 5,000 in the case of accident causing serious bodily injury.

In 'General Manager, Wheel and Axle Plant, Bangalore V. State of Karnataka' – 1996 (1) FLR 23 (Kar) it was held that where an offence, which is punishable under Section 92 of the Act, has been committed by an officer of the Railways and he is a public servant within the meaning of Section 21 of the Indian Penal Code, the requirement of obtaining sanction to prosecute him is mandatory and taking cognizance of an offence in the absence of sanction cannot be allowed to stand.

Liability of owners

Section 93 provides that where in any premises separate buildings are leased to different occupiers for use as separate factories, the owner of the premises shall be responsible for the provision and maintenance of common

facilities and services, such as approach roads, drainage, water supply, lighting and sanitation. The owners of the premises shall be liable as if they were the occupier or manager of a factory for any contravention of the provisions of this Act.

Enhanced penalty

Section 94 provides that if any person who has been convicted of any offence punishable under Section 92 of the Act is again guilty of an offence involving a contravention of the same provision, he shall be punishable on a subsequent conviction with imprisonment for a term which may extend to 3 years or with fine which shall not be less than ₹10,000 but which may extend to ₹2 lakhs or with both. The Court may, for any adequate and special reasons recorded in writing, impose of a fine of less than ₹10,000. No cognizance shall be taken of any conviction made more than 2 years before the commission of the offence for which the person is subsequently convicted.

Penalty for obstructing Inspector

Section 95 provides that whoever-

- willfully obstructs an Inspector in exercise of any power conferred on him; or
- fails to produce on demand any registers or other documents in his custody before the Inspector, or conceals or prevents any worker in a factory from appearing before; or
- being examined by, an Inspector shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to ₹10,000 or with both.

Penalty for contravention of the provisions relating to hazardous process

Section 96A provides that whoever fails to comply with or contraventions any of the provisions of Section 41B, 41C or 41H or the rules made there under, shall, in respect of such failure or contravention, be punishable with imprisonment for a term which may extend to seven years and with fine which may extend to ₹2 lakhs and in case of the failure or contravention continues, with additional fine which may extend to ₹5,000 for every day during which such failure or contravention continues after the conviction for the first such failure or contravention. If the failure or contravention continues beyond a period of 1 year after the date of conviction, the offender shall be punishable with imprisonment for a term which may extend to 10 years.

Offences by workers

Section 97 provides that if any worker employed in a factory contravenes any provision of this Act or any rules or by order made there under, imposing any duty or liability on workers, he shall be punishable with fine which may extend to ₹500.

Penalty for using false certificate of fitness

Section 98 provides that whoever knowingly uses or attempts to use, as a certificate of fitness granted to himself a certificate granted to another person or who, having procured such a certificate, knowingly allows it to be used, or an attempt to use it to be made, by another person, shall be punishable with imprisonment for a term which may extend to 2 months or with fine which may extend to ₹1,000 or with both.

Penalty for permitting double employment of child

Section 99 provides that if a child works in a factory on any day on which he has already been working in another factory, the parent or guardian of the child or the person having custody of or control over him or obtaining any director benefit from his wages, shall be punishable with fine which may extend to ₹1000 unless it appears to the Court that the child so worked without the consent or connivance of the parent, guardian or person.

EXERCISE

Multiple Choice Question:

1. Age of adolescent worker is-
   a) 10 b) 14
   c) 18 d) 21
2. Certificate of fitness to be young worker is to be granted by-
   a) Occupier of the factory b) Inspector of the factory
   c) Certifying surgeon d) None of the above
3. White wash or color wash should be carried out atleast once in every period of-
   a) 14 months; b) 24 months;
   c) 48 months; d) 60 months
4. Where more than_____ workers are employed provision shall be made for cool drinking water during hot weather.
   a) 100 b) 250
   c) 500 d) 1000
5. Shelter rooms with suitable lunch rooms are to be provided, if more than _____ workers are employed.
   a) 100 b) 250
   c) 500 d) none of the above.
6. No female child shall be allowed to work in any factory except between-
   a) 8 a.m., and 7 p.m.; b) 6 p.m., and 6 a.m.,
   c) 6 a.m., and 7 p.m., d) 10 p.m. and 5 a.m.,
7. Compensatory holidays are to be availed within _____ month.
   a) 1 month b) 2 months
   c) 6 months d) 9 months
8. Which one of the following amounts to safety measure?
   a) Artificial humidification; b) Ventilation;
   c) Fencing of factory; d) First aid appliances.
9. Identify from the following which is the power of Inspector of Factory.
   a) Enter into any place ofa factory; b) Make inquiry into any accident;
   c) Seize or take copies of any document; d) All the above.
10. Weekly holiday shall be_____
    a) First day of the week; b) Last day of the week;
    c) Third day of the week; d) None of the above.

State TRUE or FALSE

1. The Occupier is bound to inform the changes taken place to the authorities by means of a notice.
2. Welfare Officer is required to be appointed if there are 100 or more workers are employed in a factory.
3. Double employment is allowed in factories act.
4. A dismissed employee is entitled to the wages in lieu of the quantum of leave at the time of his dismissal.
5. Government cannot inquire to the standards of health and safety observed in a factory.
6. A woman employee may be allowed to work between 6 p.m. and 6 a.m.
7. If the inspector is obstructed in a factory penalty is imposed on the concerned person.
8. Leave may be availed on oral request to the Supervisor.
9. Strike period is not counted as duty for the purposes of computation of the period of 240 days meant for calculation of leave entitlement.
10. Register of adult workers is to be maintained in a factor.

Fill in the blanks

1. Safety Officer is required to be appointed where more than _____ workers are ordinarily employed.
2. If more than _____ workers are employed in a factory, a canteen or canteens shall be provided and maintained by the occupier for the use of the workers.
3. No adult worker shall be allowed to work in a factory for more than _____ hours in any day.
4. In respect of overtime work, the employee is entitled to wages at the rate of _____ his ordinary rate of wages.
5. No woman employee shall be required to work in any factory except between _____ and _____.
6. A child who has completed his 14th year of an adolescent shall not be allowed to work in any factory unless _____granted in the custody of the manager of the factory.
7. _____ shall be provided and maintained for the use of children not under the age of 6 years if more than _____women workers are employed.
8. Occupier is the person who has_____ over the affairs of the factory.
9. The total number of leave that may be carried forward shall not exceed _____ days in the case of adult or _____ in the case of child worker.
10. _____ shall examine an application for an establishment of a factory involving hazardous process.

Short Essay Type Questions

1. What are the responsibilities of an occupier in a factory?
2. List the welfare measures to be taken by an Occupier in a factory.

3. Write a short note on -
   (a) hazardous processes
   (b) Manufacturing Process and Factory
   (c) prohibition of employment of young persons under this Act

⊙ **Essay Type Questions**

1. Discuss the obligations and the right of the worker under the Factories Act.
2. What are the powers that can be exercised by an Inspector under this Act?
3. What are the measures to be taken to keep the factory clean?
4. Critically examine the duties of certified surgeon.
5. Briefly discuss the provisions in respect of first aid appliances.

Answer:

Multiple Choice Question

1. b; 2. c; 3. a; 4. b; 5. d; 6. a; 7. b; 8. c; 9. d; 10. c.

State TRUE or FALSE

1. True; 2. False; 3. False; 4. True; 5. False; 6. False; 7. True; 8. False; 9. True; 10. True.

Fill in the blanks

1. 1000; 2. 250; 3. 9; 4. Twice; 5. 6 a.m. and 5 p.m.; 6. A certificate of fitness; 7. Crèche, 30; 8. Ultimate control; 9. 30, 40; 10. Site Appraisal Committee.

Payment of Gratuity Act, 1972 8

SLOB Mapped against the Module

To acquire conceptual knowledge & objectives about payment of Gratuity Act.

Module Learning Objectives:

After studying this module, the students will be able -

- To acquire the requisite knowledge of the Payment of Gratuity Act, 1972 and its object of paying a one-time gratuity to retired employees in certain industries such as, factories, mines, oilfields, plantations, ports and railway companies.
- To develop an understanding about the different applications of the Act in the case of shops or establishments and organisations where 10 or more persons are employed.

Payment of Gratuity Act, 1972

8

The term 'gratuity' is derived from the Latin word 'gratuitous'. 'Gratuity' is the payment made by the employer to the employee at the time of termination of his service either by retirement on superannuation or on resignation or on termination of the service. This is the old age retiral social security benefit. A lump sum is payable in consideration of the past services rendered by the employee. The payment of gratuity will be a relief to the retired employee or to the family members of the employee who dies during his service. For this purpose the Payment of Gratuity Act, 1972 was enacted. The Act was amended from time to time. To carry out the provisions of the Act the Central Government made 'The Payment of Gratuity Rules, 1972 which came into force with effect from 16th September, 1972.

The Supreme Court in 'Burhanpur Tapti Mills Limited V. Burhanpur Tapti Mills Mazdoor Sangh' – 1964 (11) TMI 79 - SUPREME COURT – it was held that it is a gratuitous payment extended to an employee on retirement or discharge, in addition to the retrial benefits payable to the employee.

Object

An Act to provide for a scheme for the payment of gratuity to employees engaged in factories, mines, oilfields, plantations, ports, railway companies, shops or other establishments and for matters connected therewith or incidental thereto, employing 10 or more persons (with aid of power) and 20 (without aid of power).

8.1 Important Definitions:

Appropriate Government

Section 2(a) defines the term 'appropriate Government' as-

- in relation to an establishment-
  - belonging to, or under the control of, the Central Government,
  - having branches in more than one State,
  - of a factory belonging to, or under the control of, the Central Government,
  - of a major port, mine, oilfield or railway company - the Central Government,
- in any other case - the State Government;

Employee

Section 2(e) of the Act defines the term 'employee' as any person, other than an apprentice, who is employed for wages, whether the terms of such employment are express or implied, in any kind of work, manual or otherwise, in or in connection with the work of a factory, mine, oilfield, plantation, port, railway company, shop or other establishment to which this Act applies, but does not include any such person who holds a post under the Central Government or a State Government and is governed by any other Act or by any rules providing for payment of gratuity.

In 'Ahmedabad Private Primary Teachers Association V. Administrative Officer' – AIR 2004 SC 1426 it was

held that teacher was held to be not an employee under the Act. The teachers are clearly not intended to be covered by the definition of employee. But the Payment of Gratuity (Amendment) Act, 2009 has amended the definition of 'employee, including teachers in educational institutions within the purview of the Act.

Important Amendments:

The amendment has increased the ceiling limit of the maximum amount of gratuity payable in 2010. This upper cap prescribed by Section 4(3) of the Act, has been removed. Section 4(5) of the Act prescribes that if the terms of employment contract provide for a higher amount of gratuity over and above the ceiling limit stated in the Act, then the employee will be entitled to such higher amount. This transition has been introduced for the implementation of the 7th Central Pay Commission, whereby the ceiling of gratuity for Central Government employees has been enhanced from ₹10 lakhs to ₹20 lakhs. Instead of mentioning and specifying the ceiling amount in Act, the amendment empowers the Central Government to notify the ceiling proposed so that the limit can be revised from time to time keeping in view the increase in wage and inflation, and future Pay Commissions.

Also the period of maternity leaves for females in continuous service which was twelve weeks under section 2A of the earlier Act, the amendment has modified the maternity leave period from twelve weeks to twenty-six weeks in order to keep the Act in tune with the recently amended Maternity Benefit Act.

Employer

Section 2(f) defines the term 'employer', in relation to any establishment, factory, mine, oilfield, port, Railway Company or shop-

- belonging to, or under the control of, the Central Government or a State Government, a person or authority appointed by appropriate Government for the supervision or control of employees, or where no person or authority has been so appointed, the head of the Ministry or the Department concerned;
- belonging to, or under the control of, any local authority, the person appointed by such authority for supervision and control of employees or where no person has been so appointed, the Chief Executive Officer of the local authority;
- in any other case, the person, who, or the authority which, has the ultimate control over the affairs of the establishment, factory, mine, oil field, plantation, port, railway company or shop, and where the said affairs are entrusted to any other person, whether called a manager, managing director or by any other name, such person.

Family

Section 2(h) defines the term 'family' in relation to an employee, shall be deemed to consist of-

i) in case of a male employee, himself, his wife, his children, whether married or unmarried, his dependent parents and the dependent parents of his wife and the widow and children of his predeceased son, if any;

ii) in the case of a female employee, herself, her husband, her children, whether married or unmarried, her dependent parents and the dependent parents of her husband and the widow and children of her predeceased son, if any.

The explanation to this section provides that where the personal law of an employee permits the adoption by him of a child, any lawfully adopted by him shall be deemed to be included in his family, and where a child of an employee has been adopted by another person and such adoption is, under the personal law of the person making such adoption lawful such child shall be deemed to be excluded from the family of the employees.

Rule 5 provides that a notice under the proviso to sub clause (ii) of clause (h) of section 2 shall be in Form D and sent in triplicate by the employee to the employer, who shall, after recording its receipt on one copy thereof, return the copy to the employee and send the second copy to the controlling authority of the area.

Rule 5(2) provides that an employee may withdraw the notice referred to in sub-rule (1) by giving another notice in triplicate in Form 'E' to the employer, who shall follow the same procedure as in sub- rule (1).

Retirement

Section 2(q) of the Act defines the term 'retirement' as termination of the service of an employee otherwise than on superannuation.

Superannuation

Section 2(r) defines the term 'superannuation' as in relation to an employee, the attainment by the employee of such age as is fixed in the contract or conditions of service as the age on the attainment of which the employee shall vacate the employment.

Wages

Section 2(s) defines the term 'wages' as all emoluments which are earned by an employee while on duty or on leave in accordance with the terms and conditions of his employment and which are paid or payable to him in cash and includes dearness allowance but does not include any bonus, commission, house rent allowance, over time wages and any other allowance.

Continuous service

Section 2A deals with the continuous service. According to this section-

1. an employee shall be said to be in 'continuous service' for a period if he has, for that period been in un-interrupted service, including service which may be interrupted on account of sickness, accident leave, absence from duty without leave (not being absence in respect of which an order treating the absence as break in service has been passed in accordance with the standing orders, rules or regulations governing the employees of the establishment), lay off, strike or a lock out or cessation of work not due to any fault of the employee, whether such uninterrupted or interrupted service was rendered before or after the commencement of the Act;
2. where an employee (not being an employee employed in a seasonal establishment) is not in continuous service within the meaning of clause (1) for any period of 1 year or 6 months, he shall be deemed to be in continuous service under the employer:
   a) for the said period of one year, if the employee during the period of 12 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) 190 days in the case of an employee employed below the ground in mine or in an establishment which works for less than 6 days a week; and
      ii) 240 days in any other case;
   b) for the period of 6 months, if the employee during the period of 6 calendar months preceding the date with reference to which the calculation is to be made, has actually worked under the employer for not less than-
      i) 95 days, in the case of an employee below the ground in a mine or in an establishment which works for less than 6 days in a week; and
      ii) 120 days in any other case.

      The explanation to this section provide that for the purpose of clause (2), the number of days on which the employee has actually worked under an employer shall include the days on which-

      - he has been laid off under an agreement or as permitted by the standing orders made under the Industrial Establishment (Standing Orders) Act, 1946, or under the Industrial Disputes Act,

1947, or under any other law applicable to the establishment;

- he has been on leave with full wages, earned in the previous year;
- he has been absent due to temporary disablement caused by accident arising out of and in the course of his employment; and
- 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 26 weeks.

3. 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 75%, of the number of days on which the establishment was in operation during such period.

Disablement

Disablement means such disablement as incapacitates an employee for the work which he was capable of performing before the accident or disease resulting in such disablement.

Exemption

Section 5 of the Act gives powers to the appropriate Government to give exemption to any establishment from the purview of this Act, if it is satisfied that the employees in such establishment are in receipt of gratuity or pensionary benefits not less favorable than the benefits covered under this Act.

Notice of openings, change and closure of the establishment

Rule 3 provides that within thirty days of the rules becoming applicable to an establishment, a notice in Form A shall be submitted by the employer to the Controlling Authority of the area.

A notice in Form B shall be submitted by the employer to the controlling authority of the area within thirty days of any change in the name, address, employer or nature of business.

Where an employer intends to close down the business he shall submit a notice in Form C to the controlling authority of the area at least sixty days before the intended closure.

Display of notice

Rule 4 provides that the employer shall display conspicuously a notice at or near the main entrance of the establishment in bold letters in English and in a language understood by the majority of the employees specifying the name of officer with designation authorized by the employer to receive on his behalf notices under the Act or the rules.

Payment of Gratuity

Section 4(1) provides that 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 completion of continuous service of five years shall not be necessary where the termination of the employment of any employee is due to death or disablement. In the case of death of the employee, gratuity payable to him shall be paid to his nominee or, if no nomination has been made, to the heirs.

Section 4(2) provides that for every completed year of service or part thereof in excess of six months, the

employer shall pay gratuity to an employee at the rate of fifteen days' wages based on the rate of wages last drawn by the employee concerned. In the case of piece-rated employee, daily wages shall be computed on the average of the total wages received by him for a period of three 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 an employee employed in a seasonal establishment, the employer shall pay the gratuity at the rate of seven days' wages for each season.

Section 4(3) provides that the amount of gratuity payable to an employee shall not exceed such amount as may be notified by the Central Government from time to time.

Ministry of Labour & Employment vide Notification No. S.O. 1420(E) dated 29th March 2018 has notified that the amount of gratuity payable to an employee under the Act shall not exceed ₹20 lakhs.

Section 4(4) provides that for the purpose of computing the gratuity payable to an employee who is employed, after his disablement, on reduced wages, his wages for the period preceding his disablement shall be taken to be the wages received by him during that period, and his wages for the period subsequent to his disablement shall be taken to be the wages as so reduced.

Section 4(5) provides that nothing in this section shall affect the right of an employee to receive better terms of gratuity under any award or agreement or contract with the employer.

Forfeiture of Gratuity

Section 4(6) provides that notwithstanding anything contained in sub-section (1),-

- 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;
- the gratuity payable to an employee may be wholly or partially forfeited,-
  - if the services of such employee have been terminated for his riotous or disorderly conduct or any other act of violence on his part, or
  - if the services of such 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 right of receiving the gratuity by the employee is the statutory right. Once it is eligible to receive the gratuity the employee is entitled to receive the same unless otherwise restricted by the provisions of law. The Court in 'KSRTC, Bangalore V. Deputy Labor Commissioner and the Appellate Authority, Bangalore and others' – 2014 (2) TMI 629 - KARNATAKA HIGH COURT held that right to gratuity is a statutory right and cannot be withheld under any circumstances but for the exception enumerated in Section 4(6) of the Act.

In 'D.S. Nakara V. Union of India' – 1982 (12) TMI 151 - SUPREME COURT the Supreme Court held that gratuity is a social welfare measure rendering socio-economic justice by providing economic security in the fall of life when physical and mental prowess is ebbing, corresponding to ageing process and when, one falls, back on savings. Such payment cannot be withheld unless specifically permitted by any statutory provision.

In 'D.V. Kapoor V. Union of India' – 1990 (8) TMI 390 - SUPREME COURT OF INDIA it was held that the right to gratuity is also a statutory right. The appellant was not charged with nor was given an opportunity that this gratuity would be withheld as a measure of punishment. No provision of law has been brought to our notice under which, the President is empowered to withhold gratuity as well, after his retirement as a measure of punishment. Therefore, the order to withhold the gratuity as a measure of penalty is obviously illegal and is devoid of jurisdiction.

If circumstances require forfeiting either partially or fully a specific order shall be passed by the employer in this regard. For this purpose the employer shall issue a show cause notice to the employee indicating the grounds for forfeiture of gratuity and he shall be given a reasonable opportunity of being heard. The final decision will be taken on the basis of reply, if any, given by the employer and the order of forfeiture shall be passed and intimated

to the employee.

In 'Karnataka State Road Transport Corporation, Bangalore V. Deputy Labor Commissioner and the Appellate Authority, Bangalore and others' – 2012-III-LLJ-384 (Kant) the Court held that having regard to the mandate of Section 4(6) of the Act before forfeiting the gratuity amount, the petitioner employer ought to have extended an opportunity of hearing to the employee over the proposal to forfeit the amount of gratuity. Even otherwise, the statutory provision for forfeiture of gratuity when construed strict the petitioner corporation was required to prove before the Controlling Authority the extent of damage or loss cause by the employee for the acts of alleged misconduct by reason of which the employer is disentitled to gratuity.

Amount of gratuity payable

Gratuity is calculated on the basis of the continuous service rendered by the employee, for every completed year of service or part in excess of six months at the rate of fifteen days wages last drawn. The maximum amount of gratuity allowed under the Act is ₹20 lakhs with effect from 29.03.2018.

Formula for calculation of gratuity = Last wage drawn × 15/26 × completed years of service

In calculation of gratuity one month is taken as 26 days.

Nomination

Section 6 provides for filing nomination for receiving the gratuity after the death of the employee. The following are the points to be noted in respect of nomination-

- Each employee, who has completed one year of service, shall make nomination in Form – F;
- He may distribute the amount of gratuity payable to him under this Act amongst more than one nominee;
- If an employee has a family at the time of making a nomination, the nomination shall be made in favor of one or more members of his family, and any nomination made by such employee in favor of a person who is not a member of his family shall be void.;
- If at the time of making a nomination the employee has no family, the nomination may be made in favor of any person or persons but if the employee subsequently acquires a family, such nomination shall forthwith become invalid and the employee shall make, within such time as may be prescribed, a fresh nomination in favor of one or more members of his family;
- A nomination may, subject to above, be modified by an employee at any time, after giving to his employer a written notice in such form and in such manner as may be prescribed, of his intention to do so;
- If a nominee predeceases the employee, the interest of the nominee shall revert to the employee who shall make a fresh nomination, in the prescribed form, in respect of such interest;
- Every nomination, fresh nomination or alteration of nomination, as the case may be, shall be sent by the employee to his employer, who shall keep the same in his safe custody.

Rule 6 (1) provides that a nomination shall be submitted in duplicate by personal service by the employee, after taking proper receipt or by sending through registered post acknowledgement due to the employer,

- in the case of an employee who is already in employment for a year or more on the date of commencement of these rules, ordinarily, within ninety days from such date, and
- in the case of an employee who completes one year of service after the date of commencement of these rules, ordinarily within thirty days of the completion of one year of service.

Nomination in Form 'F' shall be accepted by the employer after the specified period, if filed with reasonable grounds for delay, and no nomination so accepted shall be invalid merely because it was filed after the specified period.

Rule 6(2) provides that within thirty days of the receipt of nomination in Form 'F' under sub-rule (1), the employer shall get the service particulars of the employee, as mentioned in the form of nomination, verified with reference to the records of the establishment and return to the employee, after obtaining a receipt thereof, the duplicate copy of the nomination in form 'F' duly attested either by the employer or an officer authorized in this behalf by him, as a token of recording of the nomination by the employer and the other copy of the nomination shall be recorded.

Rule 6(3) provides that an employee who has no family at the time of making a nomination shall, within ninety days of acquiring a family submit in the manner specified in sub-rule (1), a fresh nomination, as required under sub-section (4) of section 6, duplicate in Form 'G' to the employer and thereafter the provisions of sub-rule (2) shall apply mutatis mutandis as if it was made under sub-rule (1).

Rule 6(4) provides that a notice of modification of a nomination, including cases where a nominee predeceases an employee, shall be submitted in duplicate in Form 'H' to the employer in the manner specified in sub-rule (1), and thereafter the provisions of sub-rule (2) shall apply mutatis mutandis.

Rule 6(5) provides that a nomination or a fresh nomination or a notice of modification of nomination shall be signed by the employee or, if illiterate, shall bear his thumb impression, in the presence of two witnesses, who shall also sign a declaration to that effect in the nomination, fresh nomination or notice of modification of nomination, as the case may be.

Rule 6(6) provides that a nomination, fresh nomination or notice of modification of nomination shall take effect from the date of receipt thereof by the employer.

8.2 Determination of the amount of gratuity

Section 7 prescribes the procedure for determination of the amount of gratuity. As soon as the gratuity becomes payable, the employer shall, whether the employee has made application or not, determine the amount of gratuity. Then he is to give notice to the person to whom the gratuity is payable and also to the Controlling Authority, specifying the amount of gratuity so determined. The notice shall be in Form L.

The employer shall arrange to pay the amount of gratuity within 30 days from the date of its becoming payable to the person to whom it is payable. If it is not paid within the stipulated period the employer is liable to pay interest at the rate of 10% per annum. If the delay in payment is due to the fault of the employee and the employer has obtained permission in writing from the controlling authority for the delayed payment, on this ground, no interest is payable.

If the claim for gratuity is not found admissible, issue a notice in Form 'M' to the applicant employee, nominee or legal heir, as the case may be, specifying the reasons why the claim for gratuity is not considered admissible. In either case a copy of the notice shall be endorsed to the controlling authority.

8.3 Dispute

Section 7(4) provides that if there is a dispute as to the amount of gratuity payable to the employee, the employer shall deposit the gratuity with the Controlling Authority. The controlling authority shall, after due inquiry and after giving the parties to the dispute a reasonable opportunity of being heard, determine the amount of gratuity payable to an employee. If as a result of such inquiry any amount in excess of the amount deposited by the employer is found to be payable, the controlling authority shall direct the employer to pay such amount as is in excess of the amount deposited by him.

Then the Controlling Authority shall pay the amount of the deposit-

- to the applicant where he is the employee; or
- where the applicant is not the employee, to the nominee or heir of the employee if the controlling authority

is satisfied that there is no dispute as to the right of the applicant to receive the amount of gratuity.

8.4 Application for gratuity

Rule 7(1) provides that an employee who is eligible for payment of gratuity under the Act, or any person authorized, in writing, to act on his behalf, shall apply, ordinarily within thirty days from the date the gratuity became payable, in Form 'I' to the employer. Where the date of superannuation or retirement of an employee is known, the employee may apply to the employer before thirty days of the date of superannuation or retirement.

Rule 7(2) provides that a nominee of an employee who is eligible for payment of gratuity under the second proviso to sub-section (1) of section 4 shall apply, ordinarily within thirty days from the date of gratuity became payable to him, in Form 'J' to the employer. An application in plain paper with relevant particulars shall also be accepted. The employer may obtain such other particulars as may be deemed necessary by him.

Rule 7(3) provides that a legal heir of an employee who is eligible for payment of gratuity under the second proviso to sub-section (1) of section 4 shall apply, ordinarily within one year from the date of gratuity became payable to him, in Form 'K' to the employer.

Rule 7(4) provides that where gratuity becomes payable under the Act before the commencement of these rules, the periods of limitation specified in sub-rules (1), (2) and (3) shall be deemed to be operative from the date of such commencement.

Rule 7(6) provides that an application under this rule shall be presented to the employer either by personal service or by registered post acknowledgement due.

Belated application

Rule 7(5) provides that an application for payment of gratuity filed after the expiry of the periods specified in this rule shall also be entertained by the employer, if the applicant adduces sufficient cause for the delay in preferring his claim, and no claim for gratuity under the Act shall be invalid merely because the claimant failed to present his application within the specified period. Any dispute in this regard shall be referred to the controlling authority for his decision.

8.5 Notice for payment of gratuity

1. Within fifteen days of the receipt of an application under rule 7 for payment of gratuity, the employer shall-
   i) if the claim is found admissible on verification, issue a notice in Form 'L' to the applicant employee, nominee or legal heir, as the case may be, specifying the amount of gratuity payable and fixing a date, not being later than the thirtieth day after the date of receipt of the application, for payment thereof, or
   ii) if the claim for gratuity is not found admissible, issue a notice in Form 'M' to the applicant employee, nominee or legal heir, as the case may be, specifying the reasons why the claim for gratuity is not considered admissible. In either case a copy of the notice shall be endorsed to the controlling authority.
2. In case payment of gratuity is due to be made in the employer's office, the date fixed for the purpose in the notice in Form 'L' under clause (1) of sub-rule (1) shall be re fixed by the employer, if a written application in this behalf is made by the payee explaining why it is not possible for him to be present in person on the date specified.
3. If the claimant for gratuity is a nominee or a legal heir, the employer may ask for such witness or evidence as may be deemed relevant for establishing his identity or maintainability of his claim, as the case may be. In that 'case, the time limit specified for issuance of notices under sub-rule (1) shall be operative with effect from the date such witness or evidence, as the case may be, called for by the employer is furnished to the employer.
4. A notice in Form 'L' or Form 'M' shall be served on the applicant either by personal service after taking

receipt or by registered post with acknowledgement due.

5. A notice under sub-section (2) of section 7 shall in Form 'L

Mode of service of notice

Rule 8(5) provides that a notice in Form 'L' or Form 'M' shall be served on the applicant either by personal service after taking receipt or by registered post with acknowledgement due.

8.6 Mode of payment

Rule 9 provides that the gratuity payable under the Act shall be paid in cash or, if so desired by the payee, in Demand Draft or bank Cheque to the eligible employee, nominee or legal heir, as the case may be. In case the eligible employee, nominee or legal heir, as the case may be, so desires and the amount of gratuity payable is less than one thousand rupees, payment may be made by postal money order after deducting the postal money order commission there for from the amount payable.

Intimation about the details of payment shall also be given by the employer to the controlling authority of the area.

In the case of nominee, or an heir, who is minor, the controlling authority shall invest the gratuity amount deposited with him for the benefit of such minor in term deposit with the State Bank of India or any of its subsidiaries or any Nationalized Bank.

8.7 Application for direction

Rule 10 provides that if the employer-

- refuses to accept nomination; or
- to entertain an application for gratuity; or
- rejects the eligibility of gratuity; or
- indicates less amount than the eligible amount of gratuity in the notice; or
- fails to issue notice

the eligible person to receive the gratuity may file an application in Form – N within 90 days from the date of occurrence of the cause, to the Controlling authority for the issue of directions to the employer. Additional copies are to be sent along with the application for the purpose of issuing the same to the opposite parties.

If the said application is filed after the limitation period of 90 days, the Controlling Authority may admit the application if the applicant shows sufficient cause for the delay in filing the application.

The said application may be submitted to the Controlling authority in person or it may be sent through registered post with acknowledgment due.

Directions issued by Authority

On receipt of an application under rule 10 the controlling authority shall, by issuing a notice in Form 'O', call upon the applicant as well as the employer to appear before him on a specified date, time and place, either by himself or through his authorized representative together with all relevant documents and witnesses, if any.

Any person desiring to act on behalf of an employer or employee, nominee or legal heir, as the cases may be, shall present to the controlling authority a letter of authority from the employer or the person concerned, as the case may be, on whose behalf he seeks to act together with a written statement explaining his interest in the matter and praying for permission so to act. The controlling authority shall record thereon an order either according his approval or specifying, in the case of refusal to grant the permission prayed for, the reasons for the refusal.

A party appearing by an authorized representative shall be bound by the acts of the representative.

After completion of hearing on the date fixed under sub-rule (1), or after such further evidence, examination of documents, witnesses, hearing and enquiry, as may be deemed necessary, the controlling authority shall record his finding as to whether any amount is payable to the applicant under the Act. A copy of the finding shall be given to each of the parties.

If the employer concerned fails to appear on the specified date of hearing after due service of notice without sufficient cause, the controlling authority may proceed to hear and determine the application ex parte. If the applicant fails to appear on the specified date of hearing without sufficient cause, the controlling authority may dismiss the application. Such an order may, on good cause being shown within thirty days of the said order, be reviewed and the application re-heard after giving not less than fourteen days' notice to the opposite party of the date fixed for rehearing of the application.

The sittings of the controlling authority shall be held at such times and at such places as he may fix and he shall inform the parties of the same in such manner as he thinks fit.

The controlling authority may authorize a clerk of his office to administer oaths for the purpose of making affidavits.

The controlling authority may, at any stage of the proceedings before him, either upon or without an application by any of the parties involved in the proceedings before him, and on such terms as may appear to the controlling authority just, issue summons to any person in Form 'P' either to give evidence or to produce documents or for both purposes on a specified date, time and place.

Any notice, summons, process or order issued by the controlling authority may be served either personally or by registered post acknowledgement due or in any other manner as prescribed under the Code of Civil Procedure, 1908.

Where there are numerous persons as parties to any proceeding before the controlling authority and such persons are members of any trade union or association or are represented by an authorized person, the service of notice on the Secretary, or where there is no Secretary, on the principal officer of the trade union or association, or on the authorized person shall be deemed to be service on such persons.

If a finding is recorded that the applicant is entitled to payment of gratuity under the Act, the controlling authority shall issue a notice to the employer concerned in Form 'R' specifying the amount payable and directing payment thereof to the applicant under intimation to the controlling authority within thirty days from the date of the receipt of the notice by the employer. A copy of the notice shall be endorsed to the applicant employee, nominee or legal heir, as the case may be.

8.8 Powers of the Controlling Authority

For the purpose of conducting an 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, in respect of the following matters, namely :-

- enforcing the attendance of any person or examining him on oath;
- requiring the discovery and production of documents;
- receiving evidence on affidavits;
- issuing commission for the examination of witnesses.

8.9 Appeal

Any person aggrieved by an order may, within 60 days from the date of the receipt of the order, prefer an appeal to the appropriate Government or such other authority as may be specified by the appropriate Government in this behalf. The appropriate Government or the appellate authority, as the case may be, may, if it is satisfied that the appellant was prevented by sufficient cause from preferring the appeal within the said period of sixty

days, extend the said period by a further period of sixty days. The appropriate Government or the appellate authority, as the case may be, may, after giving the parties to the appeal a reasonable opportunity of being heard, confirm, modify or reverse the decision of the controlling authority.

8.10 Recovery of gratuity

Section 8 provides that 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 the rate of nine per cent per annum, from the date of expiry of the prescribed time, as arrears of land revenue and pay the same to the person entitled thereto.

8.11 Penalties

Section 9(1) provides that whoever, for the purpose of avoiding any payment to be made by himself under this Act or enabling any other person to avoid such payment, knowingly makes or causes to be made any false statement or false representation shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees, or with both.

Section 9(2) provides that an employer who contravenes, or makes default in complying with, any of the provisions of this Act or any rule or order made there under shall be punishable with imprisonment for a term which may extend to one year, or with fine which may extend to one thousand rupees, or with both.

Where the offence relates to non-payment of any gratuity payable under this Act, the employer shall be punishable with imprisonment for a term which shall not be less than three months unless the court trying the offence, for reasons to be recorded by it in writing is of opinion that a lesser term of imprisonment or the imprisonment of a fine would meet the ends of justice.

8.12 Exemption of employer from liability in certain cases

Section 10 provides that where an employer is charged with an offence punishable under this Act, he shall be entitled, upon complaint duly made by him and on giving to the complainant not less than three clear days' notice in writing of his intention to do so, to have any other person whom he charges as the actual offender brought before the court at the time appointed for hearing the charge; and if, after the commission of the offence has been proved, the employer proves to the satisfaction of the court-

- that he has used due diligence to enforce the execution of this Act, and
- that the said other person committed the offence in question without his knowledge, consent or connivance, that other person shall be convicted of the offence and shall be liable to the like punishment as if he were the employer and the employer shall be discharged from any liability under this Act in respect of such offence;

In seeking to prove as aforesaid, the employer may be examined on oath and his evidence and that of any witness whom he calls in his support shall be subject to cross-examination on behalf of the person he charges as the actual offender and by the prosecutor. 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 the said 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

Section 11 provides that no court shall take cognizance of any offence punishable under this Act save on a complaint made by or under the authority of the appropriate Government. Where the amount of gratuity has not been paid, or recovered, within six months from the expiry of the prescribed time, the appropriate Government

shall authorize the controlling authority to make a complaint against the employer, whereupon the controlling authority shall, within fifteen days from the date of such authorization, make such complaint to a magistrate having jurisdiction to try the offence. No court inferior to that of a Presidency Magistrate or a Magistrate of the first class shall try any offence punishable under this Act.

8.13 Protection of gratuity

Section 13 provides that no gratuity payable under this Act shall be liable to attachment in execution of any decree or order of any civil, revenue or criminal court.

Section 13A provides that notwithstanding anything contained in any judgment, decree or order of any court, for the period commencing on and from the 3rd day of April 1997 and ending on the day on which the Payment of Gratuity (Amendment) Act 2009 receives the assent of the president, the gratuity shall be payable to an employee in pursuance of this notification of the Government of India in the Ministry of Labor and Employment vide SO 1080 dated the 3rd day of April 1997 and the said notification shall be valid and shall be deemed always to have been valid as if the payment of gratuity (Amendment) Act 2009 had been in force at all material times and the gratuity shall be payable accordingly.

Nothing contained in this section shall extend or be construed to extend to affect any person with any punishment or penalty whatsoever by reason of the non employment by him of the gratuity during the period specified in this section which shall become due in pursuance of the said notification.

8.14 Act to override other enactments etc.,

Section 14 provides that the provisions of this Act or any rule made there under shall have effect notwithstanding anything inconsistent therewith contained in any enactment other than this Act or in any instrument or contract having effect by virtue of any enactment other than this Act.

In 'Jaswant Sing Gill V. Bharat Coking Coal Limited and others' – 2006 (11) TMI 550 - SUPREME COURT OF INDIA the Supreme Court held that the rules framed under the Coal India Executives' Conduct Discipline and Appeal Rules, 1978 which provided for a forfeiture of gratuity were not statutory rules and the provisions of Gratuity Act must therefore prevail over the rules.

But in 'Rajan Shanthi P. V. Union of India' – 2010-IV-LLJ-600, the Supreme Court considered a seeming conflict between the provisions of Gratuity act, 1972 with reference to the provisions which have been extracted, namely, Section 4(6) and Section 5 of the Working Journalists and Other Newspaper Employees (Condition of Service) and Miscellaneous Provisions Act, 1955. Section 5 of the latter Act is very similar to Clause 5 of the Regulations, 1964. Section 5(1)(a)(i) extends the benefit of gratuity to an employee whose services are terminated by the employer for any reason whatever, otherwise than a punishment inflicted by way of disciplinary act. The Supreme Court reasoned that the Payment of Gratuity Act was a general act and the Working Journalists and Other Newspaper Employees (Conditions of service) and Misc. Provisions of Act, 1955 was a special enactment will prevail when there is a conflict between a general act and a special act. Thus if the service of an employee has been terminated by way of disciplinary action under the Working Journalists and other Newspaper Employees (Conditions of Service) and Misc. Provisions of Act,1955, he is not entitled to gratuity.

8.15 Display of abstract of the Acts and Rules

The employer shall display an abstract of the Act and the rules made there under as given in Form 'U' in English and in the language understood by the majority of the employees at conspicuous place at or near the main entrance of the establishment.

EXERCISE

Multiple Choice Question:

1. Which does not amount to retirement?
   a) Retrenchment; b) Resignation;
   c) Dismissal; d) Superannuation.
2. Gratuity is payable to an employee-
   a) On his superannuation; b) Retirement;
   c) Retrenchment; d) In all the above cases.
3. The gratuity is payable to an employee shall not exceed-
   a) 12 months pay; b) 16 months pay;
   c) 20 months pay; d) 24 months pay.
4. The employer shall display an abstract of the Act and the Rules in Form No-
   a) U b) H
   c) O d) N
5. If sufficient cause is shown the appropriate Government may condone the delay in filing appeal against the order of the Controlling Authority, for-
   a) 30 days; b) 60 days;
   c) 90 days; d) No time limit.
6. Nomination is to be made by an employee-
   a) Immediately on his appointment; b) After completion of one year service;
   c) After he is made permanent; d) None of the above.
7. Which one of the following is to be included in the definition of 'wage'?
   a) Dearness allowance; b) Overtime allowance;
   c) Commission; d) House rent allowance.
8. If an employer intends to close the business he is to send notice to the Controlling Authority within _____ before the intended closure.
   a) 10 days; b) 30 days;
   c) 60 days; d) 90 days.
9. Nomination is to be filed in_____
   a) Single form b) Duplicate
   c) Triplicate d) Quadruplicate.
10. Which will not amount to service of notice under the rule?
    a) Personal service; b) By registered post;
    c) By courier; d) Both a and b.

State TRUE or FALSE

1. A person holding a post under the Central Government is an employee under the Payment of Gratuity act.
2. The father-in-law of a female employee will come under the term 'family'.
3. The maternity leave granted for 90 days will be included for the calculation of continuous service.
4. An employee is not required to obtain insurance for liability for payment of gratuity.
5. An employee may give nomination to his friend to receive gratuity after his marriage.
6. No gratuity payable shall be liable to attachment in execution of any decree of court.
7. The Controlling Authority may pay the gratuity to a minor, a nominee to receive the gratuity after the death of an employee.
8. For the purpose of calculation of gratuity 26 days are taken as a month.
9. The employer can make agreement with the employer to pay gratuity below the amount fixed by the Act.
10. Gratuity is a lump sum payable on consideration of the past services rendered by the employee.

Fill in the blanks

1. The gratuity is payable to an employee after he has rendered continuous service for not less than _____ years.
2. The maximum amount of gratuity payable is_____.
3. The employer shall arrange to pay gratuity within_____ from the date of its becoming payable to the eligible person.
4. Appeal, against the order of the Controlling Authority may be filed within _____ days from the date of receipt of the order.
5. If the gratuity is not paid in time the employer is liable to pay interest at _____ per annum.
6. Nomination is to be made by an employee in Form_____.
7. Gratuity is calculated for every completed year of service or part in excess of six months at the rate of _____ wages last drawn.
8. Section 4A may exempt the employer employing _____ or more persons who establishes an approved gratuity fund.
9. An employee, within _____ of acquiring a family shall submit a fresh nomination.
10. If there is a dispute as to the amount of gratuity payable to the employee, the employer shall deposit the gratuity with the _____.

⊙ Short Essay Type Questions

1. Discuss the grounds on which the gratuity may be forfeited.
2. Describe the procedure for mode of payment of gratuity.
3. Write a short on approved gratuity fund.

⊙ Essay Type Questions

1. Define 'continuous service'. Elucidate the requirement of minimum no of days for continuous service in respect of regular employment and seasonal employment.
2. Explain the provisions relating to 'nomination'.
3. What are the powers of the Controlling Authority in deciding an application for payment of gratuity?
4. What is the remedy available if the employer rejects the application of an employee for payment of gratuity?
5. Explain the procedure for an employer to determine the gratuity payable to the employee.
6. Explain the provisions relating to exemption given to the employer from the liability in certain cases from payment of gratuity.
7. Discuss the penal provisions under this Act.

Answer:

Multiple Choice Question:

1. d; 2. d; 3. c; 4. a; 5. b; 6. b; 7. a; 8. c; 9. b; 10. c.

State TRUE or FALSE

1. False; 2. True; 3. True; 4. False; 5. False; 6. True; 7. False; 8. True; 9. False; 10. True.

Fill in the blanks

1. 5; 2. ₹10 lakhs; 3. 30 days; 4. 60 days; 5. 10%; 6. F; 7. 15 days; 8. 500; 9. 90 days; 10. Controlling Authority.

Employees' Provident Funds and Miscellaneous Provisions Act, 1952

9

SLOB Mapped against the Module

To acquire the requisite knowledge of Employees's Provident Fund Organisation along with the regulation and management of provident funds in India.

Module Learning Objectives:

After studying this module, the students will be able -

- To acquire the requisite knowledge of Employees' Provident Fund Organisation along with the regulation and management of provident funds in India.
- To develop an understanding about the provisions relating to mandatory provident fund and social security agreements with other countries.

Employees' Provident Funds and Miscellaneous Provisions Act, 1952

9

The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 is a social welfare legislation to provide for the institution of Provident Fund, Pension Fund and Deposit Linked Insurance Fund for employees working in factories and other establishments. The Act aims at providing social security and timely monetary assistance to industrial employees and their families when they are in distress.

The following three schemes have been framed under the Act by the Central Government:

a) The Employees' Provident Fund Schemes, 1952;

b) The Employees' Pension Scheme, 1995; and

c) The Employees' Deposit-Linked Insurance Scheme; 1976.

The three schemes mentioned above confer significant social security benefits on workers and their dependents.

These schemes taken together provide to the employees an old age and survivorship benefits, a long term protection and security to the employee and after his death to his family members, and timely advances including advances during sickness and for the purchase/ construction of a dwelling house during the period of membership.

The Act is now applicable to employees drawing pay not exceeding ₹15,000 per month. The Act extends to whole of India. The term pay includes basic wages with dearness allowance, retaining allowance (if any), and cash value of food concession.

9.1 Applicability

Section 1(3) provides that subject to Section 16, this Act applies-

- To every establishment which is a factory engaged in any industry specified in Schedule I and in which 20 or more persons are employed; and
- To any other establishment employing 20 or more persons or class of such establishments which the Central Government may, by notification in the Official Gazette, specify in this behalf.
- The Central Government may apply the provisions of this Act to any establishment employing such number of persons less than 20 as may be specified in the notification. Not less than 2 months' notice is to be given by the Central Government to such establishments;
- Where it appears to the Central Provident Fund Commissioner, that the employer and the majority of the employees have agreed that the provisions of this Act should be made applicable to their establishment, he may, by notification, apply the provisions of this Act to that establishment on and from the date of such

agreement or from any subsequent date specified in such agreement;

- Once the Act is covered to any establishment it shall continue to apply notwithstanding the number of the persons employed therein shall at any time falls below 20.

In 'Goods Shepherd Public School V. EPF organization' – 2014 LLR 611 (Del HC) it was held that a school rightly covered under PF when the principal has affirmed about employment of 20 employees.

In 'M/s Nasiruddin Beedi Merchant Limited V. CPF Commissioner' – AIR 2001 SC 850, the Supreme Court held that this Act would apply even in respect of home workers engaged through contractors and cannot be objected any more.

In 'Annamma Iype V. Regional Provident Fund Commissioner' – 1993 LLR 287 it was held that wherein an establishment the strength of the employees at a particular time is below 20, it cannot be contended by the employer that the establishment is no longer within the purview of the Act.

Non applicability of the Act

Section 16(1) of the Act provides that this Act is not applicable to the following-

- To any establishment registered under the Co-operative Societies Act, 1912 or under any other law for time being in force in any State relating to co-operative Societies, employing less than 50 persons and working without the aid of the power; or
- To any other establishment belong 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
- To any other establishment set up under the 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.

9.2 Important Definitions

Appropriate Government

Section 2(a) defines the term 'appropriate Government'

- in relation to an establishment belonging to, or under the control of, the Central Government or in relation to an establishment connected with-
  - a railway company;
  - a major port;
  - a mine or an oil field; or
  - a controlled industry; or
  - in relation to an establishment having departments or branches in more than one State, the appropriate Government is the 'Central Government';
- in relation to any other establishment, the appropriate Government is the 'State Government'.

Authorized Officer

Section 2(aa) defines the term 'authorized officer' as-

- the Central Provident Fund Commissioner;
- Additional Central Provident Fund Commissioner;
- Deputy Provident Fund Commissioner;
- Regional Provident Fund Commissioner; or

such other officer as may be authorized by the Central Government, by Notification in the Official Gazette.

Basic wages

Section 2(b) defines the term '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-

- the cash value of any consideration;
- 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, over time allowance, bonus, commission or any other similar allowance payable to the employee in respect of his employment or of work done in such employment;
- any presents made by the employer.

Contribution

Section 2(c) defines the term 'contribution' as a contribution payable in respect of a member under a scheme or the contribution payable in respect of an employee to whom the Insurance scheme applies.

Fund

It means Provident Fund established under the Scheme. [Section 2(h)]

Employer

Section 2(e) defines the term 'employer' as-

- 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
- 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, managing director or managing agent, such manager, managing director or managing agent.

Employee

Section 2(f) defines the term 'employee' as any person who is employed for wages in any kind of work, manual or otherwise, in or in connection with the work of an establishment, and who gets, his wages directly or indirectly from the employer, and includes any person-

- employed by or through a contractor in or in connection with the work of the establishment;
- engaged as an apprentice, not being an apprentice engaged under the Apprentices Act, 1961 or under the Standing orders of the establishment.

In 'Prakash D. Shah V. Union of India'- 2004 LLR 218 (Bom) the High Court held that a partner of a firm having a status of beneficiary will not be employee either to be covered or counted under the Act.

Factory

Section 2(g) defines the term 'factory' as 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 or power.

Occupier of a factory

Section 2(k) defines the term 'occupier of a factory' as the person who has ultimate control over the affairs of a factory, and, where the said affairs are entrusted to a managing agent, such agent shall be deemed to be the occupier of the factory.

In 'Srikanta Dutta Narasimharava Wodiyar V. Enforcement Officer, Mysore'- 1993 LLR 497 it was held that the person who is in charge or responsible for the management or ultimate control over the affairs of the factory or establishment, in the event of entrustment to a managing agent, such managing agent shall also be deemed to be the occupier of the factory.

In 'B.K. Basu V. Regional Provident Fund Commissioner' – 2002 LLJ 512 (Cal) the High Court held that the clear meaning of the 'occupier' indicates a person, who is in actual possession and control. It may be an individual or a firm. Unless a notice is given, notifying the individual of a firm, all the members of the firm are to be liable.

Schemes

The Act provides three types of schemes for the benefit of the employees as detailed below-

- Section 5 – Employees' Provident Fund Schemes;
- Section 6A – Employees' Pension Scheme;
- Section 6C – Employees' Deposit Linked Insurance Scheme.

The details of the schemes will be seen. Section 7 gives powers to the Central Government to amend or vary, either prospectively or retrospectively, the Scheme, the Pension Scheme or the Insurance scheme, as the case may be.

Employees' Provident Fund Schemes

Section 5 provides that the Central Government framed a scheme called the Employees' Provident Fund Scheme ('Scheme' for short) for the establishment of provident funds for employees. The Central Government framed 'The Employees' Provident Fund Scheme, 1952 which came into effect from 2nd September, 1952. The fund shall vest in and be administered by the Central Board constituted under Section 5A of the Act. The scheme framed may provide for all or any of the matters specified in Schedule II. The scheme may provide that any of the provisions shall take effect either prospectively or retrospectively on such date as may be specified in the scheme.

Central Board

Section 5A provides for the establishment of Central Board by the Central Government. The Board consists of a Chairman and a Vice Chairman to be appointed by the Central Government. The Central Provident Fund Commissioner is ex officio. Members to this Board are being appointed by the Central Government as per the provisions contained in Section 5A.

Section 5AA provides for the appointment an Executive Committee by the Central Government to assist the Central Board in the performance of its functions. The members of the Executive Committee are appointed by the Central Government.

State Board

Section 5B gives powers to the Central Government, in consultation with the Government of any State, constitutes for that State, a Board of Trustees to exercise such powers and perform such duties as the Central Government may assign to it from time to time.

Contributions

As per Section 6, the contribution which shall be paid by the employer to the Fund shall be 10%, of the basic wages, dearness allowance and retaining allowance, if any, for the time being payable to each of the employees whether employed by him directly or through a contractor and the employees contribution shall be equal to the contribution payable by the employer. Employees, if they desire, may make contribution exceeding the prescribed rate but subject to the condition that employer shall not be under any obligation to contribute over and above the contribution payable as prescribed by the Government from time to time under the Act. The Government has raised the rate of Provident Fund Contribution from the current 8.33% to 10% in general and in cases of establishments specially notified by the Government, from 10% to 12% with effect from September 22, 1997.

Each contribution shall be calculated to the nearest rupee, fifty paise or more to be counted as the next higher rupee and fraction of a rupee less than fifty paise to be ignored.

Dearness allowance shall include the cash value of any food concession allowed to an employee. Retaining allowance is the allowance payable to an employee for retaining his services, when the establishment is not working.

The Provident Fund Scheme has made the payment of contribution mandatory and the Act provides for no exception under which a specified employer can avoid his mandatory liability.

Wage limit

Contribution is paid up to a maximum of ₹15,000 by employer and employee with effect from 01.09.2014. To pay a contribution on higher wages, a joint request from employee and employer is required. In such case the employer has to pay administrative charges on the higher wages. For the international worker wage ceiling of ₹15,000 is not applicable.

9.3 Applicability of the scheme

This scheme shall apply to all factories and other establishments to which the Act applies. This scheme shall not applicable to the tea factories in the State of Assam.

9.4 Withdrawal from the fund

Withdrawal from the fund is allowed for the following purposes-

- For the purchase of a dwelling house/flat or for the construction of a dwelling house including the acquisition of a suitable site for this purpose;
- For repayment of loans in special cases;
- Withdrawal within one year before the retirement;
- Withdrawal upto 75% of the balance, if not employed from one month or more, subject to approval of P.F. Commissioner or any officer authorised by him.

Such withdrawals are not required to be repaid.

9.5 Advances from the fund

Advances from the fund are paid for the following purposes-

- For illness in certain cases;
- For marriages or post matriculation education of children;
- In abnormal conditions such as calamity of exceptional nature such as flood, earthquakes or riots – (non-refundable)
- Granted to members affected by cut in the supply of electricity; (non-refundable)
- Grant of advance to members who are physically handicapped; (non-refundable)

9.6 Employees' Pension Scheme - Section 6A

The Central Government framed Employees' Pension Scheme for the purpose of providing for-

- Superannuation pension;
- Retiring pension or permanent total disablement pension to the employees of any establishment or class of establishments to which this Act applies; and
- Widow or widower's pension;
- Children pension or orphan pension payable to the beneficiaries of such employees.

The Pension Scheme may provide for all or any of its provisions shall take effect either prospectively or retrospectively on such date as may be specified in that behalf in that scheme.

9.7 Contribution

There is no contribution from the employee. The employer is to contribute 8.33% of the basic wages, dearness allowance and retaining allowance, if any of the concerned employees as may be specified in the pension scheme. Contribution is not payable when the employee crosses 58 years of age since the scheme ceases on completion of 58 years

9.8 Pension Fund

A pension fund has been created for the purpose of this scheme. The Pension Fund shall vest in and administered by the Central Board. The pension scheme may provide for all or any of the matters in Schedule II, as detailed below-

- The employees or class of employees to whom the Pension scheme shall apply;
- The portion of employers' contribution to the Provident Fund which shall be entitled to the Pension Fund and the manner in which it is credited;
- The minimum qualifying service for being eligible for pension and the manner in which the employees may be granted the benefits of their past service;
- The regulation of the manner in which and the period of service, for which no contribution is received;
- The manner in which the employees' interest will be protected against default in payment of contribution by the employer;
- The manner in which the accounts of the Pension fund shall be kept and investment of moneys belonging to Pension Fund to be made subject to such pattern of investment as may be determined by Central Government;
- The form in which an employee shall furnish particulars about himself and the members of his family whenever required;
- The forms, registers and records to be maintained in respect of employees, required for the administration of the Pension Scheme;
- The scale of pension and pensionary benefits and the conditions relating to the grant of such benefits to the employees;
- The manner in which the exempted establishments have to pay contribution towards the pension scheme and the submission of returns relating thereto;
- The mode of disbursement of pension and arrangements to be entered into with such disbursing agencies as may be specified for the purpose;
- The manner in which the expenses for administering the Pension Scheme will be met from the income of the Pension Fund;
- Any other matter which is to be provided for in the Pension Scheme or which may be necessary for the purpose of implementation of the Pension Scheme.

9.9 Employees' Deposit linked Insurance Scheme- Section 6C

The Central Government made the Employees' Deposit Linked Insurance Scheme, 1976 which came into effect from 01.09.1976. It applies to all factories and other establishments to which the Act applies except tea factories in State of Assam.

The wage ceiling limit under Employees Deposit linked Insurance Scheme has been increased from ₹6,500 to ₹15,000.

The insurance benefit under the scheme shall be an amount between 2.5 lakhs and 6 lakhs.

Contribution

The Deposit Linked Insurance Fund has been created for this purpose. In this Fund the employer shall pay such amount not being more than 1% of the aggregate of basic wages, dearness allowance and retaining allowance of every such employee in relation to whom he is the employer. The employer shall pay into the Insurance Fund such further amount of money not exceeding one fourth of the contribution which is required to make as the Central Government may from time to time determine to meet all the expenses in connection with the administration of the scheme other than the expenses towards the cost of any benefits provided by or under that scheme.

Where the monthly pay of an employee exceeds ₹ 15,000 the contribution payable is restricted to the amounts payable on a monthly pay of ₹ 15,000, dearness allowance, retaining allowance and cash value of food concession.

9.10 Determination of moneys due from employers

Section 7A provides that in case where a dispute arises regarding the applicability of this Act to an establishment, the Authority concerned may conduct such enquiry as he may deem necessary decide such dispute and determine the amount due from any employer under the provision of this Act, the scheme or the Pension Scheme or the Insurance Scheme as the case may be. Before passing such order the employer concerned shall be given a reasonable opportunity of representing his case.

For the purpose of conducting inquiry the Authority shall have the same powers as are vested in a court under CPC for trying a suit in respect of the following matters-

- enforcing the attendance of any person or examining him on oath;
- requiring the discovery and production of documents;
- receiving evidence on affidavit;
- Issuing commissions for the examination of witnesses.

Where the employer, employee or any other person required to attend the inquiry, fails to attend such inquiry, the Authority shall decide the case ex-parte and pass orders based on the available documents put forth before him. The employer, within three months from the date of communication of such order, may apply to the Authority to set aside the ex-parte order showing that there are sufficient causes for not enabling him to attend the hearing on the prescribed date. If the Authority is satisfied, he may set aside the ex-parte order and shall appoint a date for proceeding with the inquiry.

In 'S.K. Nasiruddin Beedi Merchant Limited V. Central Provident Fund Commissioner' – AIR 2001 SC 850 it was held that the applicability of the Act to any class of employees is not determined and decided by any proceeding under Section 7A of the Act but under the provisions of the Act itself. When the Act became applicable to the employees in question, the liability arises. What is done under Section 7A of the Act is only determination of quantification of the same.

9.11 Review of order under Section 7A

Section 7B provides that any person aggrieved by an order under Section 7A may apply for a review of that order to the Officer who passed the order, if he-

- discovered new and important matter of 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.

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

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

In 'Balu Fire Clay Mines V. Union of India' – 2003 LLR 578 it was held that review is a statutory remedy. A review petitioner should also be disposed of by a speaking order.

9.12 Determination of escaped amount

Section 7C provides that the officer can re-open the case within five years from the date of order passed under Section 7A or Section 7B if he has reason to believe that by reason of 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 any amount so due from such employer for any period has escaped his notice. The Officer may pass appropriate orders re-determining the amount due from the employer in accordance with the provisions of this Act.

9.13 EPF Appellate Tribunal

Section 7D provides for the appointment of EPF Appellate Tribunal to hear the appeal against the order passed by the Central Government or any authority under Section 7A or 7B or 7C. The Appellate Tribunal may, after giving reasonable opportunities to the parties decided the appeal either confirming, modifying or annulling the order appealed against or may refer the case back to the authority which passed such order with such directions as the Tribunal may think fit. The Tribunal may rectify any mistake apparent from the record within five years from the date of its appeal order. No appeal by the employer shall be entertained unless he has deposited with it 75% o the amount due from him. The Tribunal may, for reasons to be recorded in writing, waive or reduce the amount to be deposited under this section.

9.14 Protection against attachment

Section 10 provides that the amount standing to the credit of any member of the Fund shall not in any way be capable of being assigned or charged and shall not be liable to attachment under any decree or any court in respect of any debt or liability incurred by the member and neither the Official assignee nor any receiver shall be entitled to, or have any claim on, any such amount.

9.15 Employer not to reduce wages

Section 12 provides that no employer in relation to an establishment to which any scheme or the insurance scheme applies shall, by reason only of his liability for the payment of any contribution to the fund or any charges or the scheme or the insurance scheme, reduce, whether directly or indirectly, the wages of any employee to whom they apply.

9.16 Transfer of Accounts

Section 17A provides that where an employee employed in an establishment to which the Act applies, leaves his employment and obtains re-employment in other establishment to which this Act does not apply, the amount

of accumulations to the credit of such employee shall be transferred 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.

9.17 Penalties

Section 14(1) provides that for the purpose of avoiding any payment whoever knowingly makes or causes to be made any false statement or false representation shall be punishable with imprisonment for a term which may extend to one year, or with fine of ₹5,000 or with both.

Section 14(1A) provides that an employer, who contravenes or makes default in complying with the provisions of Section 6 as it relates to the payment of inspection charges, administrative charges shall be punishable with imprisonment for a term which may extend to three years but-

- Which shall not be less than one year and fine of ₹10,000 in case of default of payment of the employees' contribution ;
- Which shall not be less than six months and a fine of ₹5,000 in any other case.

Section 14(1B) provides that an employer who contravenes or makes default in complying with the provisions of Section 6C in so far as it relates to the payment of inspection charges, shall be punishable with imprisonment for a term which may extend to one year but which shall not be less than six months and shall also be liable to fine which may extend to ₹5,000.

Section 14(2) provides that subject to the provisions of this Act, the Scheme, the Pension Scheme or the Insurance scheme may provide that any person who contravenes or makes default in complying with, any of the provisions thereof shall be punishable with imprisonment for a term which may extend to one year or with fine which may extend to ₹4,000 or with both.

Section 14(3) provides that whoever, contravenes or makes default in complying with any provision of this Act or of any condition subject to which exemption was granted shall, if no other penalty is elsewhere provided by or under this Act for such contravention or noncompliance, be punishable with imprisonment which may extend to six months but which shall not be less than one month and shall be liable to fine which may extend to ₹5,000.

9.18 Offences by companies

Section 14A (1) provides that if the person committing an offence under this Act, the Scheme etc., is a company, every person who at the time of the offence was committed was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. Nothing contained in this section shall render any such person liable to any punishment, if he proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of the offence.

Section 14A(2) provides that where an offence under the Act, the scheme or the pension scheme or the Insurance scheme has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to, any neglect on the part of, any director or manager, secretary or other officer of the company, such director, manager, secretary or other officer shall be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

EXERCISE

⊙ Multiple Choice Question:

1. Which one of the following will not include in the definition of basic wages?
   a) Dearness allowance; b) Overtime;
   c) Cash value for consideration; d) All the above.
2. The contribution of employer to insurance fund is-
   a) 1% b) 10%
   c) 12% d) None of the above.
3. Contribution of 10% to PF is applicable to-
   a) Any establishment in which less than 20 employees are employed; b) Any establishment declared as sick industrial company;
   c) Jute company; d) All of the above.
4. The minimum administrative charge payable by the employer to the fund is-
   a) ₹75 b) ₹500
   c) ₹1,000 d) None of the above
5. The maximum penalty recoverable from the employer who makes the default in payment of any contribution to the fund is-
   a) 5% b) 10%
   c) 15% d) 25%
6. Withdrawal from PF may be allowed for-
   a) Marriage of the employer; b) Post matriculation education of children;
   c) For the purchase of a dwelling place; d) For illness in certain cases.
7. The Employees Pension Scheme provides for-
   a) Superannuation pension; b) Orphanage pension;
   c) Both (a) and (b); d) None of (a) or (b).
8. Contribution of the employer to employees' pension scheme is-
   a) 8.33% b) 10%
   c) 12% d) None of the above.
9. The following cannot be nominated for the purposes of EPF Act-
   a) Wife; b) Sons of a deceased sons who have attained majority;
   c) Father in law; d) Unmarried daughter.

10. While filing appeal to EPF Appellate Tribunal the employer has to deposit___of the amount due from him.

a) 25%
b) 50%
c) 75%
d) None of the above.

State TRUE or FALSE

1. Once the EPF Act is covered to any establishment it shall continue to apply notwithstanding the number of persons employed shall at any time false below 20.
2. The wage limit ₹15,000 is applicable for the contribution to the Fund in respect of international workers.
3. The employer cannot reduce wages of the employee to avoid his liability under the Act.
4. If an employee is transferred from one employment to another, the balance at his credit in his PF Account cannot be transferred to the new establishment.
5. The Central Government may add to amend or vary either prospectively or retrospectively, the scheme, Pension Scheme or the Insurance Scheme.
6. Where the pay of an employee exceeds ₹15,000 the contribution to insurance scheme is restricted to ₹15,000.
7. Contribution to pension scheme is recoverable when the employee crosses 58 years of age.
8. The employer shall in the first instance pay the contribution payable by himself and also on behalf of the member employed by him through a contractor.
9. The PF scheme is applicable to the tea factories in the State of Assam.
10. The EPF Act is applicable to any establishment registered under the Co-Operative Societies Act, 1912.

Fill in the blanks

1. EPF Act is applicable to every establishment employing _____or more persons.
2. The contribution or employer to the Fund is_____of basic wages, dearness allowance and retaining allowance, if any.
3. The Pension fund is administered by the _____.
4. The Employee's Deposit Linked Insurance Scheme, 1976 came into effect from_____.
5. The contribution to insurance fund is to be remitted by the employer within_____days of the close of the month.
6. The wage limit contribution under the scheme has been fixed at ₹15,000 with effect from _____.
7. The Central Government may give exemption to any establishment considering its_____.
8. Contribution to EPF is payable by_____and_____.
9. _____is not covered under the EPF Act.
10. Section 5AA provides for the appointment of_____by the Central Government to assistant the Central Board in the performance of its functions.

⊙ Short Essay Type Questions

1. What are the schemes available in the EPF Act?
2. Narrate the features of Employees' Pension Scheme.
3. Short notes on -
   (a) Appropriate Government
   (b) Employee
   (c) EPF Appellate Tribunal

⊙ Essay Type Questions

1. What are the consequences if an employer makes default in the payment of any contribution to the Fund?
2. Under what circumstances advances can be received by employer from the PF Fund?
3. Discuss the matters provided for the insurance fund under the Schedule.
4. How the money due from employers is determined in respect of PF, pension scheme or the insurance scheme?
5. Explain the provisions relating to EPF Appellate Tribunal.
6. Discuss the procedure involved in review of order of the officer passed under Section 7A of the Act.
7. Describe the procedure for the payment of assured benefits in case of no nomination is filed by the employee.

Answer:

Multiple Choice Question:

1. d; 2. a; 3. d; 4. b; 5. d; 6. c; 7. c; 8. a; 9. b; 10. c.

State TRUE or FALSE

1. True; 2. Flase; 3. True; 4. False; 5. True; 6. True; 7. False; 8. True; 9. False; 10. False.

Fill in the blanks

1. 20; 2. 10%; 3. Central Board; 4. 01.09.1976; 5. 15; 6. 01.09.2014; 7. Financial position; 8. Employer, employee; 9. Apprentice; 10. Executive Committee.

Employees State Insurance Act, 1948 10

SLOB Mapped against the Module

To acquire the requisite knowledge of Employees State Insurance Act.

Module Learning Objectives:

After studying this module, the students will be able -

- To acquire the requisite knowledge of the benefits given to employees in case of sickness, maternity and injuries suffered in the course of employment.
- To develop an understanding about the establishment of employees' state insurance corporation and its constitution, also about the powers and obligations of the Corporation, the standing committee and medical benefit council.

Employees State Insurance Act, 1948

10

The Employees' State Insurance Act, 1948 is the first major legislation on social security for the employees in India. It is devised to provide social protection to employees in contingencies such as illness, long term sickness or any other health risks due to exposure to employment injury or occupational hazards. The medical facilities are also made available to legal dependents of the employees who are insured person. This facility is also extended to retired persons also.

Object of the Act

The object of the Act is to provide for certain benefits to employees in case of sickness, maternity and employment injury and to make provision for certain other matters in relation thereto.

10.1 Applicability

This Act extends to whole of India. This Act applies to-

- in the first instance applicable to all factories, including factories belonging to the Government, other than season factories;
- the appropriate Government may, in consultation with the corporation and where the appropriate Government is a State Government, with the approval of Central Government, after giving one month's notice of its intention of so doing by notification in the Official Gazette, extend the provisions of this Act or any of them, to any other establishment or classes of establishments, industrial, commercial, agricultural or otherwise;
- a factory or an establishment to which this Act applies shall continue to be governed by this Act notwithstanding that the number of persons employed therein at any time falls below the limit specified by or under this Act or the manufacturing process therein ceases to be carried on with the aid of power.

The Central Government has since prescribed the wage limit for coverage of an employee under Section 2(9) of the Act, as ₹21,000 per month. Further it is provided that an employee whose wages (excluding remuneration for overtime work) exceeds ₹21,000 a month at any time after and not before the beginning of the contribution period, shall continue to be an employee until the end of the said period.

In 'Employees' State Insurance Corporation V. Premlal' – 2009 LLR 282 (Ker HC) it was held that ESI scheme will be applicable to establishment preparing sweets with the aid of LPG.

In 'Employees State Insurance Corporation, Orissa Region V. Gujarat Co-operative Milk Marketing Federation Limited' – 2009 LLR 615 (Ori.HC) it was held that in the absence of required number of employees in Milk Federation, ESI Act could not be extended upon it.

In 'Kuriacose V. Employees' State Insurance Corporation' – (1988) 2 CLR 301 (Ker) it was held that once the Act has become applicable to a factory or an establishment, its application will be continuous.

10.2 Important Definitions:

Appropriate Government

Section 2(1) defines the term 'appropriate Government', in respect of establishments under the control of the Central Government or a railway administration or a major port or a mine or oilfield, the Central Government, and in all other cases, the State Government.

Confinement

Section 2(3) defines the term 'confinement' as labour resulting in the issue of a living child or labour after 26 weeks of pregnancy resulting in the issue of a child, whether alive or dead.

Dependant

Section 2(6A) defines the term 'dependant' as any of the following of a deceased insured person:

- a widow, a legitimate or adopted son who has not attained the age of 25 years, an unmarried legitimate or adopted daughter;
- a widowed mother;
- if wholly dependent on the earnings of the insured person at the time of his death, a legitimate or adopted son or daughter who has attained the age of 25 years and is infirm;
- if wholly or in part dependant on the earnings of the insured person at the time of his death-
  - a parent other a widowed mother;
  - a minor illegitimate son, an unmarried illegitimate daughter or a daughter legitimate or adopted or illegitimate if married and a minor or if widowed and a minor;
- a minor brother or an unmarried sister or a widowed sister if a minor;
- a widowed daughter-in-law;
- a minor child of a pre-deceased son;
- a minor child of a pre-deceased daughter where no parent of the child is alive; or
- a paternal grand-parent if no parent of the insured person is alive.

Employment injury

Section 2(8) defines the term 'employment injury' as a personal injury to an employee caused by accident or an occupational disease arising out of and in the course of employment, being an insurable employment, whether the accident occurs or the occupation disease is contracted within or outside the territorial limits of India.

Employee

Section 2(9) defines the term 'employee' as any person employed for wages in or in connection with the work of a factory or establishment to which the Act applies and-

- who is directly employed by the principal employer, on any work of, or incidental or preliminary to or connected with the work of, the factory or establishment, whether such work is done by the employee in the factory or establishment, whether such work is done by the employee in the factory or establishment or elsewhere; or
- who is employed by or through an immediate employer, on the premises of the factory or establishment or under the supervision of the principal employer or his agent on work which is ordinarily part of the work of the factory or establishment or which is preliminary to the work carried on in or incidental to the purpose

of the factory or establishment; or

- whose services are temporarily lent or let on hire to the principal employer by the person with whom the person whose services are so lent or let on hire has entered into a contract of service;

and includes any person employed for wages on any work connected with the administration of the factory or establishment or any part, department or branch thereof or with the purchase of raw materials for, or the distribution or sale of the productions of, the factory or establishment or any person engaged as apprentice, not being an apprentice engaged under the Apprentices Act, 1961 and includes such person engaged as apprentice whose training period is extended to any length of time but does not include-

- any member of the Indian naval, military or air forces; or
- any person so employed whose wages (excluding remuneration for overtime work) exceed such wages as may be prescribed by the Central Government provided that an employee whose wages as may be prescribed by the Central Government at any time after (and not before) the beginning of the contribution period, shall continue to be an employee until the end of that period.

In 'Director, Hassan Co-operative Milk Producer's Society Union Limited V. Assistant Regional Director, Employees' State Insurance Corporation' AIR 2010 SC 2109 it was held that merely being employed in connection with the work of an establishment, in itself, does not entitle a person to be an 'employee'; he must not only be employed in connection with the work of the establishment but also be shown to be employed in or other of the three categories mentioned in Section 2(9) of the Act.

In 'Employees' State Insurance Corporation V. Tata Engineering & Locomotive Co., Limited' – AIR 1976 SC 66 it was held that an apprentice who is mere trainee for a distinct purpose is not an employee.

In 'Regional Director, Employees' State Insurance Corporation V. Ramanuja Match Industries' – AIR 1985 SC 278 it was held that a partner is not an employee.

The following categories are coming under the purview of the term 'employee'-

- Canteen workers – Employees State Insurance Corporation V. Shri Ram Chemical Industries' – (1978) 2 LLN 227 (Raj);
- Employees who are working in a show room or sales office – 'Bhopal Motors Private Limited V. Employees' State Insurance Corporation' – (1982) 2 LLN 827 (MP);
- Workers rendering services outside the place of establishment or shop – 'Hindu Jea Band V. Regional Director, Employees' State Insurance Corporation' – 1986 LLR 95;
- Part time employees employed on daily rate basis – 'Hindu Jea Band' (supra);
- Casual workers – 'Regional Director, Employees' State Insurance Corporation V. South India Flour Mill (Pvt) Limited' – AIR 1986 SC 1686;

Family

Section 2(11) defines the term 'family' as all or any of the following relatives of an insured person-

- a spouse;
- a minor legitimate or adopted child dependent upon the insured person;
- a child who is wholly dependent on the earnings of the insured person and who is-
  - receiving education, till he or she attains the age of 21 years;
  - an unmarried daughter;

- a child who is infirm by reason of any physical or mental abnormality or injury and is wholly dependent on the earnings of the insured person, so long as the infirmity continues;
- dependent parents, whose income from all sources does not exceed such income as may be prescribed by the Central Government;
- in case the insured person is unmarried and his or her parents are not alive, a minor brother or sister wholly dependent upon the earnings of the insured person.

Factory

Section 2(12) defines the term 'factory' as any premises including the precincts thereof whereon ten or more persons are employed or were employed on any day of the preceding 12 months and in any part of which a manufacturing process is being carried on or is ordinarily so carried on, but does not include a mine subject to the operation of the Mines Act, 1952 or a railway running shed.

Immediate employer

Section 2(13) defines the terms 'immediate employer' in relation to employees employed by or through him, as a person who has undertaken the execution, on the premises of a factory or an establishment to which this Act applies or under the supervision of the principal employer or his agent, of the whole or any part of any work which is ordinarily part of the work of the factory or establishment of the principal employer or is preliminary to the work carried on in, or incidental to the purpose of, any such factory or establishment, and includes a person by whom the services of an employee who has entered into a contract of service with him are temporarily lent on hire to the principal employer and includes a contractor.

In 'Employees' State Insurance Corporation V. T. Shankar Singh T. Byali' – (1988) 92 FJR 645 (Kar) it was held that a person will be the immediate employer and not the principal employer even if the employees have been employed by him, if he supplied services to a factory or establishment.

Insured Person

Section 2(14) defines the term 'insured person' as a person who is or was an employee in respect of whom contributions are or were payable under the Act and who is by reason thereof, entitled to any of the benefits provided by this Act.

Permanent partial disablement

Section 2(15A) defines the expression 'permanent partial disablement' as such disablement of a permanent nature, as reduces the earning capacity of an employee in every employment which he was capable of undertaking at the time of the accident resulting in the disablement. Every injury specified in Part II of the Second Schedule shall be deemed to result in permanent partial disablement.

Permanent total disablement

Section 2(15B) defines the expression 'permanent total disablement' as such disablement of a permanent nature as incapacitates an employee for all work which he was capable of performing at the time of the accident in such disablement. The permanent total disablement shall be deemed to result from every injury specified in Part I of the Second Schedule or from any combination of injuries specified in Part II thereof where the aggregate percentage of the loss of earning capacity, as specified in the said Part II against those injuries, amounts to 100% or more.

Principal Employer

Section 2(17) defines the term 'principal employer' as-

- in a factory, the owner or occupier of the factory and includes the managing agent of such owner or

occupier, the legal representative of a deceased owner or occupier, and where a person has been named as the manager of the factory under the Factories Act, 1948, the person so named;

- in any establishment under the control of any department of any Government in India, the authority appointed by such Government in this behalf or where no authority is so appointed, the head of the Department;
- in any other establishment, any person responsible for the supervision and control of the establishment.

Seasonal factory

Section 2(19A) defines the term 'Seasonal factory' as a factory which is exclusively engaged in one or more of the following manufacturing processes, namely, cotton ginning, cotton or jute pressing, decortications of groundnuts, the manufacture of coffee, indigo, lac, rubber, sugar (including gur) or tea or any manufacturing process which is incidental to or connected with any of the aforesaid processes and includes a factory which is engaged for a period not exceeding seven months in a year-

- in any process of blending, packing or repacking of tea or coffee; or
- in such other manufacturing process as the Central Government may, by notification in the Official Gazette, specify.

Temporary disablement

Section 2(21) defines the term 'temporary disablement' as a condition resulting from an employment which requires medical treatment and renders an employee, as a result of such injury, temporarily incapable of doing the work which he was doing prior to or at the time of the injury.

Wages

Section 2(22) defines the term 'wages' as all remuneration paid or payable in cash to an employee, if the terms of the contract of employment, express or implied, were fulfilled and includes any payment to an employee in respect of any period of authorized leave, lock out, strike which is not illegal or lay-off and other additional remuneration, if any, paid at intervals not exceeding two months, but not include-

- any contribution paid by the employer to any pension fund or provident fund, or under this Act;
- any travelling allowance or the value of any travelling concession;
- any sum paid to the person employed to defray special expenses entailed on him by the nature of his employment; or
- any gratuity payable on discharge.

In 'Regional Director, Employees' State Insurance Corporation' – 1994 LLR 1 (SC) it was held that bonus or ex-gratia amount is not 'wages'. The following are treated as wages-

- LIC Premium subsidy;
- House rent allowance, heat, gas and dust allowance and incentive allowance;
- Incentive bonus;
- Over time allowance;

Employees' State Insurance Incorporation

Section 3 provides for the establishment of Employees' State Insurance Corporation with effect from 01.10.1948. The Corporation is a body corporate having perpetual succession and a common seal and shall by the said name sue and be sued.

Constitution of Corporation

Section 4 provides that the Corporation shall consist of a Chairman, a Vice Chairman and other members representing the interests of employers, employees, state governments, union territories and medical professions. Three members of the Parliament and the Director General of the Corporation are its ex-officio members. Section 5 provides for the term of office of members of Corporation. Section 6 provides for the eligibility for re-nomination or re-election.

All orders and decisions of the Corporation shall be authenticated by the signature of the Director General.

Regional Boards

Section 25 provides that the Corporation may appoint Regional Boards, Local Committees and Regional and Local Medical Benefit Councils in such areas and in such manner and delegate to them such powers and functions, as may be provided by the regulations.

Other bodies of Corporation

Standing Committee

Section 8 of the Act provides for the constitution of Standing Committee which shall be constituted form among its members consisting of-

- a Chairman;
- three members of the Corporation;
- three members of the Corporation representing such three State Governments;
- eight members elected by Corporation –
  - three members from among the members of the Corporation representing employers;
  - three members from among the members of the Corporation representing employees;
  - one member from among the members of the Corporation representing medical profession; and
  - one member from among the members of the Corporation elected by Parliament.
- the Director General of the Corporation, ex-officio.

Term of office

Section 9 provides that the term of office of a member of the Standing Committee shall be two years from the date on which his election is notified. A member of the Standing Committee shall cease to hold office when he ceases to be a member of the Corporation.

Powers of the Standing Committee

Section 18 provides that subject to the general superintendence and control of the Corporation, the Standing Committee shall administer the affairs of the Corporation and may exercise any of the powers and perform any of the functions of the Corporation. The Standing Committee shall submit for the consideration and decision of the Corporation all such cases and matters as may be specified in the regulations made in this behalf. The Standing Committee may, in its discretion, submit any other case or matter for the decision of the Corporation.

Meetings of Standing Committee, Corporation and Medical Benefit Council

Section 20 of the Act provides that the Standing Committee shall meet at such times and places and shall observe such rules or procedure in regard to transaction of business at their meetings as may be specified in the regulations made in this behalf.

Supersession of the Corporation and Standing Committee

Section 21 of the Act provides that if in the opinion of the Central Government, the Corporation or the Standing Committee persistently makes default in performing the duties imposed on it by or under this Act or abuses its powers, that Government may, by notification in the Official Gazette, supersede the Standing Committee in consultation with the Standing Committee. Before issuing a notification the Standing Committee shall be given a reasonable opportunity to show cause why it should not be superseded and shall consider the explanations and objections, if any, of the Standing Committee. On such superseding all the members shall be deemed to vacate their office. A new Standing Committee shall be immediately constituted.

Medical Benefit Council

Section 10 provides for the constitution of Medical Benefit Council consisting of-

- the Director General of ESI, ex-officio – Chairman;
- the Director General, Health Services, ex-officio – Co-Chairman;
- the Medical Commissioner of the Corporation – ex-officio;
- one member each representing each state other than Union territories;
- three members representing employers;
- three members representing employees;
- three members representing the medical profession; among them one shall be a woman.

Term of office

The term of the office of the members of Medical Benefit Council (last three categories) shall be four years from the date on which the appointment is notified.

Duties of Medical Benefit Council

Section 22 provides the duties of the Medical Benefit Council as to-

- advise the Corporation and the Standing Committee on matters relating to the administration of medical benefit, the certification for purposes of the grant of benefits and other connected matters;
- have such powers and duties of investigation as may be prescribed in relation to complaints against medical practitioners in connection with the medical treatment and attendance; and
- perform such other duties in connection with the medical treatment and attendance as may be specified in the regulations.

Disqualification

Section 13 provides that a person shall be disqualified as a member of the Corporation, the Standing Committee or the Medical Benefit Council-

- if he is declared to be of unsound mind by a competent court; or
- if he is an undischarged insolvent; or
- if he has directly or indirectly by himself or by his partner any interest in a subsisting contract with, or any work being done for, the Corporation except as a medical practitioner or as a share holder of a company; or
- if before or after commencement of this Act, he has been convicted of an offence involving moral turpitude.

Resignation

Section 11 provides that a member of the Corporation, the Standing Committee or the Medical Benefit Council may resign his office by notice in writing to the Central Government and his seat fall vacant on the acceptance of the resignation by Government.

Cessation

Section 12 provides that a member of the Corporation, the Standing Committee or the Medical Benefit Council shall cease to be a member if he fails to attend three consecutive meeting. The Corporation, the Standing Committee or the Medical Benefit Council may restore the membership subject to the rules made by the Government.

Registration of employees

Every employee is to register himself under the provisions of the Act. Registration is the process of obtaining and recording information about his employment which is insurable employment. This process also identifies to provide the benefits available under the Act that are related to the contributions paid by the employer on behalf of insured employees. The employee is required to give his details and his family details to his employer. A family photo is also to be provided so that the employer can register the employee.

Registration is the process of obtaining and recording information about the entry of an employee into 'insurable employment', for the purpose of his identification under the Act. Registration of employee is the process of identification to provide the benefits under the Act which are related to the contributions paid by the employer on behalf of each of the insured persons. At the time of joining the insurable employment, an employee is required to provide his and his family details to the employer along with a family photo so that the employer can register the employee online. This exercise of registering an employee has to be a onetime exercise in life time of an employee. The insurance number generated on the first occasion of registration is to be used throughout his life time irrespective of change of employment including change of place.

Employees' State Insurance Fund

Section 26 of the Act provides for the creation of Employees' State Insurance Fund held and administered by the Corporation. All contributions paid under this Act and all other moneys received on behalf of the corporation shall be paid into this fund. The grants, donations and gifts received from the Central Government or any State Government, local authority or any individual or body whether incorporated or not, are also paid into this Fund.

Purposes for which the fund may be expended

Section 28 of the Act provides the Central Government may utilize the State Insurance Fund only for the following purposes:

- payment of benefits and provision of medical treatment and attendance to insured persons and, where the medical benefit is extended to their families, the provision of such medical benefit to their families in accordance with the provisions of this Act and defraying the charges and costs in connection therewith;
- payment of fees and allowances to members of the Corporation, the Standing Committee and the Medical Benefit Council, the Regional Boards, Local Committees and Regional and Local Medical Benefit Councils;
- payment of salaries, leave and joining time allowances, travelling and compensatory allowances, gratuities and compassionate allowances, pensions, contributions to provident or other benefit fund of officers and servants of the Corporation and meeting the expenditure in respect of offices and other services set up for the purpose of giving effect to the provisions of this Act;
- establishment and maintenance of hospitals, dispensaries and other institutions and the provision of medical and other ancillary services for the benefit of insured persons and, where the medical benefit is extended to their families;

- payment of contributions to any State Government, local authority or any private body or individual, towards the cost of medical treatment and attendance provided to insured persons and, where the medical benefit is extended to their families, including the cost of any building and equipment, in accordance with any agreement entered into by the Corporation;
- defraying the cost (including all expenses) of auditing the accounts of the Corporation and of the valuation of its assets and liabilities;
- defraying the cost (including all expenses) of the Employees' Insurance Courts set up under this Act;
- payment of any sums under any contract entered into for the purpose of this Act by the Corporation or the Standing Committee or by any officer duly authorized by the Corporation or the Standing Committee in that behalf;
- payment of sums under any decree, order or award of any Court or Tribunal against the Corporation or any of its officers or servants for any act done in the execution of his duty or under a compromise or settlement of any suit or other legal proceeding or claim instituted or made against the Corporation;
- defraying the cost and other charges of instituting or defending any civil or criminal proceedings arising out of any action taken under this Act;
- defraying expenditure, within the limits prescribed, on measures for the improvement of the health, welfare of insured persons and for the rehabilitation and re-employment of insured persons who have been disabled or injured; and
- such other purposes as may be authorized by the Corporation with the previous approval of the Central Government.

Contributions

The contribution payable under this Act is of two types – one is the contribution of the employer and the other is the contribution of the employee which is recovered from his wages and remitted to the Fund. The present rate contribution is 3.25% and 0.75% of workers' wages by employers and employees respectively.

Contribution against employee must be deposited within due date. One shall not be able to deposit contribution online after 42 days from the end date of the contribution period.

Employee whose salary per day is ₹176 or less need not to pay Employee's contribution and the same will be paid by the Govt. However, employer will have to pay their share of contribution.

The employer is required to file monthly contributions online through ESIC portal on a monthly basis in respect of all its employees after duly registering them. Through this, the employer has to file employee wise number of days for which wages paid and the amount of the wages paid respectively to ascertain the amount of contributions payable. The total amount of contribution, both by the employer and the employee, for each month is to be deposited in any branch of SBI in cash or by cheque or demand draft on generation of such a challan through ESIC portal using credentials. The contributions can also be paid through SBI internet banking.

Principal employer to pay contribution in the first instance

Section 40(1) provides that the principal employer shall pay in respect of all employer, whether directly employed by him or by or through an immediate employer, both the employer's contribution and the employee's contribution.

Section 40(4) provides that any sum deducted by the principal employer from wages shall be deemed to have been entrusted to him by the employee for the purpose of paying the contribution in respect of which it was deducted. The principal employer shall bear the expenses of remitting the contributions to the corporation.

Recovery of contribution from immediate employer

Section 41 provides that a principal employer, who has paid contribution in respect of an employee employed through an immediate employer, shall be entitled to recover the amount of the contribution so paid from the immediate employer, either by deduction from any amount payable to him by the principal employer under any contract or as a debt payable by the immediate employer.

The immediate employer shall maintain a register of employees employed by or through him and submit the same to the principal employer before the settlement of any amount payable by him.

Method of payment of contribution

Section 43 provides that the Corporation may make regulations for payment and collection of contributions payable. Such regulations may provide for-

- the manner and time of payment of contributions;
- the payment of contributions by means of adhesive or other stamps affixed to or impressed upon books, card or otherwise and regulating the manner, times and conditions, in, at and under which, such stamps are to be affixed or impressed;
- the date of which evidence of contributions have been paid is to be received by the Corporation;
- the entry in or upon books or cards of particulars of contributions paid and benefits distributed in the case of the insured persons to whom such books or cards relate; and
- the issue, sale, custody, production, inspection and delivery of books or card and the replacement of books or cards which have been lost, destroyed or defaced.

Recovery of contributions

Section 45B provides that any contribution payable under this Act may be recovered as an arrear of land revenue.

Section 45C provides that the authorized officer may issue certificate to Recovery Officer, who in turn proceed to recover the amount by one or more of the modes mentioned below-

- attachment and sale of moveable or immovable property of the factory or establishment or, as the case may be, the principal, or immediate employer;
- arrest of the employer and his detention in prison;
- approving a receiver for the management of the movable or immovable properties of the factory or establishment or, as the case may be, the employer.

The attachment shall first be effected against the properties of the factory or the establishment and such attachment and sale is insufficient for recovering the whole of the amount of arrears, the Recovery Officer may take such proceedings against the property of the employer.

Benefits

Section 46 provides that the insured persons, their dependents shall be entitled to the following benefits-

- periodical payments to any insured person in case of his sickness;
- periodical payments to an insured woman in case of confinement or mis-carriage or sickness arising out of the pregnancy, confinement, premature birth of child or miscarriage;
- periodical payments to an insured person suffering from a disablement as a result of an employment injury sustained as an employee;

- periodical payments to such dependants of an insured person who dies as a result of an employment injury sustained as an employee;
- medical treatment for and attendance on insured persons;
- payment to the eldest surviving member of the family of an insured person, who has died, towards the expenditure on the funeral of the deceased insured person; if the injured person at the time of his death does not have a family, the funeral payment will be paid to the person who actually incurs the expenditure.

The amount of such payment shall not exceed such amount as may be prescribed by the Central Government. The claim for such payments shall be made within 3 months of the death of the insured person or within such extended period as the Corporation allow in this behalf.

Bar against receiving compensation under any other law

Section 53 provides that an insured person or his dependants shall not be entitled to receive or recover, whether from the employer or from any other person, any compensation or damages under the Workmen Compensation Act, 1923 or any other law for the time being in force or otherwise in respect of an employment injury sustained by the insured person as an employee.

Medical benefit

Section 56 provides that an insured person or a member of his family whose condition requires medical treatment and attendance shall be entitled to receive medical benefits. Such medical benefit may be given either in the form of out-patient treatment and attendance in a hospital or dispensary, clinic or other institution or by visits to the home of the insured person or treatment as in-patient in a hospital or other institution. A person shall be entitled to medical benefit during any period for which contributions are payable in respect of him or which he is qualified to claim sickness benefit or maternity benefit or is in receipt of such disablement benefit as does not disentitle him to medical benefit under the regulations.

Establishment of hospital by Corporation

Section 59 provides that the Corporation may, with the approval of the State Government, establish and maintain in a State such hospitals, dispensaries and other medical and surgical services as it may think fit for the benefit of insured persons and their families.

Benefits not assignable

Section 60 provides that the right to receive any payment or any benefit under this Act shall not be transferable or assignable.

Benefits not to be combined

Section 65 provides that an insured person shall not be entitled to receive for the same period-

- both sickness benefit and maternity benefit; or
- both sickness benefit and disablement benefit for temporary disablement; or
- both maternity benefit and disablement benefit for temporary disablement.

Where a person is entitled to more than one of the benefits he shall be entitled to choose which benefit he shall receive.

Repayment of benefit improperly received

Section 70 provides that where any person has received any benefit or payment under this Act when he is now lawfully entitled to receive the same, he shall be liable to the Corporation the value of the benefit or the amount

of such payment, or in the case of his death his representative shall be liable to repay the same from the assets of the deceased, if any, in his hands. The amount recoverable may be recovered as if it were an arrear of land revenue or by the Recovery Officer.

Employer not to reduce wages etc.

Section 72 provides that no employer by reason only of his liability for any contributions payable under this Act shall, directly or indirectly reduce the wages of any employee, or except as provided by the regulations discontinue or reduce benefits payable to him under the conditions of his service, which are similar to the benefits conferred by this Act.

Employer not to dismiss or punish the employee during sickness etc.

Section 73 provides that no employee shall dismiss, discharge or reduce or otherwise punish an employee during the period the employee is in receipt of sickness benefit or maternity benefit, nor shall be, except as provided under the regulations, dismiss, discharge or reduce or otherwise punish an employee during the period which he is in receipt of disablement benefit for temporary disablement or is under medical treatment for sickness or is absent from work as a result of illness duly certified in accordance with the regulars to arise out of the pregnancy or confinement rendering the employee unfit for work.

Adjudication of disputes and claims

Section 74 provides that the State Government shall constitute an ESI Court for such local area as may be specified in the notification. Section 75 provides that ESI Court may decide any question or dispute arises as to-

- whether any person is an employee within the meaning of this Act or whether he is liable to pay the employee's contribution; or
- the rate of wages or average daily wages of an employee for the purposes of this Act; or
- the rate of contribution payable by a principal employer in respect of any employee;
- the person who is or was the principal employer in respect of any employee; or
- the right of any person to any benefit and as to the amount and duration thereof; or
- any direction issued by the Corporation on a review of any payment of dependents' benefit; or
- any other matter which is in dispute between-
  - a principal employer and the Corporation; or
  - a principal employer and an immediate employer; or
  - a person and the Corporation; or
  - an employee and a principal or immediate employer,

The following claims shall be decided by ESI Court-

- claim for the recovery of contributions from the principal employer;
- claim by a principal employer to recover contributions from any immediate employer;
- claim against a principal employer;
- claim for the recovery of the value or amount of the benefits received by a person when he is not lawfully entitled thereto; and
- any claim for the recovery of any benefit admissible under the Act.

An appeal shall lie to the High Court from an order of ESI Court if it involves a substantial question of law.

The appeal shall be filed within 60 days from the date of the order of ESI Court.

Jurisdiction of Civil Court

Section 75(3) provides that no Civil Court have jurisdiction to decide or deal with any question or dispute as aforesaid or to adjudicate on any liability which is to be decided by a medical board or a medical appeal tribunal or ESI Court.

In 'ESI Corporation V. Jalandhar Gymkhana Club'- 1972 LLR 733 (P&H) it was held that a civil court cannot determine whether this Act is applicable to an establishment or not.

10.3 Penal Provisions under Sections 84 to 86 of ESI Act, 1948

Sections 84 to 86 of the Act provide for penalties for certain offences. These penalties were substantially increased by the Employee's State Insurance (Amendment) Act, 1975. The amended Act introduced three new sections namely, Section 85-A, 85-B and 85-C.

The following are the penalties as per the Act:

Section 84: This section deals with penalties for making wrong / false statements made by the Insured Persons with a view to take any benefit which is not admissible to him under the Act. Such Act is an offence punishable under Act with imprisonment for a term which may extend to six months or with fine which may extend to Two thousand rupees or with both.

It is also provided under this section that if an insured person is convicted by the Court for an offence committed by him under this section, he shall not be entitled to any cash benefits available under the Act for such a period as may be prescribed by the Central Government.

Section 85: This section deals with penalties for non-compliance with the various provisions of the ESI Act and Regulations made there under. Such non-compliance with any of the provisions of the Act constitutes an offence committed by the employer of a covered Factory / Establishment which is punishable under Section 85(a) to 85(g) of the Act.

Section 85(a): Envisages that if an employer fails to pay any contribution payable under the Act within the prescribed time-limit, he thus commits an offence u/s 85(a) of the Act, which is punishable with imprisonment for a term which may extend to three years u/s 85(i) of the Act, provided it shall not be less than 1 year and fine of ₹10,000 u/s 85(i) (a) of the Act where employees' share of contribution is deducted by the employer from their wages but not paid. In other case where term of imprisonment shall not be less than 6 months and fine of ₹5,000 u/s 85(i) (b).

Section 85(b) to 85(g): Says that if an employer commits an offence under this section for noncompliance with any other provisions of the Act, which is punishable with imprisonment for a term which may extends to 1 year or with fine up to ₹4,000 or with both.

Section 85-A: This section deals with enhanced punishment in certain cases after previous conviction. If any employer convicted by a Court for an offence punishable under the Act, committing the same offence, shall, for every such subsequent offence, be punished with imprisonment for a term which may extend to 2 years and with fine of ₹5,000.

It is provided that if such subsequent offence is for failure to pay contribution payable under the Act, the employer shall, for every such subsequent offence, be punished with imprisonment for a term which may extend to 5 years but which shall not be less than 2 years and shall be liable to pay fine of ₹25,000.

Section 85-B: Provides that the corporation may recover damages from the employer by way of penalty under this section if any employer fails to pay contribution payable under the Act within the specified time-limit or pays

contribution belatedly provided that before recovering such damages, the employer shall be given a reasonable opportunity of being heard.

The amount of damages may not exceed the amount of contribution paid / payable.

There is also a provision to reduce or waive damages recoverable under this section in respect of a Factory/ Establishment which is a Sick Industrial Unit and in respect of which Rehabilitation Scheme has been sanctioned by BIFR, under Regulation 31-C, of ESI (General) Regulations, 1950.

a) In case of change of Management including transfer of undertaking to worker's Co-operative or in case of merger or amalgamation of Sick Industrial Unit with a healthy company, damages levied/ leviable can be waived completely.

b) In other cases, depending on merits, damages levied/leviable can be waived upto 50%.

c) In exceptional hard cases, the damages levied/leviable can be waived either partially/totally.

Section 85-C: Provides that where an employer is convicted for an offence of non-payment of contribution under this Act, the Court in addition to giving any punishment by order, direct him to pay the amount of contribution for which he was convicted within a time period. The Court can also extend the time given periodically.

If the employer still fails to pay the contribution and submit returns within the time given by the court or within the extended time period given, the employer is deemed to have committed a further offence and shall be punishable with imprisonment under Section 85 and is also liable to pay a fine which may extend to one thousand rupees for every day of default.

Section 86: Provides that no prosecution under this Act shall be instituted without previous sanction of the Insurance Commissioner or of such other officer of the corporation as may be authorized in this behalf by the Director General of the Corporation.

It is also provided that No Court inferior to that of a Metropolitan Magistrate or Judicial Magistrate of the First Class shall try any offence under this Act.

And No Court shall take cognizance of any offence under this Act except on a complaint made in writing in respect thereof.

Section 75: Deals with provisions for Adjudication of Disputes & claims:

If any employer or employee under the Act has any disputes/questions that may be settled by E.I. Court after adjudicating the matter if made before it, subject to the condition that 50 % security deposit is required to be made u/s.75 (2B) (unless it is waived/reduced for the reasons recorded by the Ld. Court).

Penal Action u/s 138 of N.I. Act:

If employer submits a cheque to the corporation towards payment of contribution, interest, damages or any other amount due, which is bounced subsequently by the Bank for the reasons of Insufficient Fund he thereby commits an offence under this section and shall be punished with imprisonment for a term upto One year or with fine which may extend to twice the amount of cheque or with both.

Penal Action u/s 405/406/409 of I.P.C:

If an employer deducts employees' share of contribution from their wages but does not pay the said contribution, he thereby commits an offence of criminal Breach of Trust which is punishable under this section with imprisonment which may extend to 3 years or with fine or with both.

EXERCISE

Multiple Choice Questions:

1. The contribution shall be paid in a bank within ___days of the last day of the calendar month in which the contribution fall due for any wage period.

   a) 7 b) 14

   c) 21 d) 30

2. An appeal shall lie to High Court from the orders of ESI within _____ days from the date of order of the ESI Court.

   a) 30 b) 60

   c) 90 d) None of the above.

3. A member of the Corporation shall cease to be a member if he fails to attend _____ consecutive meeting.

   a) 3 b) 5

   c) 7 d) None of the above.

4. ESI Fund consists of-

   a) Contribution; b) Grants from governments;

   c) Donations; d) All the above.

5. The Corporation may with the approval of _____ establish and maintain in a State, hospitals, dispensaries etc.,

   a) Central Government; b) State Government;

   c) Local Authority; d) None of the above.

6. Who will not the following be considered as an employee?

   a) Canteen workers; b) Casual workers;

   c) Partners; d) Part time employee.

7. Who, among the following, is not the Principal Employer?

   a) Occupier of the factory; b) Owner of the factory;

   c) Legal representative of the owner; d) Legal representative of the contractor.

8. Seasonal factory is the one which is engaged for a period not exceeding_____ in a year.

   a) 7 months; b) 6 months;

   c) 3 months; d) None of the above.

9. Which, among the following, will not be included in the definition of 'wages'?

   a) Payment made on authorized leave; b) Travelling allowance;

   c) Payment made on lock out; d) Payment made for lay off.

10. ESI Corporation is a-
    a) Partnership firm;
    b) Limited Liability Partnership;
    c) Body Corporate;
    d) Hindu Undivided Family.

State TRUE or FALSE

1. The members of Indian Naval, military or air force is coming under the definition of 'employee' under ESI Act.
2. Wage does not include any gratuity payable on discharge.
3. Every employee is to register himself under the provisions of ESI Act.
4. An employee insured under the ESI Act can also claim compensation under the Workmen Compensation Act.
5. The benefits of medical benefits under this Act are assignable.
6. Civil Court has no jurisdiction to decide or deal with any dispute or to dispute on any liability to be decided by a medical board or tribunal or ESI Court.
7. Attachment of bank account of the defaulter can be undertaken for recovery of dues.
8. The Central Government cannot supersede the ESI Corporation.
9. Employees represent the Station Commission of ESI Corporation.
10. There shall be one woman among the members representing the medical profession in the Medical Benefit Council.

Fill in the blanks

1. The two types of permanent establishment is_____and_____.
2. The term of the members of Medical Benefit Council shall be _____.
3. The rate of contribution is_____ and _____ of worker's wages by employees and employers respectively.
4. The amount recoverable under this Act may be recovered as if it_____.
5. Standing Committee shall consist of_____ members of the Corporation;
6. _____ is the ex-officio member of Medical Benefit Council;
7. A member of the Corporation, the Standing Committee or the Medical Benefit Council may resign his office by notice in writing to_____.
8. The payment towards the expenditure on the funeral of the deceased insured person is payable to the _____.
9. Confinement is the labor resulting in the issue of living child or labor after_____ of pregnancy resulting in the issue of child, whether alive or dead.
10. Factory is defined as any premises including the precincts thereof whereon_____or more persons are employed on any day of the preceding _____.

Short Essay Type Questions

1. Define the terms 'immediate employer' and 'employee' under ESI Act.
2. List the benefits that are entitled to the insured persons under this Act.
3. State the obligations of Principal Employer.
4. Write a short notes on -
   (a) Seasonal factory
   (b) Medical Benefit Council

Essay Type Questions

1. Distinguish between the 'permanent partial disablement' and 'permanent total disablement'.
2. What are the various bodies constituted by the ESI Corporation and describe the functions of such bodies.
3. What is 'Employees' State Insurance Fund' and for what purposes the fund may be expended?
4. Discuss the method of recovery of contribution from the employer.
5. Whether an employee can be dismissed or punished during sickness? Substantiate your answer.
6. What are the disputes that can be settled by ESI Court?
7. What are the punishments described under Section 85 of the Act for failure to pay contribution etc.,

Answer:

Multiple Choice Questions:

1. c; 2. b; 3. a; 4. d; 5. b; 6. c; 7. d; 8. a; 9. b; 10. c.

State TRUE or FALSE

1. False; 2. True; 3. True; 4. False; 5. False; 6. True; 7. True; 8. False; 9. True; 10. True.

Fill in the blanks

1. Permanent partial disablement, permanent total disablement; 2. 4 years; 3. 3.25%, 0.75%; 4. Were an arrear of land revenue; 5. Three; 6. Medical Commissioner of the Corporation; 7. Central Government; 8. Eldest surviving member of the family; 9. 26 weeks; 10. 10 months, 12 months.

The Code on Wages, 2019 11

SLOB Mapped against the Module

To acquire knowledge of the various provisions dealing with payment of wages and related information incidental to existing labour laws.

Module Learning Objectives:

After studying this module, the students will be able -

- To acquire knowledge of the various provisions dealing with payment of wages and related information incidental to existing labour laws.
- To develop an understanding about the different provisions relating to floor wage, fixing the minimum wage, overtime, payment of wages, deductions, determination of bonus, gender discrimination, advisory boards, and penalties for offences.

The Code on Wages, 2019

11

The Code on Wages, 2019 was enacted in 2020 which enlists the provisions relating to payment of wages, overtime, bonus, minimum wages and other provisions incidental to existing labour laws. This Code has subsumed four Central labour legislations namely the Payment of Wages Act, 1936, the Minimum Wages Act, 1948, the Payment of Bonus Act, 1965 and the Equal Remuneration Act, 1976. This has also been mentioned in Section 69 of the Code which lays down that the Payment of Wages Act, 1936, the Minimum Wages Act, 1948, the Payment of Bonus Act, 1965 and the Equal Remuneration Act, 1976 are hereby repealed, with the enactment of this Code.

The Code not only regulates the wages of workmen but also the wages of employees performing managerial, supervisory functions. This Code therefore, brings uniformity in the definition of various terms overlapping in various pieces of legislation and eases the burden of documentation. Moreover, the Central Government under Section 68 of the Code lays down that in case of any difficulty, the Central Government shall notify provisions not inconsistent with the provisions of this Code, as may appear to be necessary for removing the difficulty within a period of three years from the commencement of this Code.

The Code on Social Security, 2020, the Industrial Relations Code, 2020 and the Occupational Safety, Health and Working Conditions Code, 2020, have also been enacted by the Government simultaneously. These codes also comprehensively lay down most provisions that used to exist in many scattered pieces of legislation.

This code is a welcome change to the existing labour law regime as it seeks to regulate wage and bonus payments in all sectors such as industry, trade, business, or manufacture, wherever employees are appointed. Through this Code the Central Government will get the power to regulate wages for sectors like railways, mines and oil fields among other sectors, whereas the State Governments will reserve the power to make decisions for all other employments.

According to Section 2 (y) of the Code, "wages" means:

All remuneration whether by way of salaries, allowances or otherwise, expressed in terms of money or capable of being so expressed which would, if the terms of employment, express or implied, were fulfilled, be payable to a person employed in respect of his employment or of work done in such employment, and includes:

i) basic pay;

ii) dearness allowance; and

iii) retaining allowance, if any, but does not include—

a) any bonus payable under any law for the time being in force, which does not form part of the remuneration payable under the terms of employment;

b) the value of any house-accommodation, or of the supply of light, water, medical attendance or other amenity or of any service excluded from the computation of wages by a general or special order of the appropriate Government;

c) any contribution paid by the employer to any pension or provident fund, and the interest which may have accrued thereon;

d) any conveyance allowance or the value of any travelling concession;

e) any sum paid to the employed person to defray special expenses entailed on him by the nature of his employment;

f) house rent allowance;

g) remuneration payable under any award or settlement between the parties or order of a court or Tribunal;

h) any overtime allowance;

i) any commission payable to the employee;

j) any gratuity payable on the termination of employment;

k) any retrenchment compensation or other retirement benefit payable to the employee or any ex gratia payment made to him on the termination of employment:

Provided that, for calculating the wages under this clause, if payments made by the employer to the employee under clauses (a) to (i) exceeds one-half, or such other per cent. as may be notified by the Central Government, of the all remuneration calculated under this clause, the amount which exceeds such one-half, or the per cent. so notified, shall be deemed as remuneration and shall be accordingly added in wages under this clause:

Provided further that for the purpose of equal wages to all genders and for the purpose of payment of wages, the emoluments specified in clauses (d), (f), (g) and (h) shall be taken for computation of wage.

Explanation: Where an employee is given in lieu of the whole or part of the wages payable to him, any remuneration in kind by his employer, the value of such remuneration in kind which does not exceed fifteen per cent. of the total wages payable to him, shall be deemed to form part of the wages of such employee; Wages include salary, allowance, or any other component expressed in monetary terms. This does not include bonus payable to employees or any travelling allowance, among others.

Example: In a factory, Sita is a female labourer who operates a plant. Whereas Mahesh is a male worker who does the same work in the same factory. However, since Sita is married to Ramesh, who also works at the same plant, the employer pays Sita half of what he pays to Mahesh as Sita's husband also works for gains at the same plant. According to this Code, this practice of the employer shall be illegal and prohibited, as the law seeks to put an end to all gender based discriminations in the case of minimum wages.

The definition of basic wage under the Employees Provident Funds and Miscellaneous Provisions Act, 1952 is defined under Section 2 (b) 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:

i) the cash value of any food concession;

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;

iii) any presents made by the employer;

The definition of basic wage was for a long time used by unscrupulous employers to minimise their contributions payable towards the EPF, which in turn defeated the purpose of the Act. This issue was dealt by the Supreme Court in the case of The Regional Provident Fund Commissioner (II) West Bengal Versus Vivekananda

Vidyamandir and Others where the Supreme Court held that all allowances which are universally, uniformly, necessarily and ordinarily paid to all employees would form a part of the basic wage, which shall be used for fund contribution to the provident fund. The exclusion of allowance from the basic wage can be permitted when the same is shown to be either a variable, or were linked to any incentive for production resulting in a greater output, or the allowance in question is not paid across the board, or paid especially to those who avail the opportunity.

The new definition of wage under the Code specifically excludes –

a) any bonus payable under any law for the time being in force;

b) the value of any house-accommodation, or of the supply of light, water, medical attendance or other amenity;

c) contribution paid by the employer to any pension or provident fund, and the interest which may have accrued thereon;

d) any conveyance allowance or the value of any travelling concession;

e) any sum paid to the employed person to defray special expenses entailed on him by the nature of his employment;

f) house rent allowance;

g) remuneration payable under any award or settlement between the parties or order of a court or Tribunal; (h) any overtime allowance;

h) any commission payable to the employee;

i) any gratuity payable on the termination of employment;

j) any retrenchment compensation or other retirement benefit payable to the employee or any ex gratia payment made to him on the termination of employment.

This change will impact the basis to calculate wage for the purpose of contribution towards certain benefits like EPF and Gratuity as now the same will have to be calculated on 50% of the total remuneration of an employee.

Whereas, employee, as mentioned in the previous provision, refers to any person (other than an apprentice engaged under the Apprentices Act, 1961), employed on wages by an establishment to do any skilled, semi-skilled or unskilled, manual, operational, supervisory, managerial, administrative, technical or clerical work for hire or reward, whether the terms of employment be express or implied, and also includes a person declared to be an employee by the appropriate Government, but does not include any member of the Armed Forces of the Union, as per Section 2 (k) of the Code.

1. Also, a workman has been defined under Sec 2 (z) which refers to any person (except an apprentice as defined under clause (aa) of section 2 of the Apprentices Act, 1961) employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward, whether the terms of employment be express or implied, and includes: (i) working journalists as defined in clause (f) of section 2 of the Working Journalists and other Newspaper Employees (Conditions of Service) and Miscellaneous Provisions Act, 1955; and
2. sales promotion employees as defined in clause (d) of section 2 of the Sales Promotion Employees (Conditions of Service) Act, 1976, and for the purposes of any proceeding under this Code in relation to an industrial dispute, includes any such person who has been dismissed, discharged or retrenched or otherwise terminated in connection with, or as a consequence of, that dispute, or whose dismissal, discharge or retrenchment has led to that dispute, but does not include any such person-

   a) who is subject to the Air Force Act, 1950, or the Army Act, 1950, or the Navy Act, 1957; or

b) who is employed in the police service or as an officer or other employee of a prison; or

c) who is employed mainly in a managerial or administrative capacity; or

d) who is employed in a supervisory capacity drawing wage of exceeding fifteen thousand rupees per month or an amount as may be notified by the Central Government from time to time.

The social purpose of the Code that it seeks to achieve is to avoid all kinds of gender based discrimination. Section 3 of the Code states that:

1. There shall be no discrimination in an establishment or any unit thereof among employees on the ground of gender in matters relating to wages by the same employer, in respect of the same work or work of a similar nature done by any employee.
2. No employer shall -
   a) for the purposes of complying with the provisions of sub-section (1), reduce the rate of wages of any employee; and
   b) make any discrimination on the ground of sex while recruiting any employee for the same work or work of similar nature and in the conditions of employment, except where the employment of women in such work is prohibited or restricted by or under any law for the time being in force.

The Code also lays down the various components of minimum wage that the appropriate Government shall fix. Under Section 7, the Code lays down that:

1. Any minimum rate of wages fixed or revised by the appropriate Government under section 8 may consist of:
   a) a basic rate of wages and an allowance at a rate to be adjusted, at such intervals and in such manner as the appropriate Government may direct, to accord as nearly as practicable with the variation in the cost of living index number applicable to such workers (hereinafter referred to as "cost of living allowance"); or
   b) a basic rate of wages with or without the cost of living allowance, and the cash value of the concessions in respect of supplies of essential commodities at concession rates, where so authorised; or
   c) an all-inclusive rate allowing for the basic rate, the cost of living allowance and the cash value of the concessions, if any.
2. The cost of living allowance and the cash value of the concessions in respect of supplies of essential commodities at concession rate shall be computed by such authority, as the appropriate Government may by notification, appoint, at such intervals and in accordance with such directions as may be specified or given by the appropriate Government from time to time.

The procedure for fixing wages has been given in Section 8 which states:

1. In fixing minimum rates of wages for the first time or in revising minimum rates of wages under this Code, the appropriate Government shall either—
   a) appoint as many committees as it considers necessary to hold enquiries and recommend in respect of such fixation or revision, as the case may be; or
   b) by notification publish its proposals for the information of persons likely to be affected thereby and specify a date not less than two months from the date of the notification on which the proposals shall be taken into consideration.
2. Every committee appointed by the appropriate Government under clause (a) of sub-section (1) shall consist of persons:

a) representing employers;

b) representing employees which shall be equal in number of the members specified in clause (a); and

c) independent persons, not exceeding one-third of the total members of the committee.

3. After considering the recommendation of the committee appointed under clause (a) of sub-section (1) or, as the case may be, all representations received by it before the date specified in the notification under clause (b) of that sub-section, the appropriate Government shall by notification fix, or as the case may be, revise the minimum rates of wages and unless such notification otherwise provides, it shall come into force on the expiry of three months from the date of its issue:

   Provided that where the appropriate Government proposes to revise the minimum rates of wages in the manner specified in clause (b) of sub-section (1), it shall also consult concerned Advisory Board constituted under section 42.

4. The appropriate Government shall review or revise minimum rates of wages ordinarily at an interval not exceeding five years.

Additionally, the powers to fix the minimum wages have been given under Section 6, which says:

1. Subject to the provisions of section 9, the appropriate Government shall fix the minimum rate of wages payable to employees in accordance with the provisions of section 8.
2. For the purposes of sub-section (1), the appropriate Government shall fix a minimum rate of wages:

   a) for time work; or

   b) for piece work.

3. Where employees are employed on piece work, for the purpose of sub-section (1), the appropriate Government shall fix a minimum rate of wages for securing such employees a minimum rate of wages on a time work basis.
4. The minimum rate of wages on time work basis may be fixed in accordance with any one or more of the following wage periods, namely:

   a) by the hour; or

   b) by the day; or

   c) by the month

5. Where the rates of wages are fixed by the hour or by the day or by the month, the manner of calculating the wages shall be such, as may be prescribed.
6. For the purpose of fixation of minimum rate of wages under this section, the appropriate Government,:

   a) shall primarily take into account the skill of workers required for working under the categories of unskilled, skilled, semi-skilled and highly-skilled or geographical area or both; and

   b) may, in addition to such minimum rate of wages for certain category of workers, take into account their arduousness of work like temperature or humidity normally difficult to bear, hazardous occupations or processes or underground work as may be prescribed by that Government; and

   c) the norms of such fixation of minimum rate of wages shall be such as may be prescribed.

7. The number of minimum rates of wages referred to in sub-section (6) may, as far as possible, be kept at minimum by the appropriate Government.

Section 67 of the Code additionally mentions all the grounds over which the appropriate governments would

have the power to make rules.

Section 8 of the Code lays down provision relating to procedure for fixing and revising minimum wages. It contemplates the following:

1. In fixing minimum rates of wages for the first time or in revising minimum rates of wages under this Code, the appropriate Government shall either:
   a) appoint as many committees as it considers necessary to hold enquiries and recommend in respect of such fixation or revision, as the case may be; or
   b) by notification publish its proposals for the information of persons likely to be affected thereby and specify a date not less than two months from the date of the notification on which the proposals shall be taken into consideration.
2. Every committee appointed by the appropriate Government under clause (a) of sub-section (1) shall consist of persons:
   a) representing employers;
   b) representing employees which shall be equal in number of the members specified in clause (a); and
   c) independent persons, not exceeding one-third of the total members of the committee.
3. After considering the recommendation of the committee appointed under clause (a) of sub-section (1) or, as the case may be, all representations received by it before the date specified in the notification under clause (b) of that sub-section, the appropriate Government shall by notification fix, or as the case may be, revise the minimum rates of wages and unless such notification otherwise provides, it shall come into force on the expiry of three months from the date of its issue:

   Provided that where the appropriate Government proposes to revise the minimum rates of wages in the manner specified in clause (b) of sub-section (1), it shall also consult concerned Advisory Board constituted under section 42.
4. The appropriate Government shall review or revise minimum rates of wages ordinarily at an interval not exceeding five years.

Section 9 lays down provisions relating to power of Central Government to fix floor wage. It says:

1. The Central Government shall fix floor wage taking into account minimum living standards of a worker in such manner as may be prescribed:

   Provided that different floor wage may be fixed for different geographical areas.
2. The minimum rates of wages fixed by the appropriate Government under section 6 shall not be less than the floor wage and if the minimum rates of wages fixed by the appropriate Government earlier is more than the floor wage, then, the appropriate Government shall not reduce such minimum rates of wages fixed by it earlier.
3. The Central Government may, before fixing the floor wage under sub-section (1), obtain the advice of the Central Advisory Board constituted under sub-section (1) of section 42 and consult State Governments in such manner as may be prescribed.

Section 10 of the Code talks about wages of employee who works for less than normal working day. The section contemplates that:

If an employee whose minimum rate of wages has been fixed under this Code by the day works on any day on which he was employed for a period of less than the requisite number of hours constituting a normal working

day, he shall, save as otherwise hereinafter provided, be entitled to receive wages in respect of work done on that day, as if he had worked for a full normal working day: Provided that he shall not be entitled to receive wages for a full normal working day,:

i) in any case where his failure to work is caused by his unwillingness to work and not by the omission of the employer to provide him with work; and

ii) in such other cases and circumstances, as may be prescribed.

Section 11 of the Code talks about wages for two or more classes of work. It says where an employee does two or more classes of work to each of which a different minimum rate of wages is applicable, the employer shall pay to such employee in respect of the time respectively occupied in each such class of work, wages at not less than the minimum rate in force in respect of each such class.

Section 12 lays down provisions relating to minimum time rate wages for piece work. It says where a person is employed on piece work for which minimum time rate and not a minimum piece rate has been fixed under this Code, the employer shall pay to such person wages at not less than the minimum time rate.

Fixing hours of work for normal working day:

1. Where the minimum rates of wages have been fixed under this Code, the appropriate Government may:
   a) fix the number of hours of work which shall constitute a normal working day inclusive of one or more specified intervals;
   b) provide for a day of rest in every period of seven days which shall be allowed to all employees or to any specified class of employees and for the payment of remuneration in respect of such days of rest;
   c) provide for payment for work on a day of rest at a rate not less than the overtime rate.
2. The provisions of sub-section (1) shall, in relation to the following classes of employees apply, only to such extent and subject to such conditions as may be prescribed, namely:
   a) employees engaged in any emergency which could not have been foreseen or prevented; (b) employees engaged in work of the nature of preparatory or complementary work which must necessarily be carried on outside the limits laid down for the general working in the employment concerned;
   b) employees whose employment is essentially intermittent;
   c) employees engaged in any work which for technical reasons has to be completed before the duty is over; and
   d) employees engaged in a work which could not be carried on except at times dependent on the irregular action of natural forces.
3. For the purposes of clause (c) of sub-section (2), employment of an employee is essentially intermittent when it is declared to be so by the appropriate Government on the ground that the daily hours of duty of the employee, or if there be no daily hours of duty as such for the employee, the hours of duty normally include periods of inaction during which the employee may be on duty but is not called upon to display either physical activity or sustained attention.

The central or state government may fix the number of hours that constitute a normal working day. In case employees work in excess of a normal working day, they will be entitled to overtime wage, which must be at least twice the normal rate of wages.

Wages for overtime work

Section 14 - Where an employee whose minimum rate of wages has been fixed under this Code by the hour, by

the day or by such a longer wage-period as may be prescribed, works on any day in excess of the number of hours constituting a normal working day, the employer shall pay him for every hour or for part of an hour so worked in excess, at the overtime rate which shall not be less than twice the normal rate of wages.

Mode of payment of wages

Section 15- All wages shall be paid in current coin or currency notes or by cheque or by crediting the wages in the bank account of the employee or by the electronic mode:

Provided that the appropriate Government may, by notification, specify the industrial or other establishment, the employer of which shall pay to every person employed in such industrial or other establishment, the wages only by cheque or by crediting the wages in his bank account.

Fixation of wage period

Section 16- The employer shall fix the wage period for employees either as daily or weekly or fortnightly or monthly subject to the condition that no wage period in respect of any employee shall be more than a month:

Provided that different wage periods may be fixed for different establishments.

Time limit for payment of wages

Section 17-

1. The employer shall pay or cause to be paid wages to the employees, engaged on:
   a) daily basis, at the end of the shift;
   b) weekly basis, on the last working day of the week, that is to say, before the weekly holiday;
   c) fortnightly basis, before the end of the second day after the end of the fortnight;
   d) monthly basis, before the expiry of the seventh day of the succeeding month.
2. Where an employee has been:
   a) removed or dismissed from service; or
   b) retrenched or has resigned from service, or became unemployed due to closure of the establishment, the wages payable to him shall be paid within two working days of his removal, dismissal, retrenchment or, as the case may be, his resignation.
3. Notwithstanding anything contained in sub-section (1) or sub-section (2), the appropriate Government may, provide any other time limit for payment of wages where it considers reasonable having regard to the circumstances under which the wages are to be paid.
4. Nothing contained in sub-section (1) or sub-section (2) shall affect any time limit for payment of wages provided in any other law for the time being in force.

Section 18: Deductions which may be made from wages:

1. Notwithstanding anything contained in any other law for the time being in force, there shall be no deductions from the wages of the employee, except those as are authorised under this Code.

   Explanation: For the purposes of this sub-section,

   a) any payment made by an employee to the employer or his agent shall be deemed to be a deduction from his wages;
   b) any loss of wages to an employee, for a good and sufficient cause, resulting from:
      i) the withholding of increment or promotion, including the stoppage of an increment; or

ii) the reduction to a lower post or time-scale; or

iii) the suspension, shall not be deemed to be a deduction from wages in a case where the provisions made by the employer for such purposes are satisfying the requirements specified in the notification issued by the appropriate Government in this behalf.

2. Deductions from the wages of an employee shall be made in accordance with the provisions of this Code, and may be made only for the following purposes, namely:—

a) fines imposed on him;

b) deductions for his absence from duty;

c) deductions for damage to or loss of goods expressly entrusted to the employee for custody; or for loss of money for which he is required to account, where such damage or loss is directly attributable to his neglect or default;

d) deductions for house-accommodation supplied by the employer or by appropriate Government or any housing board set up under any law for the time being in force, whether the Government or such board is the employer or not, or any other authority engaged in the business of subsidising house-accommodation which may be specified in this behalf by the appropriate Government by notification;

e) deductions for such amenities and services supplied by the employer as the appropriate Government or any officer specified by it in this behalf may, by general or special order, authorise and such deduction shall not exceed an amount equivalent to the value of such amenities and services. Explanation.—For the purposes of this clause, the expression "services" does not include the supply of tools and raw materials required for the purposes of employment;

f) deductions for recovery of:

i) advances of whatever nature (including advances for travelling allowance or conveyance allowance), and the interest due in respect thereof, or for adjustment of overpayment of wages;

ii) loans made from any fund constituted for the welfare of labour, as may be prescribed by the appropriate Government, and the interest due in respect thereof;

g) deductions for recovery of loans granted for house-building or other purposes approved by the appropriate Government and the interest due in respect thereof;

h) deductions of income-tax or any other statutory levy levied by the Central Government or State Government and payable by the employee or deductions required to be made by order of a court or other authority competent to make such order;

i) deductions for subscription to, and for repayment of advances from any social security fund or scheme constituted by law including provident fund or pension fund or health insurance scheme or fund known by any other name;

j) deductions for payment of co-operative society subject to such conditions as the appropriate Government may impose;

k) deductions made, with the written authorisation of the employee, for payment of the fees and contribution payable by him for the membership of any Trade Union registered under the Trade Unions Act, 1926;

l) deductions for recovery of losses sustained by the railway administration on account of acceptance by the employee of counterfeit or base coins or mutilated or forged currency notes;

m) deductions for recovery of losses sustained by the railway administration on account of the failure of

the employee to invoice, to bill, to collect or to account for the appropriate charges due to the railway administration whether in respect of fares, freight, demurrage, wharfage and cranage or in respect of sale of food in catering establishments or in respect of commodities in grain shops or otherwise;

n) deductions for recovery of losses sustained by the railway administration on account of any rebates or refunds incorrectly granted by the employee where such loss is directly attributable to his neglect or default;

o) deductions, made with the written authorisation of the employee, for contribution to the Prime Minister's National Relief Fund or to such other fund as the Central Government may, by notification, specify.

p) Notwithstanding anything contained in this Code and subject to the provisions of any other law for the time being in force, the total amount of deductions which may be made under sub-section (2) in any wage period from the wages of an employee shall not exceed fifty per cent. of such wages.

3. Where the total deductions authorised under sub-section (2) exceed fifty per cent. of the wages, the excess may be recovered in such manner, as may be prescribed.

4. Where any deduction is made by the employer from the wages of an employee under this section but not deposited in the account of the trust or Government fund or any other account, as required under the provisions of the law for the time being in force, such employee shall not be held responsible for such default of the employer.

Section 19 talks about fines. It lays down the following:

1. No fine shall be imposed on any employee save in respect of those acts and omissions on his part as the employer, with the previous approval of the appropriate Government or of such authority as may be prescribed, may have specified by notice under sub-section (2).

2. A notice specifying such acts and omissions shall be exhibited in such manner as may be prescribed, on the premises in which the employment is carried on.

3. No fine shall be imposed on any employee until such employee has been given an opportunity of showing cause against the fine or otherwise than in accordance with such procedure as may be prescribed for the imposition of fines.

4. The total amount of fine which may be imposed in any one wage-period on any employee shall not exceed an amount equal to three per cent. of the wages payable to him in respect of that wage-period.

5. No fine shall be imposed on any employee who is under the age of fifteen years.

6. No fine imposed on any employee shall be recovered from him by instalments or after the expiry of ninety days from the day on which it was imposed.

7. Every fine shall be deemed to have been imposed on the day of the act or omission in respect of which it was imposed.

8. All fines and all realisations thereof shall be recorded in a register to be kept in such manner and form as may be prescribed; and all such realisations shall be applied only to such purposes beneficial to the persons employed in the establishment as are approved by the prescribed authority.

Section 20 talks about deductions for absence from duty:

1. Deductions may be made under clause (b) of sub-section (2) of section 18 only on account of the absence of an employee from the place or places where by the terms of his employment, he is required to work, such absence being for the whole or any part of the period during which he is so required to work.

2. The amount of such deduction shall in no case bear to the wages payable to the employed person in respect of the wage-period for which the deduction is made in a larger proportion than the period for which he was absent bears to the total period within such wage-period during which by the terms of his employment he was required to work:

Provided that, subject to any rules made in this behalf by the appropriate Government, if ten or more employed persons acting in concert absent themselves without due notice (that is to say without giving the notice which is required under the terms of their contracts of employment) and without reasonable cause, such deduction from any such person may include such amount not exceeding his wages for eight days as may by any such terms be due to the employer in lieu of due notice. Explanation: For the purposes of this section, an employee shall be deemed to be absent from the place where he is required to work if, although present in such place, he refuses, in pursuance of a stay-in strike or for any other cause which is not reasonable in the circumstances, to carry out his work.

All employees whose wages do not exceed a specific monthly amount, notified by the central or state government, will be entitled to an annual bonus. The bonus will be at least: (i) 8.33% of his wages, or (ii) Rs 100, whichever is higher. In addition, the employer will distribute a part of the gross profits amongst the employees. This will be distributed in proportion to the annual wages of an employee. An employee can receive a maximum bonus of 20% of his annual wages.

Section 26 onwards the code talks about provisions relating to payment of bonus

Eligibility for Bonus

1. There shall be paid to every employee, drawing wages not exceeding such amount per mensem, as determined by notification, by the appropriate Government, by his employer, who has put in at least thirty days work in an accounting year, an annual minimum bonus calculated at the rate of eight and one-third per cent. of the wages earned by the employee or one hundred rupees, whichever is higher whether or not the employer has any allocable surplus during the previous accounting year.
2. For the purpose of calculation of the bonus where the wages of the employee exceeds such amount per mensem, as determined by notification by the appropriate Government, the bonus payable to such employee under sub-sections (1) and (3) shall be calculated as if his wage were such amount, so determined by the appropriate Government or the minimum wage fixed by the appropriate Government, whichever is higher.
3. Where in respect of any accounting year referred to in sub-section (1), the allocable surplus exceeds the amount of minimum bonus payable to the employees under that sub-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 wages earned by the employee during the accounting year, subject to a maximum of twenty per cent. of such wages.
4. In computing the allocable surplus under this section, the amount set on or the amount set off under the provisions of section 36 shall be taken into account in accordance with the provisions of that section.
5. Any demand for bonus in excess of the bonus referred to in sub-section (1), either on the basis of production or productivity in an accounting year for which the bonus is payable shall be determined by an agreement or settlement between the employer and the employees, subject to the condition that the total bonus including the annual minimum bonus referred to in sub-section (1) shall not exceed twenty per cent. of the wages earned by the employee in the accounting year.
6. 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, from such establishment, bonus shall be payable only in respect of the accounting year in which the employer derives profit from such

establishment and such bonus shall be calculated in accordance with the provisions of this Code in relation to that year, but without applying the provisions of section 36.

7. For the sixth and seventh 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, from such establishment, the provisions of section 36 shall apply subject to the following modifications, namely:
   a) for the sixth accounting year set on or set off, as the case may be, shall be made, in the manner as may be prescribed by the Central Government, 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 fifth and sixth accounting years;
   b) for the seventh accounting year set on or set off, as the case may be, shall be made, in the manner as may be prescribed by the Central Government, 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 fifth, sixth and seventh accounting years.
8. 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 36 shall apply in relation to such establishment as they apply in relation to any other establishment.

   Explanation 1: For the purpose of sub-section (6), an employer shall not be deemed to have derived profit in any accounting year, unless: (a) he has made provision for depreciation of that year 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 him in respect of the establishment for the previous accounting years have been fully set off against his profits.

   Explanation 2: For the purposes of sub-sections (6), (7) and (8), sale of the goods produced or manufactured during the course of the trial running of any factory or of the prospecting stage of any mine or an oil-field shall not be taken into consideration and where any question arises with regard to such production or manufacture, the appropriate Government may, after giving the parties a reasonable opportunity of representing the case, decide upon the issue.
9. The provisions of sub-sections (6), (7) and (8) shall, so far as may be, apply to new departments or undertakings or branches set up by existing establishments.

Proportionate reduction in bonus in certain cases has been talked about under Section 27. It lays down that where an employee has not worked for all the working days in an accounting year, the minimum bonus under sub-section (1) of section 26, if such bonus is higher than eight and one third per cent. of the salary or wage of the days such employee has worked in that accounting year, shall be proportionately reduced.

Whereas Section 28 of the Code mentions the method of Computation of number of working days. It lays down that for the purposes of section 27, an employee shall be deemed to have worked in an establishment in any accounting year also on the days on which,:

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 wages;
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 wages, during the accounting year.

However, in certain cases there can also be a disqualification for bonus. Section 29 of the Code mentions the provisions relating to it. It says:

Notwithstanding anything contained in this Code, an employee shall be disqualified from receiving bonus under this Code, if he is 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; or

d) conviction for sexual harassment.

Section 30 of the Code lays down provisions relating to establishments that must include departments, undertakings and branches.

It says where an establishment consists of different departments or undertakings or has branches, whether situated in the same place or in different places, all such departments or undertakings or branches shall be treated as parts of the same establishment for the purpose of computation of bonus under this Code:

Provided 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 Code 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.

Payment of bonus out of allocable surplus can also be done according to Section 31 of the Code. The section says that:

1. The bonus shall be paid out of the allocable surplus which shall be an amount equal to sixty per cent. in case of a banking company and sixty-seven per cent. in case of other establishment, of the available surplus and the available surplus shall be the amount calculated in accordance with section 33.
2. Audited accounts of companies shall not normally be questioned.
3. Where there is any dispute regarding the quantum of bonus, the authority notified by the appropriate Government having jurisdiction may call upon the employer to produce the balance sheet before it, but the authority shall not disclose any information contained in the balance sheet unless agreed to by the employer.

Whereas computation of gross profits can be done as per Section 32 of the Code in the following method:

The gross profits derived by an employer from an establishment in respect of the accounting year shall:

a) in the case of a banking company, be calculated in the manner as may be prescribed by the Central Government;

b) in any other case, be calculated in the manner as may be prescribed by the Central Government.

Also computation of available surplus under Section 33 can be done as follows:

The available surplus in respect of any accounting year shall be the gross profits for that year after deducting therefrom the sums referred to in section 34:

Provided that the available surplus in respect of the accounting year commencing on any day in a year after the commencement of this Code and in respect of every subsequent accounting year shall be the aggregate of:

a) the gross profits for that accounting year after deducting therefrom the sums referred to in section 34; and

b) an amount equal to the difference between:

i) the direct tax, calculated in accordance with the provisions of section 35, in respect of an amount equal to the gross profits of the employer for the immediately preceding accounting year; and

ii) the direct tax, calculated in accordance with provisions of section 35, in respect of an amount equal to the gross profits of the employer for such preceding accounting year after deducting therefrom the amount of bonus which the employer has paid or is liable to pay to his employees in accordance with the provisions of this Code for that year.

Section 34 of the Code lays down the provision relating to sums deductible from gross profits. It says that the following sums shall be deducted from the gross profits as prior charges, namely:

a) any amount by way of depreciation admissible in accordance with the provisions of sub-section (1) of section 32 of the Income-tax Act or in accordance with the provisions of the agricultural income-tax law, for the time being in force, as the case may be;

b) subject to the provisions of section 35, any direct tax which the employer is liable to pay for the accounting year in respect of his income, profits and gains during that year;

c) such further sums in respect of the employer as may be prescribed by the Central Government.

Section 35 lays down provisions relating to calculation of direct tax payable by employer. It says:

For the purposes of this Code, any direct tax payable by the employer for any accounting year shall, subject to the following provisions, be calculated at the rates applicable to the income of the employer for that year, namely:

a) in calculating such tax no account shall be taken of,:

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 succeeding accounting year or years under sub-section (2) of section 32 of the Income-tax Act;

b) where the employer is a religious or a charitable institution to which the provisions of section 41 do not apply and the whole or any part of its income is exempt from the tax under the Income-tax Act, then, with respect to the income so exempted, such institution shall be treated as if it were a company in which the public are substantially interested within the meaning of that Act;

c) where the employer is an individual or a Hindu undivided family, the tax payable by such employer under the Income-tax Act shall be calculated on the basis that the income derived by him from the establishment is his only income;

d) where the income of any employer includes any profits and gains derived from the export of any goods or merchandise out of India and any rebate on such income is allowed under any law for the time being in force relating to direct taxes, then, no account shall be taken of such rebate;

e) no account shall be taken of any rebate other than development rebate or investment allowance or development allowance or credit or relief or deduction (not hereinbefore mentioned in this section) in the payment of any direct tax allowed under any law for the time being in force relating to direct taxes or under the relevant annual Finance Act, for the development of any industry.

Section 36 of the Code lays down provisions relating to set on and set off of allocable surplus. It lays down that:

1. Where for any accounting year, the allocable surplus exceeds the amount of maximum bonus payable to the

employees in the establishment under section 26, then, the excess shall, subject to a limit of 20% of the total salary or wage of the employees employed in the establishment in that accounting year, be carried forward for being set on in the succeeding accounting year and so on up to and inclusive of the fourth accounting year to be utilised for the purpose of payment of bonus in such manner as may be prescribed by the Central Government.

2. Where for any accounting year, there is no available surplus or the allocable surplus in respect of that year falls short of the amount of minimum bonus payable to the employees in the establishment under section 26, and there is no amount or sufficient amount carried forward and set on under sub-section (1) which could be utilised for the purpose of payment of the minimum bonus, then, such minimum amount or the deficiency, as the case may be, shall be carried forward for being set off in the succeeding accounting year and so on up to and inclusive of the fourth accounting year in such manner as may be prescribed by the Central Government.
3. The principle of set on and set off as may be provided in rules by the Central Government under this Code shall apply to all other cases not covered by sub-section (1) or sub-section (2) for the purpose of payment of bonus under this Code.
4. Where in any accounting year any amount has been carried forward and set on or set off under this section, then, in calculating bonus for the succeeding accounting year, the amount of set on or set off carried forward from the earliest accounting year shall first be taken into account.

Section 37 of the Code lays down requirements of adjustment of customary or interim bonus against bonus payable under this Code.

Where in any accounting year,:

a) an employer has paid any puja bonus or other customary bonus to employee; or

b) an employer has paid a part of the bonus payable under this Code to an employee before the date on which such bonus becomes payable, then, the employer shall be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to the employee under this Code in respect of that accounting year and the employee shall be entitled to receive only the balance.

Section 38 of the Code lays down that where in any accounting year, an employee is found guilty of misconduct causing financial loss to the employer, then, it shall be lawful for the employer to deduct the amount of loss from the amount of bonus payable by him to the employee under this Code in respect of that accounting year only and the employee shall be entitled to receive the balance, if any.

Section 39 of the Code lays down that:

1. All amounts payable to an employee by way of bonus under this Code shall be paid by crediting it in the bank account of the employee by his employer within a period of eight months from the close of the accounting year: Provided that the appropriate Government or such authority as the appropriate Government may specify in this behalf may, upon an application made to it by the employer and for sufficient reasons, by order, extend the said period of eight months to such further period or periods as it thinks fit; so, however, that the total period so extended shall not in any case exceed two years.
2. Notwithstanding anything contained in sub-section (1), where there is a dispute regarding payment of bonus pending before any authority, such bonus shall be paid, within a period of one month from the date on which the award becomes enforceable or the settlement comes into operation, in respect of such dispute:

Provided that if, there is a dispute for payment at the higher rate, the employer shall pay eight and one-third per cent. of the wages earned by the employee as per the provisions of this Code within a period of eight months from the close of the accounting year.

Section 40 of the Code lays down that:

1. If in any accounting year an establishment in public sector sells any goods produced or manufactured by it or renders any services, in competition with an establishment in private sector, and the income from such sale or services or both, is not less than twenty per cent. of the gross income of the establishment in public sector for that year, then, the provisions of this Chapter shall apply in relation to such establishment in public sector as they apply in relation to a like establishment in private sector.
2. Save as otherwise provided in sub-section (1), nothing in this Chapter shall apply to the employees employed by any establishment in public sector.

Section 41 of the Code lays down that:

1. Nothing in this Chapter shall apply to:
   a) employees employed by the Life Insurance Corporation of India;
   b) seamen as defined in clause (42) of section 3 of the Merchant Shipping Act, 1958;
   c) employees registered or listed under any scheme made under the Dock Workers (Regulation of Employment) Act, 1948, and employed by registered or listed employers;
   d) employees employed by an establishment under the authority of any department of the Central Government or a State Government or a local authority;
   e) employees employed by:
      - the Indian Red Cross Society or any other institution of a like nature including its branches;
      - universities and other educational institutions;
      - institutions including hospitals, chamber of commerce and social welfare institutions established not for purposes of profit;
   f) employees employed by the Reserve Bank of India;
   g) employees employed by public sector financial institution other than a banking company, which the Central Government may, by notification, specify, having regard to:
      - its capital structure;
      - its objectives and the nature of its activities;
      - the nature and extent of financial assistance or any concession given to it by the Government; and
      - any other relevant factor;
   h) employees employed by inland water transport establishments operating on routes passing through any other country; and
   i) employees of any other establishment which the appropriate Government may, by notification, exempt having regard to the overall benefits under any other scheme of profit sharing available in such establishments to the employees.

Subject to the provisions of sub-section (1) and notwithstanding anything contained in any other provisions of this Chapter, the provisions of this Chapter shall apply to such establishment in which twenty or more persons are employed or were employed on any day during an accounting year.

Advisory boards: The central and state governments will constitute advisory boards. The Central Advisory Board will consist of:

(i) employers,

(ii) employees (in equal number as employers),

(iii) independent persons, and

(iv) five representatives of state governments. State Advisory Boards will consist of employers, employees, and independent persons. Further, one-third of the total members on both the central and state Boards will be women.

The Boards will advise the respective governments on various issues including:

(i) fixation of minimum wages, and

(ii) increasing employment opportunities for women.

Chapter V of the Code talks about the advisory board.

Section 42 of the Code lays down that:

1. The Central Government shall constitute the Central Advisory Board which shall consist of persons to be nominated by the Central Government:
   a) representing employers;
   b) representing employees which shall be equal in number of the members specified in clause (a);
   c) independent persons, not exceeding one-third of the total members of the Board; and
   d) five representatives of such State Governments as may be nominated by the Central Government.
2. One-third of the members referred to in sub-section (1) shall be women and a member specified in clause (c) of the said sub-section shall be appointed by the Central Government as the Chairperson of the Board.
3. The Central Advisory Board constituted under sub-section (1) shall from time to time advise the Central Government on reference of issues relating to:
   - fixation or revision of minimum wages and other connected matters;
   - providing increasing employment opportunities for women;
   - the extent to which women may be employed in such establishments or employments as the Central Government may, by notification, specify in this behalf; and
   - any other matter relating to this Code, and on such advice, the Central Government may issue directions to the State Government as it deems fit in respect of matters relating to issues referred to the Board.
4. Every State Government shall constitute a State Advisory Board for advising the State Government:
   - in fixation or revision of minimum wages and other connected matters;
   - for the purpose of providing increasing employment opportunities for women;
   - with regard to the extent to which women may be employed in such establishments or employments as the State Government may, by notification, specify in this behalf; and
   - in any other matter relating to this Code, which the State Government may refer from time to time to the Board.
5. The State Advisory Board may constitute one or more committees or sub-committees to look into issues pertaining to matters specified in clauses (a) to (d) of sub-section (4).
6. The State Advisory Board and each of the committees and sub- committees thereof shall consist of persons:
   - representing employers;
   - representing employees which shall be equal in number of the members specified in clause (a); and

- independent persons, not exceeding one-third of the total members of the Board or committee or sub-committee, as the case may be.

7. One-third of the members referred to in sub-section (6) shall be women and one among the members specified in clause (c) of the said sub-section shall be:
   - appointed by the State Government as the Chairperson of the Board;
   - appointed by the State Advisory Board as the Chairperson of the committee or sub-committee, as the case may be.
8. In tendering its advice in the matters specified in clause (b) or clause (c) of sub-section (4), the State Advisory Board shall have regard to the number of women employed in the concerned establishment, or employment, the nature of work, hours of work, suitability of women for employment, as the case may be, the need for providing increasing employment opportunities for women, including part time employment, and such other relevant factors as the Board may think fit.
9. The State Government may, after considering the advice tendered to it by the State Advisory Board and after inviting and considering the representations from establishment or employees or any other person which that Government thinks fit, issue such direction as may be deemed necessary.
10. The Central Advisory Board referred to in sub-section (1) and the State Advisory Board referred to in sub-section (4) shall respectively regulate their own procedure including that of the committees and sub-committees constituted by the State Advisory Board, in such manner as may be prescribed.
11. The terms of office of the Central Advisory Board referred to in sub-section (1) and the State Advisory Board referred to in sub-section (4) including that of the committees and sub-committees constituted by the State Advisory Board, shall be such as may be prescribed.

Chapter VI of the Code discusses about the payment of dues, claims and audit. Section 43 of the Code talks about:

Every employer shall pay all amounts required to be paid under this Code to every employee employed by him: Provided that where such employer fails to make such payment in accordance with this Code, then, the company or firm or association or any other person who is the proprietor of the establishment, in which the employee is employed, shall be responsible for such payment.

Explanation: For the purposes of this section the expression "firm" shall have the same meaning as assigned to it in the Indian Partnership Act, 1932.

Section 44 lays down provisions relating to payment of various undisbursed dues in case of death of employee.

1. Subject to the other provisions of this Code, all amounts payable to an employee under this Code shall, if such amounts could not or cannot be paid on account of his death before payment or on account of his whereabouts not being known:
   a) be paid to the person nominated by him in this behalf in accordance with the rules made under this Code; or
   b) where no such nomination has been made or where for any reasons such amounts cannot be paid to the person so nominated, be deposited with the such authority, as may be prescribed, who shall deal with the amounts so deposited in the manner as may be prescribed.
2. Where in accordance with the provisions of sub-section (1), all amounts payable to an employee under this Code:

a) are paid by the employer to the person nominated by the employee; or

b) are deposited by the employer with the authority referred to in clause (b) of sub-section (1), then, the employer shall be discharged of his liability to pay those amounts.

Section 45 deals with claims under Code and procedure thereof.

1. The appropriate Government may, by notification, appoint one or more authorities, not below the rank of a Gazetted Officer, to hear and determine the claims which arises under the provisions of this Code.
2. The authority appointed under sub-section (1), while deciding the claim under that sub-section, may order, having regard to the circumstances under which the claim arises, the payment of compensation in addition to the claim determined, which may extend to ten times of the claim determined and endeavour shall be made by the authority to decide the claim within a period of three months.
3. If an employer fails to pay the claim determined and compensation ordered to be paid under sub-section (2), the authority shall issue a certificate of recovery to the Collector or District Magistrate of the district where the establishment is located who shall recover the same as arrears of land revenue and remit the same to the authority for payment to the concerned employee.
4. Any application before the authority for claim referred to in sub-section (1) may be filed by:
   a) the employee concerned; or
   b) any Trade Union registered under the Trade Unions Act, 1926 of which the employee is a member; or
   c) the Inspector-cum-Facilitator.
5. Subject to such rules as may be made, a single application may be filed under this section on behalf or in respect of any number of employees employed in an establishment.
6. The application under sub-section (4) may be filed within a period of three years from the date on which claims referred to in sub-section (1) arises: Provided that the authority referred to in sub-section (1) may, entertain the application after three years on sufficient cause being shown by the applicant for such delay.
7. The authority appointed under sub-section (1) and the appellate authority appointed under sub-section (1) of section 49, shall have all the powers of a civil court under the Code of Civil Procedure, 1908, for the purpose of taking evidence and of enforcing the attendance of witnesses and compelling the production of documents, and every such authority or appellate authority shall be deemed to be a civil court for all the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

Section 46 lays down provisions relating to reference of disputes under this Code. It lays down that notwithstanding anything contained in this Code, where any dispute arises between an employer and his employees with respect to:

a) fixation of bonus or eligibility for payment of bonus under the provisions of this Code; or

b) the application of this Code, in respect of bonus, to an establishment in public sector, then, such dispute shall be deemed to be an industrial dispute within the meaning of the Industrial Disputes Act, 1947.

Section 47 of the Code lays down provisions relating to presumption about accuracy of balance sheet and profit and loss account of corporations and companies. It says:

1. Where, during the course of proceedings before:
   a) the authority under section 45; or
   b) the appellate authority under section 49; or
   c) a Tribunal; or

d) an arbitrator referred to in clause (aa) of section 2 of the Industrial Disputes Act, 1947, in respect of any dispute of the nature specified in sections 45 and 46 or in respect of an appeal under section 49, 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 section 141 of the Companies Act, 2013, are produced before it, then, the said authority, appellate authority, Tribunal or arbitrator, as the case may be, 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, appellate authority, Tribunal or arbitrator, as the case may be, 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.

2. When an application is made to the authority, appellate authority, Tribunal or arbitrator, as the case may be, referred to in sub-section (1), by any Trade Union being a party to the dispute or as the case may be, an appeal, and where there is no Trade Union, by the employees being a party to the dispute, or as the case may be, an appeal, requiring any clarification relating to any item in the balance sheet or the profit and loss account, then such authority, appellate authority, Tribunal or arbitrator, may, after satisfying itself that such clarification is necessary, by order, direct the corporation or, as the case may be, the company, to furnish to the Trade Union or the employees such clarification within such time as may be specified in the direction and the corporation or, as the case may be, the company, shall comply with such direction.

Section 48 of the Code discusses the compliance relating to audit of account of employers not being corporations or companies. It lays down that:

1. Where any claim, dispute or appeal with respect to bonus payable under this Code between an employer, not being a corporation or a company, and his employees is pending before any authority, appellate authority, Tribunal or arbitrator, as the case may be, as referred to in sub-section (1) of section 47 and the accounts of such employer audited by any auditor duly qualified to act as auditor of companies under the provisions of section 141 of the Companies Act, 2013, are produced before such authority, appellate authority, Tribunal or arbitrator, then the provisions of section 47 shall, so far as may be, apply to the accounts so audited.
2. When the authority, appellate authority, Tribunal or arbitrator, referred to in sub-section (1), as the case may be, finds that the accounts of such employer have not been audited by any such auditor and it is of opinion that an audit of the accounts of such employer is necessary for deciding the question referred to it, then, such authority, appellate authority, Tribunal or arbitrator, may, by order, direct the employer to get his accounts audited within such time as may be specified in the direction or within such further time as it may allow by such auditor or auditors as it thinks fit and thereupon the employer shall comply with such direction.
3. Where an employer fails to get the accounts audited under sub-section (2), the authority, appellate authority, Tribunal or arbitrator, referred to in sub-section (1), as the case may be, may, without prejudice to the provisions of section 54, get the accounts audited by such auditor or auditors as it thinks fit.
4. When the accounts are audited under sub-section (2) or sub-section (3), the provisions of section 47 shall, so far as may be, apply to the accounts so audited.
5. The expenses of, and incidental to, any audit under sub-section (3) including the remuneration of the auditor or auditors shall be determined by the authority, appellate authority, Tribunal or arbitrator, referred to in sub-section (1), as the case may be, and paid by the employer and in default of such payment shall be

recoverable by the authority referred to in sub-section (3) of section 45 from the employer in the manner provided in that sub-section.

Section 49 lays down provision relating to appeal procedures:

1. Any person aggrieved by an order passed by the authority under sub-section (2) of section 45 may prefer an appeal, to the appellate authority having jurisdiction appointed by the appropriate Government, by notification, for such purpose, within ninety days from the date of such order, in such form and manner as may be prescribed: Provided that the appellate authority may entertain the appeal after ninety days if it satisfied that the delay in filing the appeal has occurred due to sufficient cause.
2. The appellate authority shall be appointed from the officers of the appropriate Government holding the post at least one rank higher than the authority referred under sub-section (1) of section 45.
3. The appellate authority shall, after hearing the parties in the appeal, dispose of the appeal and endeavour shall be made to dispose of the appeal within a period of three months.
4. The outstanding dues under the orders of the appellate authority shall be recovered by the authority referred to in section 45, by issuing the certificate of recovery in the manner specified in sub-section (3) of that section.

Section 50 lays down provisions relating to the compliance of records, returns and notices. The provisions mandates that:

1. Every employer of an establishment to which this Code applies shall maintain a register containing the details with regard to persons employed, muster roll, wages and such other details in such manner as may be prescribed.
2. Every employer shall display a notice on the notice board at a prominent place of the establishment containing the abstract of this Code, category-wise wage rates of employees, wage period, day or date and time of payment of wages, and the name and address of the Inspector-cum-Facilitator having jurisdiction.
3. Every employer shall issue wage slips to the employees in such form and manner as may be prescribed.
4. The provisions of sub-sections (1) to (3) shall not apply in respect of the employer to the extent he employs not more than five persons for agriculture or domestic purpose: Provided that such employer, when demanded, shall produce before the Inspector-cum-Facilitator, the reasonable proof of the payment of wages to the persons so employed.

   Explanation.—For the purposes of this sub-section, the expression "domestic purpose" means the purpose exclusively relating to the home or family affairs of the employer and does not include any affair relating to any establishment, industry, trade, business, manufacture or occupation

Section 51 specifically talks about the appointment of Inspector-cum-Facilitators and their powers. It lays down that:

1. The appropriate Government may, by notification, appoint Inspector-cum-Facilitators for the purposes of this Code who shall exercise the powers conferred on them under sub-section (4) throughout the State or such geographical limits assigned in relation to one or more establishments situated in such State or geographical limits or in one or more establishments, irrespective of geographical limits, assigned to him by the appropriate Government, as the case may be.
2. The appropriate Government may, by notification, lay down an inspection scheme which may also provide for generation of a web-based inspection and calling of information relating to the inspection under this Code electronically.
3. Without prejudice to the provisions of sub-section (2), the appropriate Government may, by notification,

confer such jurisdiction of randomised selection of inspection for the purposes of this Code to the Inspector-cum-Facilitator as may be specified in such notification.

4. Every Inspector-cum-Facilitator appointed under sub-section (1) shall be deemed to be public servant within the meaning of section 21 of the Indian Penal Code.
5. The Inspector-cum-Facilitator may:
   a) advice to employers and workers relating to compliance with the provisions of this Code;
   b) inspect the establishments as assigned to him by the appropriate Government, subject to the instructions or guidelines issued by the appropriate Government from time to time.
6. Subject to the provisions of sub-section (4), the Inspector-cum-Facilitator may,:
   a) examine any person who is found in any premises of the establishment, whom the Inspector-cum-Facilitator has reasonable cause to believe, is a worker of the establishment;
   b) require any person to give any information, which is in his power to give with respect to the names and addresses of the persons;
   c) search, seize or take copies of such register, record of wages or notices or portions thereof as the Inspector-cum-Facilitator may consider relevant in respect of an offence under this Code and which the Inspector-cum-Facilitator has reason to believe has been committed by the employer;
   d) bring to the notice of the appropriate Government defects or abuses not covered by any law for the time being in force; and
   e) exercise such other powers as may be prescribed.
7. Any person required to produce any document or to give any information required by an Inspector-cum-Facilitator under sub-section (5) shall be deemed to be legally bound to do so within the meaning of section 175 and section 176 of the Indian Penal Code.
8. The provisions of the Code of Criminal Procedure, 1973 shall, so far as may be, apply to the search or seizure under sub-section (5) as they apply to the search or seizure made under the authority of a warrant issued under section 94 of the said Code.

The present code talks about provisions relating to offences and their corresponding penalties. The Code specifies penalties for offences committed by an employer, such as:

a) paying less than the due wages, or
b) for contravening any provision of the Code.

Penalties vary depending on the nature of offence, with the maximum penalty being imprisonment for three months along with a fine of up to one lakh rupees.

Section 52 talks about cognizance of offences. The provisions lays down that:

1. No court shall take cognizance of any offence punishable under this Code, save on a complaint made by or under the authority of the appropriate Government or an officer authorised in this behalf, or by an employee or a registered Trade Union registered under the Trade Unions Act, 1926 or an Inspector-cum-Facilitator.
2. Notwithstanding anything contained in the Code of Criminal Procedure, 1973, no court inferior to that of a Metropolitan Magistrate or Judicial Magistrate of the first class shall try the offences under this Code.

Section 53 talks about the power of officers of appropriate Government to impose penalty in certain cases. It lays down that:

1. Notwithstanding anything contained in section 52, for the purpose of imposing penalty under clauses

(a) and (c) of sub-section (1) and sub-section (2) of section 54 and sub-section (7) of section 56, the appropriate Government may appoint any officer not below the rank of Under Secretary to the Government of India or an officer of equivalent rank in the State Government, as the case may be, for holding enquiry in such manner, as may be prescribed by the Central Government.

2. While holding the enquiry, the officer referred to in sub-section (1) shall have the power to summon and enforce attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document, which in the opinion of such officer, may be useful for or relevant to the subject matter of the enquiry and if, on such enquiry, he is satisfied that the person has committed any offence under the provisions referred to in sub-section (1), he may impose such penalty as he thinks fit in accordance with such provisions.

Section 54 talks about penalties for offences, which lays down the following:

1. Any employer who:
   a) pays to any employee less than the amount due to such employee under the provisions of this Code shall be punishable with fine which may extend to fifty thousand rupees;
   b) having been convicted of an offence under clause (a) is again found guilty of similar offence under this clause, within five years from the date of the commission of the first or subsequent offence, he shall, on the second and the subsequent commission of the offence, be punishable with imprisonment for a term which may extend to three months or with fine which may extend to one lakh rupees, or with both;
   c) contravenes any other provision of this Code or any rule made or order made or issued thereunder shall be punishable with fine which may extend to twenty thousand rupees;
   d) having been convicted of an offence under clause (c) is again found guilty of similar offence under this clause, within five years from the date of the commission of the first or subsequent offence, he shall, on the second and the subsequent commission of the offence under this clause, be punishable with imprisonment for a term which may extend to one month or with fine which may extend to forty thousand rupees, or with both.
2. Notwithstanding anything contained in sub-section (1), for the offences of non-maintenance or improper maintenance of records in the establishment, the employer shall be punishable with fine which may extend to ten thousand rupees.
3. Notwithstanding anything contained in clause (c) of sub-section (1) or sub-section (2), the Inspector-cum-Facilitator shall, before initiation of prosecution proceeding for the offences under the said clause or sub-section, give an opportunity to the employer to comply with the provisions of this Code by way of a written direction, which shall lay down a time period for such compliance, and, if the employer complies with the direction within such period, the Inspector-cum-Facilitator shall not initiate such prosecution proceeding and, no such opportunity shall be accorded to an employer, if the violation of the same nature of the provisions under this Code is repeated within a period of five years from the date on which such first violation was committed and in such case the prosecution shall be initiated in accordance with the provisions of this Code.

Section 55 talks about offences by companies. It lays down that:

1. If the person committing an offence under this Code is a company, every person who, at the time the offence was committed was in charge of, and was responsible to the company for the conduct of business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly: Provided that nothing contained in this sub-section shall render any such person liable to any punishment if he proves that the offence was committed without his

knowledge or that he exercised all due diligence to prevent the commission of such offence.

2. Notwithstanding anything contained in sub-section (1), where an offence under this Code has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Explanation: For the purposes of this section,:

a) "company" means anybody corporate and includes:

i) a firm; or

ii) a limited liability partnership registered under the Limited Liability Partnership Act, 2008; or

iii) other association of individuals; and

b) "director" in relation to a firm means a partner in the firm.

Section 56 talks about the composition of offences. It lays down:

1. Notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence punishable under this Code, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may, on an application of the accused person, either before or after the institution of any prosecution, be compounded by a Gazetted Officer, as the appropriate Government may, by notification, specify, for a sum of fifty per cent. of the maximum fine provided for such offence, in the manner as may be prescribed.
2. Nothing contained in sub-section (1) shall apply to an offence committed by a person for the second time or thereafter within a period of five years from the date:

i) of commission of a similar offence which was earlier compounded;

ii) of commission of similar offence for which such person was earlier convicted.

3. Every officer referred to in sub-section (1) shall exercise the powers to compound an offence, subject to the direction, control and supervision of the appropriate Government.
4. Every application for the compounding of an offence shall be made in such manner as may be prescribed.
5. Where any offence is compounded before the institution of any prosecution, no prosecution shall be instituted in relation to such offence, against the offender in relation to whom the offence is so compounded.
6. Where the composition of any offence is made after the institution of any prosecution, such composition shall be brought by the officer referred to in sub-section (1) in writing, to the notice of the court in which the prosecution is pending and on such notice of the composition of the offence being given, the person against whom the offence is so compounded shall be discharged.
7. Any person who fails to comply with an order made by the officer referred to in sub-section (1), shall be punishable with a sum equivalent to twenty per cent. of the maximum fine provided for the offence, in addition to such fine.
8. No offence punishable under the provisions of this Code shall be compounded except under and in accordance with the provisions of this section.

Section 57. No court shall entertain any suit for the recovery of minimum wages, any deduction from wages, discrimination in wages and payment of bonus, in so far as the sum so claimed:

a) forms the subject of claims under section 45;

b) has formed the subject of a direction under this Code;

c) has been adjudged in any proceeding under this Code;

d) could have been recovered under this Code.

Section 58. No suit, prosecution or any other legal proceeding shall lie against the appropriate Government or any officer of that Government for anything which is in good faith done or intended to be done under this Code.

Section 59. Where a claim has been filed on account of non-payment of remuneration or bonus or less payment of wages or bonus or on account of making deductions not authorised by this Code from the wages of an employee, the burden to prove that the said dues have been paid shall be on the employer.

Section 60. Any contract or agreement whereby an employee relinquishes the right to any amount or the right to bonus due to him under this Code shall be null and void in so far as it purports to remove or reduce the liability of any person to pay such amount under this Code.

Section 61. The provisions of this Code shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or in the terms of any award, agreement, settlement or contract of service.

Section 62. The appropriate Government may, by notification, direct that any power exercisable by it under this Code shall, in relation to such matters and subject to such conditions, if any, as may be specified in the notification, be also exercisable:

a) where the appropriate Government is the Central Government, by such officer or authority subordinate to the Central Government or by the State Government or by such officer or authority subordinate to the State Government, as may be specified in the notification;

b) where the appropriate Government is a State Government, by such officer or authority subordinate to the State Government as may be specified in the notification.

Section 63. Where an employer is charged with an offence under this Code, he shall be entitled upon complaint duly made by him, to have any other person whom he charges as the actual offender, brought before the court at the time appointed for hearing the charge; and if, after the commission of the offence has been proved, the employer proves to the satisfaction of the court:

a) that he has used due diligence to enforce the execution of this Code; and

b) that the said other person committed the offence in question without his knowledge, consent or connivance, that other person shall be convicted of the offence and shall be liable to the like punishment as if he were the employer and the employer shall be discharged from any liability under this Code in respect of such offence: Provided that in seeking to prove, as aforesaid, the employer may be examined on oath, and the evidence of the employer or his witness, if any, shall be subject to cross-examination by or on behalf of the person whom the employer charges as the actual offender and by the prosecution.

Section 64. Any amount deposited with the appropriate Government by an employer to secure the due performance of a contract with that Government and any other amount due to such employer from that Government in respect of such contract shall not be liable to attachment under any decree or order of any court in respect of any debt or liability incurred by the employer other than any debt or liability incurred by the employer towards any employee employed in connection with the contract aforesaid.

EXERCISE

⊙ Multiple Choice Question:

1. The minimum rate of wages on time work basis may be fixed in accordance with
   a) by the hour; or
   b) by the day; or
   c) by the month
   d) all of the above
2. Section ____ deal with Eligibility for Bonus.
   a) 6
   b) 8
   c) 18
   d) 26
3. Every Inspector-cum-Facilitator appointed under sub-section (1) shall be deemed to be public servant within the meaning of section ___ of the Indian Penal Code.
   a) 15
   b) 18
   c) 21
   d) 26
4. Section 56 talks about the _____
   a) composition of offences
   b) offences by companies.
   c) penalties for offences,
   d) power of officers

⊙ State TRUE or FALSE

1. Section 35 lays down provisions relating to calculation of direct tax payable by employer.
2. The appropriate Government shall review or revise minimum rates of wages ordinarily at an interval not exceeding 6 years.
3. Section 9 lays down provisions relating to power of Central Government to fix floor wage.
4. Section 45 deals with claims under Code and procedure thereof.
5. The Code of Wages, 2019 was enacted in 2020.

Fill in the blanks

1. As per the bill, a committee of trade unions, employers and the state government will fix a _____for workers throughout the country.
2. Any minimum rate of wages fixed or revised by the appropriate Government under section 8 may consist of a ____and an allowance at a rate to be adjusted.
3. Every committee appointed by the appropriate Government under clause (a) of sub-section (1) shall consist of persons— (a) representing employers; (b) representing _____which shall be equal in number of the members specified in clause (a); and (c) independent persons, not exceeding one-third of the total members of the committee.
4. Where a person is employed on piece work for which minimum time rate and not a minimum piece rate has been fixed under this Code, the employer shall pay to such person wages at not less than the ___.

Short Essay Type Questions

1. What is the time limit for payment of wages under the Code?
2. How is the work wage and hours of work fixed under the Code?
3. How are deductions to the wages calculated under the Code?

Essay Type Questions

1. How are Central Advisory Board and State Advisory Boards constituted?
2. Do employers have a responsibility for payment of various dues under the Code?
3. Does the Code provide for appointment of Inspector-cum-Facilitators and what are their powers?
4. What are the powers of officers of appropriate Government to impose penalty in certain cases under the Code?

Answer:

Multiple Choice Question:

1. d, 2. d, 3. c, 4. a.

State TRUE or FALSE

1. True, 2. False, 3. True, 4. True, 5. True.

Fill in the blanks

1. floor wage**, 2.** basic rate of wages**, 3.** employees**, 4.** minimum time rate.

SECTION - C

CORPORATE LAWS

Companies Act, 2013

12

This Module includes -

12.1 Company Types, Promotion, Formation and Related Procedures (Sec 1 to Sec 122 of Companies Act, 2013)

12.2 Director - Role, Responsibilities, Qualification, Disqualification, Appointment, Retirement, Resignation, Removal, Remuneration and Powers, Directors Identification Number

12.3 Operational and Financial Control

12.4 Internal Financial Control for Financial Reporting (Section 134,143 and 177)

12.5 Rights of Shareholders

12.6 Key Managerial Personnel

Companies Act, 2013

SLOB Mapped against the Module

To obtain in-depth knowledge and application of various provisions of company law and regulations.

Module Learning Objectives:

After studying this module, the students will be able -

- To acquire the requisite skills to form an organizational structure and for corporate documentation.
- To develop an understanding about the different methods of raising corporate finance and nuances of corporate governance.

Company Types, Promotion, Formation and Related Procedures (Sec 1 to Sec 122 of Companies Act, 2013)

12.1

The role of companies is multifarious and each of us encounter the work of a company in almost every aspect of our lives. Company is a business form that is arguably one of the most convenient to conduct operations in and with the continuous amendments, incorporation of companies and doing business through these companies have been made easier. The Companies Act, 2013 refers to a company as an association of persons for economic purpose of carrying on of a business which could be for the purposes of gain or otherwise.

The Companies Act, 2013 defines a company as a company incorporated or registered under the Companies Act, 2013, or any previous laws.

In its legal form a company is an artificial entity where the identity of the members of the company is independent from the company itself. Therefore, like any other natural person, a company too has many rights and liabilities that it can incur in its course of operations. The Companies Act, 2013 is a comprehensive piece of legislation that covers incorporation, dissolution and running of companies in India. It is the first piece of legislation in India that introduced concepts like one person company and has made compliances less cumbersome while incorporating a company.

The various features of a company are that a company is a separate legal entity, it has perpetual succession, it may have common seal, the members of a company may limit their liability, it is an artificial legal person. The Companies Act, 2013 has been enacted to consolidate and amend the law relating to the companies which used to exist under Companies Act, 1956. This has helped in expansion and growth of economy of our country, by making it easier to set up companies.

The new law (i.e., the Companies Act, 2013) is rule based legislation with 470 sections and seven schedules. The entire Act has been divided into 29 chapters. The Companies Act, 2013 aims to improve corporate governance, simplify regulations and strengthens minority investors.

12.1.1 Meaning and Definition of a Company

In popular parlance, a company denotes an association of persons formed for the purpose of carrying on some business or undertaking. A company is a corporate body and a legal person having status and personality distinct and separate from the members constituting it.

According to Companies Act, 2013 a "company" means a company incorporated under this Act or under any previous company law [Section 2(20)]. Previous Company Law under section 2(67) mean any previous company law specified in the section.

Characteristics of a 'company'-

- **Separate legal entity** – Company is a separate legal person and artificial person. It is distinguished from the shareholders of the company. It has its own independent corporate existence.

- **Limited liability** – The liability of the members of a limited company having share capital is limited to the extent of the nominal value of the shares held by them. The shareholders cannot be called upon to pay more than the unpaid value of his shares, whatever may be the indebtedness of the company.
- **Perpetual succession-** The Company has its existence from the time of incorporation to winding up. Members may come and members may go but the company survives up to the winding up;
- **Separate property** – The company is having right to acquire and transfer properties in its own name.
- **Common seal** – The common seal is used by the company for affixing it in the documents such as contract etc., since it is an artificial person and cannot sign on its own in the documents.

  Now the use of common seal has been made optional as per the 2015 Amendment to Companies Act, 2013. The Companies Act, 2013 required common seal to be affixed on certain documents (such as bill of exchange, share certificates, etc.) All such documents which required affixing the common seal may now instead be signed by two directors or one director and a company secretary of the company.
- **Transferability of shares** – The shares of the members, except in the private company, may be freely transferable.
- **Capacity to sue and be sued** – Being a separate legal entity the company is having capacity to sue others and it can be sued by others.

Lifting of the corporate veil

The separate personality of a company is a statutory privilege and it must be used for legitimate business purposes only. Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court will break through the corporate shell and apply the principle/doctrine of what is called as "lifting of or piercing t he corporate veil". The Court will look behind the corporate entity and take action as though no entity separates from the members existed and make the members or the controlling persons liable for debts and obligations of the company.

In the following circumstances, different courts found it necessary to lift the corporate veil and punish the actual persons who did wrong or unlawful acts under the name of the company.

Protection of Revenue	The Court may ignore the Separate Legal Entity status of a Company, where it is used for tax invasion or circumventing tax obligation.
Determination of enemy character of the Company	Company being an artificial person cannot be enemy or friend. But during war, it may become necessary to lift the corporate veil and see the persons behind it to determine whether they are friends or enemy. This is due to the reason that though a company enjoys Separate Legal Entity but its affairs are run by individuals. (Daimler Co. Ltd. Vs Continental Tyre & Rubber Co. Ltd.)
Prevention of fraud	Where a Company is used for committing frauds or improper conduct, the Court may lift the corporate veil and look at the realities of the situation. (Jones vs Lipman)
Protection of public policy	The Court shall lift the Corporate Veil without any hesitation to protect the public policy and prevent transaction opposed to public policy.

Company mere sham or cloak	Where the Company is a mere sham and was really a ploy used for committing illegalities and to defraud people, the Court shall lift the Corporate Veil. (Gilford Motor Company vs Horne)
Where a Company acts as an agent of its shareholders	If there is an arrangement between the shareholders and a Company to the effect that the Company will act as agent of shareholders for the purpose of carrying on the business, the business is essentially of that of the shareholders and will have unlimited liability.
Avoidance of Welfare Legislation	Where a Company tries to avoid its legal obligations, the corporate veil shall be lifted to look at the real picture. (Workmen of Associated Rubber Industry Ltd. Vs Associated Rubber Industry Ltd.)
To punish for contempt of Court	Company being an artificial person cannot disobey the orders of the Court. Therefore, the persons at fault should be identified.

12.1.2 Kinds of Companies

There can be many business forms that can be used to manifest ideas in order to make economic gains. For the benefit of those who want to form a company to carry forward their business ideas and objectives, the Companies Act, 2013 has provided for various kinds of companies that have varying compliances and advantages. The most commonplace are public companies and private companies. Private companies can be further classified into one person companies (OPC) and small companies.

Chapter II of the Companies Act, 2013 lays down provisions relating to incorporation of companies and matters related to it, which majorly comprise of the compliance aspect of it.

Section 3 of the Companies Act, 2013, enlisted under Chapter II mentions the procedure for the formation of company. It states:

1. A company may be formed for any lawful purpose by—
   a) seven or more persons, where the company to be formed is to be a public company;
   b) two or more persons, where the company to be formed is to be a private company; or
   c) one person, where the company to be formed is to be One Person Company that is to say, a private company, by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration:

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

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

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

Provided also that it shall be the duty of the member of One Person Company to intimate the company the change, if any, in the name of the other person nominated by him by indicating in the memorandum or otherwise

within such time and in such manner as may be prescribed, and the company shall intimate the Registrar any such change within such time and in such manner as may be prescribed:

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

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

   a) a company limited by shares; or

   b) a company limited by guarantee; or

   c) an unlimited company.

Therefore, based on the method of incorporation, companies may be categorized based on their liability structure. Further companies may be classified into many types, such as:

- Statutory Companies
- Registered Companies
- Existing Companies
- Associations not for profit
- Government Companies
- Foreign Companies
- Holding and Subsidiary Companies

12.1.2.1 Private Company

To begin with the basic company form which is that of a private company, section 2 (68) of the Companies Act, 2013, states:

private company means a company having a minimum paid-up share capital as may be prescribed, and which by its articles,—

i) restricts the right to transfer its shares;

ii) except in case of One Person Company, limits the number of its members to two hundred: Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member:

Provided further that:

   a) persons who are in the employment of the company; and

   b) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members; and

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

The minimum paid-up share capital required for a public or a private company has been done away with as per the Companies (Amendment) Act, 2015. This was a move to make it easier for registering more and more companies. Private companies by virtue of having a tightly knit management restricts the number of members it

can have in order to take the objectives of the company forward. Moreover, the maximum number of members a private company can have is 200.

Therefore, the restrictions on transfer of shares in a private company are usually included in the Articles of Association so as to be applicable to all members alike. This restriction is not a ban on any transfer of shares. Transfer in circumstances not covered by specific restrictions is possible. These specific restrictions prevent anybody or everybody from acquiring the shares of the company by transfer. Accordingly, the articles of association empower directors to decline registration of transfer of any share, whether fully paid up or partly paid up, by exercising their absolute discretion over such matters.

However, **an important thing to note** here is: that the only permissible restrictions on transferability are those that are contained in the articles of association. An additional restriction not contained in the articles of association but in a private agreement between two shareholders which places further obstacles in the way of transferability is not binding either on the company or on the shareholders.[1]

The cap on the number of members in a private company includes counting joint holders as a single member and also not counting present or past employees who are members. However, with respect to former employees, for the benefit of the exemption being available to the company, such employees must have been members while they were in employment and continue as members after ceasing to be in employment of the company. Thus, the exemption cannot be claimed by first being enrolled as the member and then inducted as an employee.

The cap on the number of members do not affect the number of debenture holders that a private company can have. A private company cannot make a public offer of its securities, which essentially means that a private company can collect its capital through a "private approach" by giving opportunity of investment to the persons approached and not to others.

12.1.2.2 Public Company

Section 2 (71) of the Companies Act, 2013 mentions that a public company means a company which:

a) is not a private company;

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

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

A public company is different from a private company in many aspects. A public company has to have a minimum of seven members to form itself as per Section 3 of the Companies Act, 2013. Whereas, a private company needs a minimum of only two members to form. Similarly, the maximum number of members allowed for a private company is 200 but for a public company it may be unlimited.

Section 44 of the Companies Act mentions provisions on transferability of shares. According to Section 44, the shares of any member in a company shall be movable property transferable in the manner provided by the articles of the company. In a private company, by its very definition, articles of a private company have to contain restrictions on transferability of shares.

Section 2 (68) of the Companies Act, 2013 that mandates the requirement of a prospectus for making a public offer, cannot be issued by a private company but only a public company that has the liberty to make public offers inviting general public to subscribe to its shares.

V.B. Nagaraj vs V. B. Gopalakrishnan [1991] CLA 211 (SC)

On the other hand, Section 149 clearly differentiates the minimum requirement for directors in private and public companies as two and three respectively. There are further differences between a private and a public company on account of managerial remuneration, retirement of directors, quorum requirement for general meetings and so on.

Public companies have more scrutiny and regulations levied on them as compared to private companies with respect to compliances.

However, a public company can be converted to a private company and vice-versa. Multiple companies have applied for conversion of their status before the National Company Law Tribunal in the past, such as, in the case of Manorama Industrial & Technical Services Ltd, [2018] (NCLT-Kolkata).

12.1.2.3 One Person Company (OPC)

Section 2(62) of the Companies Act, 2013 states that a One Person Company means a company which has only one person as a member. It is classified as a kind of private company. The one person company is a feature that was proposed for the first time in the Companies Act, 2013. This company has been described under Section 3 (1) (c) of the Companies Act, 2013. It was the J.J. Irani Expert Committee that recommended the formation of such types of companies.

In a one person company, there is only one person appointed as its member. An OPC may be registered as 'limited by shares' or 'limited by guarantee'. However, the memorandum of OPC shall indicate the name of the other person, with his prior written consent in the prescribed form, who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall also be filed with the Registrar at the time of incorporation along with the memorandum of association and articles of association.

The title to all the shares in a one person company vests in that one member and upon his death transfers completely to the person nominated by such promoter member who shall now be entitled to receive all the dividends and rights and liabilities to which the sole promoter was hitherto entitled or liable.

There are many relaxations that are available to one person companies.

Such as, that an OPC does not need to prepare a cash-flow statement under Section 2(40); the annual return (which can be abridged by the Central Government) can be signed by the Director and not necessarily a Company Secretary (Section 92); no annual general meetings need to conducted in OPCs according to Section 96; also the specific provisions relating to extraordinary general meetings and annual general meetings do not apply to OPCs as per Section 100 and 111. Moreover, with the entry of resolutions in the minute's book of the company under Section 122, compliance is said to have been done for OPCs. According to Section 137 OPC's financial statements can be filed within six months from the close of the financial year as against 30 days.

The member of OPC may at any time change the name of such other person by giving notice in such manner as may be prescribed in the Act. However, intimation has to be done about the same in the name of the other person nominated by him indicating in the memorandum or otherwise within such time and in such manner after which the company shall intimate the Registrar of such change.

Eligibility

Rule 3 of Companies (Incorporation) Rules, 2014 provides that only a natural person who is an Indian citizen and resident in India shall be eligible to incorporate a OPC and shall be a nominee for the sole member of a OPC.

The term 'resident in India' means a person who has stayed in India for a period of not less 182 days during the immediately preceding one financial year.

Conditions

The following are the conditions in formation of a OPC:

- No natural person shall be eligible to incorporate more than a OPC or become nominee in more than a OPC;
- Where a natural person, being a member of OPC in accordance with this rule becomes a member in another such company by virtue of his being a nominee in that OPC, such person shall meet the eligibility criteria within a period of 182 days;
- No minor shall become member or nominee of OPC or can hold share with beneficial interest;
- Such company cannot be incorporated or converted into Section 8 company;
- Such company cannot carry out Non Banking Financial Investment activities including investment activities in securities of any body corporate;
- No such company can convert voluntarily into any kind of company unless two years have expired from the date of incorporation of OPC, except threshold limit of paid up share capital is increased beyond ₹ 50 lakh or its average annual turnover during the relevant period exceeds ₹ 2 crore rupees.

Benefits of One Person Company

- The concept of One Person Company is quite revolutionary. It gives the individual entrepreneurs all the benefits of a company, which means they will get credit, bank loans, and access to market, limited liability, and legal protection available to companies.
- Prior to the new Companies Act, 2013 coming into effect, at least two shareholders were required to start a company. But now the concept of One Person Company would provide tremendous opportunities for small businessmen and traders, including those working in areas like handloom, handicrafts and pottery. Earlier they were working as artisans and weavers on their own, so they did not have a legal entity of a company. But now the OPC would help them do business as an enterprise and give them an opportunity to start their own ventures with a formal business structure.
- Further, the amount of compliance by a one person company is much lesser in terms of filing returns, balance sheets, audit etc. Also, rather than the middlemen usurping profits, the one person company will have direct access to the market and the wholesale retailers. The new concept would also boost the confidence of small entrepreneurs.

Nominee

The proviso to Section 3(1) provides that the memorandum of OPC shall indicate the name of the other person as nominee in Form No. INC.-32 (SPICe). The prior written consent of the other person shall be obtained in the Form No. INC.3. The other person in the event of the subscriber's death or his incapacity to contract shall become the member of the company and the written consent of such person shall also be filed with the Registrar at the time of incorporation of OPC along with Memorandum and Articles of the Company.

The other person may withdraw his consent by giving a notice in writing to such sole member and to the One Person Company. The sole member shall nominate another person as nominee within 15 days of the notice of the withdrawal. He shall send an intimation of such nomination in writing to the company, along with the written consent of such other person so nominated in Form No. INC.3. The company shall within 30 days of receipt of the notice of the withdrawal of consent file with the Registrar, a notice of such withdrawal of consent and the intimation of the name another person nominated by the sole member in Form No. INC.4 along with the fee

prescribed and the written consent of such another person so nominated in Form No. INC-3.

The subscriber or member of OPC may change the name of such other person nominated by him at any time for any reason including in case of death or incapacity to contract of nominee. He may nominate another person after obtaining the prior consent of such another person in Form No. INC-3. The company shall, on receipt of such intimation, file with the Registrar, a notice of such change in Form No. INC-4 along with the fee and with the written consent of new nominee in Form No. INC-3 within 30 days of such receipt of intimation of change.

Where the shareholder of OPC ceases to be the member in the event of death of incapacity to contract, his nominee becomes the member of such OPC. Such new member shall nominate within 15 days of becoming member, a person who shall in the event of his death or his incapacity to contract become the member of such company. The company shall file with the Registrar an intimation of such cessation and nomination in Form No. INC-4 along with the fee within 30 days of the change in membership with the prior written consent of the person so nominated in INC-3.

Penalty

Rule 7A (with effect from 01.05.2015) provides that if a OPC or any Officer of such company contravenes any of the provisions of these rules, the OPC or any other officer of such company shall be punishable with fine which may extend to ₹5,000 and with a further fine which may extend to ₹500 for every day after the first offence during which such contravention continues.

Share certificate

The proviso to rule 5(3) of the Companies (Share Capital and Debentures) Rules, 2014 provides that in case of a OPC, every share certificate shall be issued under the seal, if any, of the company, which shall be affixed in the presence of and signed by one Director or a person authorized by the Board of Directors of the company for the purpose and the Company Secretary, or any other person authorized by the Board for the purpose and in case the OPC does not have a common seal, the share certificate shall be signed by the person in the presence of whom the seal is required to be affixed in this proviso.

Management and administration

- Section 122 of the Act provides that the following provisions shall not apply to a OPC-
- Section 98 – Power of Tribunal to call meetings of members etc.,
- Section 100- Calling of extraordinary general meeting;
- Section 101- Notice of meeting;
- Section 102 – Statement to be annexed to notice;
- Section 103 – Quorum for meetings;
- Section 104 –Chairman of meetings
- Section 105 – Proxies;
- Section 106 –Restriction on voting rights;
- Section 107 –Voting by show of hands;
- Section 108 –Voting through electronic means;
- Section 109 – Demand for poll;
- Section 111 –Circulation of members' resolution.

Section 122(3) provides that any business which is required to be transacted at an annual general meeting or other general meeting of a company by means of an ordinary or special resolution, it shall be sufficient if, in case of OPC, the resolution is communicated by the member to the company and entered in the minutes book required to be maintained under Section 118 and signed and dated by the member and such date shall be deemed to be the date of meeting for all purposes under this Act.

Section 122(4) provides that notwithstanding anything in this Act, where there is only one director on the Board of a OPC, any business which is required to be transacted at the meeting o the Board of Directors of a company, it shall be sufficient if, in such OPC, the resolution by director is entered in the minutes book required to be maintained under Section 118 and signed and dated by such director and such date shall be deemed to be the date of the meeting of the Board of Directors for all purposes under this Act.

Annual Return

The proviso to Section 92(1) provides that the Annual return of an OPC shall be signed by the Company Secretary or where there is no company secretary, by the director of the company.

Postal ballot

Rule 22(16) of the Companies (Management and Administration) Rules, 2014 provides that OPC is not required to transact any business through postal ballot.

Conversion OPC into a Public Company or a Private Company

Rule 6 provides that where the paid up share capital of an OPC exceeds ₹50 lakhs and its average annual turnover during the relevant period exceeds ₹2 crores, it shall cease to be entitled to continue as OPC. Such company is mandatorily to be required to convert within 6 months into either a public limited company with at least 7 members or a private company with minimum two members.

The OPC has to alter its memorandum and articles by passing a resolution according to Section 122(3) to give effect to the conversion and to make necessary changes incidental thereto.

The OPC shall within a period of 60 days from the date of the applicability give a notice to the Registrar in Form No. INC-5 informing that it has ceased to be a OPC and that it is now required to convert itself into a private company or a public company by virtue of its paid up share capital or average annual turnover having exceeded the threshold limit laid down for OPC.

Punishment

Rule 6(5) provides that if OPC or any officer of the OPC contravenes the provisions of these rules, OPC or any officer of the OPC shall be punishable with fine which may extend to ₹10,000 and with a further fine which may extend to ₹1000 for every day after the first during which such contravention continues.

Conversion of private company into a OPC

Rule 7 provides the procedure for conversion of private company into OPC. Rule 7(1) provides that a private company other than Section 8 company, having paid up share capital of ₹50 lakh or less and average annual turnover during the relevant period is ₹2 crores or less may convert itself into OPC by passing a special resolution in the general meeting. Before passing such resolution, the company shall obtain 'No Objection Certificate' in writing from the members and creditors. The OPC shall file copy of the resolution with the Registrar of Companies within 30 days from the date of passing such resolution in Form No. MGT-14.

The company shall file an application in Form No. INC-6 for its conversion into OPC along with fees. The following documents are to be attached:

- the directors of the company shall give a declaration by way of affidavit duly sworn in confirming that all members and creditors of the company have given their consent for conversion, the paid up share capital of the company is ₹50 lakhs or less or average annual turnover is less than ₹2 crores, as the case may be;
- the list of members and creditors;
- the latest Audited Balance sheet and the Profit and Loss Account;
- the copy of No objection letter of secured creditors.

On being satisfied and complied with the requirements the Registrar shall issue the certificate.

12.1.2.4 Small Company

The concept of small companies has also been introduced for the first time in Companies Act, 2013 much in the same way as OPCs. However, OPCs and small company cannot be formed for non-economic objectives as certain companies can be under Section 8 of the Companies Act, 2013.

The Finance Minister of India proposed revision of the definition of a small company, as covered under section 2(85) of the Companies Act, 2013 while presenting the Union Budget 2021. The basic purpose behind the proposal was to provide the facility of ease of doing the business and to reduce the compliance burden for many companies. Accordingly, the Ministry of Corporate Affairs notified the Companies (Specification of Definitions Details) Amendment Rules, 2021 vide notification dated 1st February 2021. The said amended rule notified amendment in the definition of a small company. The said amendment is made effective from 1st April 2021.

As per the new definition of small company provided under section 2(85) of the Companies Act, 2013, the small company means and covers the company which satisfies the following two conditions-

- Paid-up capital of the company should not exceed ₹2 Crores; and
- Turnover of the company should not exceed ₹20 Crores.

However, it is important to note here that the following companies, despite satisfying both the above conditions, are not eligible to qualify as a small company-

- A public company,
- A holding company,
- A subsidiary company,
- Company registered under section 8,
- A company that is governed by any special act.

Vide the Companies (Management and Administration) Amendment Rules, 2021, a new e-Form MGT-7A is introduced. Accordingly, from the Financial Year 2020-2021, the small company is required to file their annual return in new e-Form MGT-7A.Notably, the due date for filing the annual return in e-Form MGT-7A will be 60 days from the date of an annual general meeting.

12.1.2.5 Statutory Company

Bodies with special types of objects found desirable for encouragement may be formed under certain pieces of legislations passed by the Parliament. For example, Life Insurance Corporation Act, Reserve Bank of India, Insurance Act. These bodies or bodies covered by these Acts do not necessarily require to have a memorandum of association. Each statutory company is governed by the provisions of its special Act. However, as per Section

1(4), the provisions of the Companies Act, 2013 apply to them to the extent that the same are not inconsistent with the special Acts under which these companies are formed.

12.1.2.6 Registered Company

A company registered under the Companies Act, 2013 or previous company laws, is known as a registered company. They can be incorporated as limited liability companies or as unlimited liability companies. Further, they may be incorporated as public companies or as private companies. Registration is an essential feature of companies. Therefore, a registered company is an organization which is formed and registered with the appropriate statutory authority of the country as a company. Companies that do not fall under the aforementioned category are called unregistered entities.

12.1.2.7 Limited Liability Companies

According to Section 3 of the Companies Act, 2013, the liability structure has been categorized as companies limited by shares, companies limited by guarantee and unlimited liability companies.

a) Companies Limited by shares [Section 2(22)]:

A company having the liability of its members limited by the memorandum, to the amount, if any unpaid on shares respectively held by them is termed "a company limited by shares". Such a company is commonly called limited liability company. A company's liability is never limited. It is the liability of shareholders/members of a company that is limited. The liability of members can be enforced at any time during the existence and also during the winding-up of the company. Such a company must have share capital as the extent of liability is determined by the face value of shares. However, except where the articles otherwise provide, there is no liability to pay any balance amount due on the shares, except in pursuance of calls duly made in accordance with law and the articles while the company is a going concern or of calls made in the event of winding-up of the company.

b) Companies Limited by Guarantee [Section 2(21)]:

A company limited by guarantee may be defined as a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute. This contribution could be to the assets of the company in the event of it being wound-up while he is a member ot within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be. Moreover, this contribution could be to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves according to Section 4(1) (d) (ii). Companies may sometimes choose to be limited by guarantee despite having share capital. the liability of a member of a guarantee company having share capital is not merely limited to the amount as stated above in respect of guarantee companies not having share capital; he may be called upon to also contribute to the extent of any sums remaining unpaid on the shares held by him as per Section 285.

c) Unlimited Liability companies [Section 2(92)]:

A company having no limit on the liability of its members is an unlimited company, Section 2(92) of the Companies Act, 2013. This kind of liability structure allows a company to be formed as an unlimited company. Thus, in the case of an unlimited liability company, the liability of each member extends to the whole amount of the company's debts and liabilities. It may be seen that the liability of members of an unlimited company is similar to that of the partners but unlike the liability of partners, the members of the company cannot be directly proceeded against. Company being a separate legal entity, the claims can be enforced only against the company. Thus, creditors shall have to institute proceedings for winding-up of the company for their claims.

But, the Official Liquidator may call upon the members to discharge the debts and liabilities without limit. Such companies may or may not have a share capital and is not subjected to any restrictions regarding purchase of its own shares as per Section 67. Accordingly, such a company may purchase its own shares or advance monies to any person to purchase its shares.

Associations not for profit

Section 8 of the Companies Act, 2013 lays down provisions relating to companies that do not have a share capital. the section talks about the formulation of companies with charitable objects, where it is proved to the satisfaction of the Central Government that a person or an association of persons proposed to be registered under this Act as a limited company -

a) has in its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;

b) intends to apply its profits, if any, or other income in promoting its objects; and

c) intends to prohibit the payment of any dividend to its members, the Central Government may, by licence issued in such manner as may be prescribed, and on such conditions as it deems fit, allow that person or association of persons to be registered as a limited company under this section without the addition to its name of the word "Limited", or as the case may be, the words "Private Limited", and thereupon the Registrar shall, on application, in the prescribed form, register such person or association of persons as a company under this section.

Such a company registered under this section enjoys all the privileges and is subject to all the obligations of limited companies. A company registered under this section shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government. Also, among other provisions, the Central Government may, by order, revoke the licence granted to a company registered under this section if the company contravenes any of the requirements of this section or any of the conditions subject to which a licence is issued or the affairs of the company are conducted fraudulently or in a manner violative of the objects of the company or prejudicial to public interest, and without prejudice to any other action against the company under this Act, direct the company to convert its status and change its name to add the word "Limited" or the words "Private Limited", as the case may be, to its name.

In India, a non-profit organization can be registered as Trust by executing a Trust deed or as a Society under the Registrar of Societies, or as a private limited non-profit company under Section 8 Company under the Companies Act, 2013. A Section 8 Company is the same as the popular Section 25 of the old Companies Act, 1956, which was one of the most popular forms of Non- Profit Organizations in India.

There are many exemptions that a Section 8 company enjoys, such as, appointment of a qualified company secretary is not mandatory in such companies. Moreover, a general meeting of a Section 8 company can be held by giving 14 days' notice instead of the mandatory 21 days' notice, also, the provisions relating to appointment of directors under Section 149 regarding maximum and minimum number of directors is not applicable to such companies. Multiple compliance aspects have also been relaxed for such companies under the Companies Act, 2013.

Licence

Rule 19 of Companies (Incorporation) Rules, 2014 provides that a person or an association of persons desirous of incorporating a company with limited liability without the addition to its name of the word.

'Limited' or as the case may be 'Private Limited' shall make an application in Form No. INC-12 along with the fee. The memorandum of association of the proposed company shall be in Form No. INC-13.

The application shall be accompanied by the following documents:

- the draft memorandum and articles of association of the proposed company;
- the declaration in Form No. INC – 14 by an Advocate, a Chartered Accountant, Cost Accountant or Company Secretary in practice, that the draft memorandum and articles of association have been drawn up in conformity with the provisions of Section 8 and rules made there under and that all the requirements of the Act and the rules made there under relating to registration of the company under Section 8 and matter incidental or supplemental thereto have been complied with;
- an estimate of the future annual income and expenditure of the company for next three years, specifying the sources of the income and objects of the expenditure;
- the declaration by each of the persons making the application in Form No. INC-15.

If it is proved to the satisfaction of the Central Government that the proposed company has its objects as enshrined in Section 8 may, by licence issued in the prescribed form on such conditions as it deems fit, allow that person or association of persons to be registered as a limited company without the addition to its name of the word 'Limited' or 'private limited'. Thereupon the Registrar shall, on application in the prescribed form register such person or association of persons as a company under Section 8.

Licence for existing companies

Rule 20 provides for giving licence for the existing companies under Section 8 of the Act. A limited company registered under this Act or under any previous company law, with any of the objects meant for Section 8 companies and the restrictions and prohibitions and which is desirous of being registered under Section 8 shall make an application in Form No. INC – 12 along with the prescribed fee.

The application shall be accompanied by the following documents:

- the memorandum and articles of association of the company;
- the declaration as given in Form No. INC-14 by an Advocate, a Chartered Accountant, Cost Accountant or Company Secretary in practice, that the memorandum and articles of association have been drawn up in conformity with the provisions of Section 8 and rules made thereunder and that all the requirements of the Act and the rules made thereunder relating to registration of the company under Section 8 and matters incidental or supplemental thereto have been complied with;
- the financial statements, the Board's Reports and audit reports of the previous two financial years;
- a statement showing in detail the assets with the values and the liabilities of the company as on the date of the application or within 30 days preceding that date
- an estimate of the future annual income and expenditure of the company for next three years specifying the sources of the income and the objects of the expenditure;
- the certified copy of the resolutions passed in general/board meetings approving registration of the company under Section 8; and
- a declaration by each of the persons making the application in Form No. INC-15.

The company shall, within a week from the date of making the application to the Registrar, publish a notice at his own expense, and a copy of the published notice shall be sent to the Registrar in the Form No. INC-26 and shall be published-

- at least once in a vernacular newspaper in the principal vernacular language of the district in which the

registered office of the proposed company is to be situated or is situated and circulating in that district and at least once in English language in an English newspaper circulating in that district; and

- on the websites as may be notified by the Central Government.

The Registrar may require the applicant to furnish the approval or concurrence of the appropriate authority, regulatory body, department or Ministry of Central Government or the State Government(s).

The Registrar shall, after considering the objections, if any, received by it within 30 days from the date of publication of the notice, and after consulting any authority, regulatory body, Department or Ministry of the Central Government or the State Government(s) as it may, in its discretion, decide whether the licence should or should not be granted.

The licence shall be in Form No. INC-16 or Form No. INC-17, as the case may be. The Registrar shall have the power to include in the licence such other conditions as may be deemed necessary by him.

The Registrar may direct the company to insert in its memorandum, or in its articles, or partly in one and partly in the other, such conditions of the license as may be prescribed by the Registrar in this behalf.

Revocation of licence

Section 8(6) provides that the Central Government may, by order, revoke the licence granted to the company registered under this section-

- if the company contravenes any of the requirements of this section; or
- any of the conditions subject to which a licence is issued; or
- the affairs of the company are conducted fraudulently or in a manner violative of the objects of the company or prejudicial to public interest.

The Central Government shall direct the company to convert its status and change its name to add the words 'Limited' or 'Private Limited' to its name. No such order will not be passed without giving opportunity to the company of being heard. A copy of such order shall be given to the Registrar. The Registrar shall, without prejudice to any action taken, on application, in the prescribed form, register the company accordingly.

Winding up

Where a licence is revoked by the Central Government, it may direct that the company may be wound up under this Act or amalgamated with another company registered under this section, if it is satisfied that it is essential in the public interest. No such order shall be made unless the company is given a reasonable opportunity of being heard.

If on the winding up or dissolution of company registered under this Section, there remains, after the satisfaction of its debts and liabilities, any asset, they may be transferred to another company registered under this Section and having similar objects, subject to such conditions, as the Tribunal may impose or may be sold and proceeds thereof credited to the Rehabilitation and Insolvency Fund formed under Section 269.

Amalgamation

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

Punishment

Section 8(11) provides that if a company makes any default in complying with any of the requirements laid down in this section, the company shall, without prejudice to any other action under the provisions of this section, be punishable with fine which shall not be less than ₹10 lakhs but which may extend to ₹1 crore. The directors and every officer of the company, who is in default shall be punishable with imprisonment for a term which may extend to 3 years or with fine which shall not be less than ₹25,000 but which may extend to ₹25 lakhs or with both.

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

Conversion of Companies:

Conversion of Section 8 Company

Section 8(4)(ii) provides that a company registered under Section 8 may convert itself into company of any other kind only after complying with such conditions as may be prescribed.

Conditions for conversion

Rule 21 provides conditions for conversion of a company registered under Section 8 into a company of any other kind.

Rule 21(1) provides that a company registered under Section 8 which intends to convert itself into a company of any other kind shall pass a special resolution at a general meeting for approving such conversion.

Rule 21(2) provides that the explanatory statement annexed to the notice, convening the general meeting shall set out in detail the reasons for opting for such conversion including the following;

- the date of incorporation of the company;
- the principal objects of the company as set out in the memorandum of association;
- the reasons as to why the activities for achieving the objects of the company cannot be carried on in the current structure i.e., as a Section 8 company;

if the principal or main objects are proposed to be altered, then what would be the altered objects and the reasons for the alteration;

- what are the privileges or concessions currently enjoyed by the company, such as tax exemption, bond and other immovable properties, if any, that were acquired by the company at concessional rates or prices or gratuitously and, if so, the market prices prevalent at the time of acquisition and the price that was paid by the company, details of any donation or bequests received by the company with conditions attached to their utilization etc.,
- details of impact of the proposed conversion on the members of the company including the details of any benefits that may accrue to the members as a result of the conversion.

Rule 21 (3) provides that a certified true copy of the special resolution along with a copy of the notice convening the meeting including the explanatory statement shall be filed with the Registrar in Form No. MGT-14 along with the fee.

Rule 21(4) requires that the company shall also file an application in Form No. INC-18 with the Regional Director along with the fee and a certified copy of special resolution and a copy of the notice convening the

meeting including the explanatory statement. The company shall also attach, the proof of serving the notice served to all the authorities under Rule 22(2).

Rule 21(5) requires that a copy of the application with annexures as filed with Regional Director shall also be filed with the Registrar.

Other conditions

Rule 22 (1) provides that the company shall, within a week from the date of submitting the application to the Regional Director, publish a notice at its own expense. A copy of the notice as published shall be sent to the Regional Director in Form No. INC-19. The notice shall be published-

- at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated and having a wide circulation in that district, and at least once in English language in any English newspaper having a wide circulation in that district; and
- on the web site of the company, if any, and as may be notified or directed by the Central Government.

Rule 22(2) provides that the company shall send a copy of the notice, simultaneously with the publication, together with a copy of the application and all attachments by registered post or hand delivery to-

- The Chief Commissioner of Income Tax;
- The Charity Commissioner;
- The Chief Secretary of the State;
- Any other Department of the Central/State Government under whose jurisdiction the company has been operating.

If any of these authorities wish to make any representation to the Regional Director, it shall do so within 60 days of the receipt of the notice, after giving an opportunity to the company.

Rule 22(3) provides that the copy of proof of serving such notice shall be attached to the application. Rule 22(4) provides that the Board of Directors shall give a declaration to the effect that no portion of the income or property of the company has been or shall be paid or transferred directly or indirectly by way of dividend or bonus or otherwise to persons who are or have been members of the company or to any one or more of them or to any person claiming through any one or more of them.

Rule 22(5) provides that where the company has obtained special status, privilege, exemption, benefit or grant from any authority, the company has to obtain 'No Objection Certificate' from such authority if the terms and conditions of the said special status etc., so require. The said NOC shall be filed with the Regional Director along with the application.

Rule 22(6) provides that the company should have filed all its financial statements and Annual Returns up to the financial year preceding the submission of the application and all other returns required to be filed under the Act up to the date of submitting the application to the Regional Director. In the event the application is made after the expiry of three months from the date of preceding financial year to which the financial statement has been filed, a statement of the financial position duly certified by a Chartered Accountant made up to a date not preceding 30 days of filing of the application shall be attached.

Rule 22(7) provides that the company shall attach with the application a certificate from practicing Chartered Accountant or Company Secretary in practice or Cost Accountant in practice, certifying that the conditions laid down in the Act and these rules relating to conversion of a company registered under Section 8 into any other

kind of company, have been complied with.

Rule 22 (8) provides that the Regional Director may require the applicant to furnish approval or concurrence of any particular authority for grant of his approval for the conversion. He may also obtain the report from the Registrar.

Order for conversion

Rule 22 (9) provides that the Regional Director, on receipt of the application and being satisfied, shall issue an order approving the conversion of the company into a company of any other kind subject to such terms and conditions as may be imposed in the facts and circumstances of each case. The terms and conditions also include the following:

- The company shall give up and shall not claim any special status, exemptions or privileges that it enjoyed with effect from the date of its conversion;
- If the company had acquired any immovable property free of cost or at a concessional rate from any government or authority, it may be required to pay the difference between the cost at which it acquired such property and the market price of such property at the time of conversion either to the Government or to the authority that provided the immovable property;
- Any accumulated profit or utilized income of the company brought forward from previous years shall be first utilized to settle all outstanding statutory dues, amounts due to lenders claims of creditors, suppliers, service providers and others including employees and lastly any loans advanced by the promoters or members or any other amounts due to them and the balance, if any, shall be transferred to the Investor Education and Protection Fund within 30 days of receiving the approval for conversion.

Rule 22(10) provides that before imposing the conditions or rejecting the application, the company shall be given a reasonable opportunity of being heard by the Regional Director.

Filing with Registrar:

Rule 22(11) provides that the company shall convene a general meeting of its members to pass a special resolution for amending its memorandum of association and articles of association as required under the Act consequent to the conversion of Section 8 company into a company of any other kind. The company shall thereafter file with the Registrar-

- a certified copy of the approval of the Regional Director within 30 days from the date of receipt of the order in Form No. INC-20 along with the fee;
- amended memorandum of association and articles of association of the company;
- a declaration by the directors that the conditions, if any imposed by the Regional Director have been fully complied with Rule 22(12) provides that on receipt of the documents the Registrar shall register the documents and issue fresh certificate of incorporation.

12.1.2.8 Government Company

Section 2 (45) of the Companies Act, 2013 defines a Government company as any company in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary company of such a Government company.

Government companies are different from statutory companies under the Companies Act, 2013, which are formed under separate Acts of Parliament. Since every company has a separate legal personality, employees of

a Government company are not the employees of the Central Government or the State Government. When the Government engages itself in trading ventures, particularly as Government companies under the company law, it does not do so as a political State or political Government, but it does so as a company. A Government company is not a department of the Government. The rights and obligations of a company are distinct from those of its shareholders. Therefore, the legal status of a Government company is not affected just because the share capital of the company has been contributed by the Central Government and all its shares are held by the President of India or the Governor of the State and certain nominated officers of the Government. This was held in the case of Heavy Engineering Mazdoor Union vs. State of Bihar [1969] 39 Comp. Cas. 905 (SC). Government companies, just like any other company, can be incorporated either as a private or a public company. Since majority of shareholding of such companies is in the hands of the Central Government, they control majority of decisions within government companies such as place for conduction annual general meetings, managerial remuneration, appointment and rotation of directors, dividends, and so on.

12.1.2.9 Foreign Company

Section 2(42) of the Companies Act, 2013 states that a foreign company means any company or body corporate incorporated outside India which:

a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

b) conducts any business activity in India in any other manner.

Having a share transfer office or share registration office will constitute a place of business. Provisions of Section 92 of the Companies Act, 2013, relating to filing of the annual return with the Registrar of Companies are also applicable to a foreign company. However, in the case of Tovarishestvo Manufacture Liudvig Rabenek, Re [1944] Ch. 404 it was held that where representatives of a company incorporated outside the country frequently visited and stayed in a hotel for looking after purchase of machinery and other articles, it was held that the company had a place of business in the hotel. But, mere holding of property cannot amount to having a place of business.

It is important to note here that foreign companies are defined in terms of its place of incorporation. If the company is established outside India and has a place of business in India, then only it will be a foreign company under the section. Accordingly, a company incorporated outside India having shareholders who are all Indian citizens and having its business outside India is not covered. Contrarily, a company incorporated in India but having all foreign shareholders shall be an Indian company and not a foreign company as contemplated under Section 2 (42).

Sections 380, 381 and 382 of the Companies Act, 2013 are applicable to such foreign companies in India. Section 379 of the Companies Act specifically mentions that where not less than fifty per cent of the paid-up share capital, whether equity or preference or partly equity and partly preference, of a foreign company is held by one or more citizens of India or by one or more companies or bodies corporate incorporated in India, or by one or more citizens of India and one or more companies or bodies corporate incorporated in India, whether singly or in the aggregate, such company will have to comply with the provisions of Chapter XXII of the Companies Act, 2013 along with all incidental provisions as may be prescribed with regard to the business carried on by it in India as if it were a company incorporated in India.

In furtherance of the same, Section 380 lays down the documents that a foreign company has to deliver to the Registrar of Companies and Section 381 lays down provisions relating to compliances that a foreign company needs to follow with regards to maintenance of accounts.

12.1.2.10 Holding and Subsidiary Companies

Holding and subsidiary companies are relative terms. If one company controls the other, the controlling company is generally denoted as the holding company and the company so controlled is called as the subsidiary company.

Section 2 (46) of the Companies Act, 2013 explains that a holding company, in relation to one or more other companies, means a company of which such companies are subsidiary companies.

Whereas Section 2(87) of the Companies Act, 2013, lays down the provisions relating to subsidiary company or subsidiary, in relation to any other company (that is to say the holding company), means a company in which the holding company:

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

ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies: Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

Explanation: For the purposes of this clause:

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

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

c) the expression: company includes any body-corporate;

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

Composition of a company shall be deemed to be controlled by another company if that other company, by another company if that other company, by exercise of some power exercisable by it at its discretion, can appoint or remove all or a majority of the directors.

Section 2(87) envisages the existence of subsidiary companies in different situations. It may be that acquiring sufficient share capital of a company, sufficient control may be obtained over that company to enable control in the composition of board of directors. But, it is also possible to obtain such control in regard to the composition of the board of directors without making such an investment in equity capital of the company. Such a control may be by reason of an agreement such as where one company may agree to advance funds to another company and in return may, under the terms of an agreement, gain control over the right to appoint all or a majority of the Board of Directors.

12.1.2.11 Associate Company

Section 2(6) of the Companies Act, 2013, an associate company, in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

Explanation: For the purposes of this clause, significant influence means control of at least twenty per cent of total share capital, or of business decisions under an agreement. Associate company is not a subsidiary but may be a joint venture. Joint venture means a joint arrangement whereby the parties that have joint control of the arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

12.1.2.12 Public Financial Institutions

According to Section 2 (72) of the Companies Act, 2013 public financial institution has been meant to be:

i) the Life Insurance Corporation of India, established under section 3 of the Life Insurance Corporation Act, 1956 (31 of 1956);

ii) the Infrastructure Development Finance Company Limited, referred to in clause (vi) of subsection (1) of section 4A of the Companies Act, 1956 (1 of 1956) so repealed under section 465 of this Act;

iii) specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002);

iv) institutions notified by the Central Government under sub-section (2) of section 4A of the Companies Act, 1956 (1 of 1956) so repealed under section 465 of this Act;

v) such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India:

Provided that no institution shall be so notified unless:

a) it has been established or constituted by or under any Central or State Act; or

b) not less than fifty-one per cent. of the paid-up share capital is held or controlled by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments.

The Central Government has also specified institutions to be public financial institutions.

12.1.2.13 Producer Companies

The concept of Producer Company in India was introduced to allow cooperatives to function as a corporate entity under the Ministry of Corporate Affairs.

A producer company can be defined as a legally recognized body of farmers/ agriculturists with the aim to improve the standard of their living and ensure a good status of their available support, incomes and profitability. Under Companies Act 1956, a Producer Company can be formed by 10 individuals (or more) or 2 institutions (or more) or by a combination of both (10 individuals and 2 institutions) having their business objective as one of the following:

- Procurement
- Production
- Harvesting
- Grading
- Pooling
- Handling
- Marketing
- Selling, or
- Export

Of the primary produce of the Members or import of goods or services for their benefit.

The main objective of the producer company is to facilitate the formation of co-operative business as companies and to make it possible to convert the existing co-operative business into companies.

The objects given under Section 581B of the Companies Act, 1956 are as follows:

The objects of the Producer Company shall relate to all or any of the following matters, namely: Production, harvesting, procurement, grading, pooling, handling, marketing, selling, export of primary production of the Members or import of goods or services for their benefit, provided that the Producer Company may carry on any of the activities specified in this clause either by itself or through other institution.

Primary produce has been defined under the Companies Act 1956 as produce arising from agriculture by a farmer which includes animal husbandry, floriculture, horticulture, viticulture, pisciculture, re-vegetation, bee raising, forestry, forest products and farming plantation products, produce of hand-loom, handicraft and other cottage industries.

12.1.3 Formation of Company

Section 3 of Companies Act, 2013 provides for the formation of a company.

1. A Company may be formed for any lawful purpose by seven or more persons, where the company to be formed is to be a public company; two or more persons, where the company to be formed is to be a private company ; or One Person, where the company to be formed is to be One Person Company that is to say, a private company, by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration. However, the memorandum of One Person Company shall indicate the name of the other person, with his prior written consent in the prescribed form , who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall also be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles.

   This other person may withdraw his consent in such manner as may be prescribed and may at any time be changed by giving notice in such manner as may be prescribed.

2. The Registrar on the basis of documents and information filed under sub-section (1) shall register all the documents and information referred to in that sub-section in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.

3. On and from the date mentioned in the certificate of incorporation issued under sub-section (2), the Registrar shall allot to the company a corporate identity number, which shall be a distinct identity for the company and which shall also be included in the certificate.

4. The company shall maintain and preserve at its registered office copies of all documents and information as originally filed under sub-section (1) till its dissolution under this Act.

However, liability under Section 447 of Companies Act, 2013 can be attracted if any misrepresentation or false statement has been issued in the aforementioned aspect.

Selection of name for the company

Before incorporation of a company, the promoter has to select a name for the company. While selecting the name of the company the promoter has to comply with the provisions of Rule 8 which gives the list of undesirable name that cannot be adopted. Rule 9 provides for the reservation of name. An application for the reservation of name shall be made in Form – INC1 along with the fee.

Where the articles contain entrenchment, the company shall give notice to the Registrar of such provisions in Form No. INC-2 or Form No. INC-7 along with fee at the time of incorporation of the company. In case of existing company, the same shall be filed in Form No. MGT-14 within 30 days from the date of entrenchment of the articles, along with the fee.

12.1.4 Incorporation of Company

Section 7 of the Companies Act, 2013 provides for the procedure to be followed for the incorporations of a company. The promotor of the company shall submit the following documents to the Registrar of companies within whose jurisdiction the registered office of the company is proposed to be situated for registration.

a) Memorandum and articles of the company duly signed by all the subscribers to the memorandum in suc manner as may be prescribed;

b) A declaration in the prescribed form by an Advocate, a Chartered Accountant, Cost Accountant or Company Secretary in practice, who is engaged in the formation of the company and by a person named in the articles as a director, manager or secretary of the company, that all the requirements of the Act and rules made thereunder in respect of registration;

c) A declaration from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles stating that - (Form No. INC-9)

   i) he is not convicted of any offence in connection with the promotion, formation or management of any company, or

   ii) he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the last five years and

   iii) that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief;

d) The address for correspondence till registered office is established;

e) All particulars of every subscriber to the memorandum along with the proof of identity;

f) The particulars of the persons mentioned in the articles as the first directors of the company;

g) The consent to act as directors of company in such form as may be prescribed.

The memorandum of association and articles of association are the basic essential documents of the company.

A new section (10A) has been introduced with the introduction of Companies Amendment Ordinance. It provides that every company, incorporated after the notification of the ordinance, shall not commence business, unless the directors file a declaration within 180 days of incorporation that every subscriber has paid for the shares as agreed and the registered office has been verified by filing necessary returns. Under 12A (new in section) the name of the company may be striked off if no office is found on physical verification.

Memorandum of Association

The Memorandum of Association of company is in fact its charter; it defines its constitution and the scope of the powers of the company with which it has been established under the Act. It is the very foundation on which the whole edifice of the company is built.

As per Section 4(1), the memorandum of a limited company must state the following:

a) the name of the company with "Limited" as its last word in the case of a public limited company; and "Private Limited" as its last words in the case of a private limited company; (**Name Clause**)

   This shall not apply in case of companies registered under section 8.

   Similarly, in case of Government companies the name of the company shall end with the words "Limited". This is as per the exemptions to Government Companies under Section 462 of Companies Act, 2013 vide notification dated June 5, 2013.

b) the State in which the registered office of the company is to be situated; (**Situation Clause**)

c) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof;(**objects clause)**

Provided that nothing in this clause shall apply to a company registered under section 8;

d) the liability of members of the company, whether limited or unlimited, and also state, – (**Liability Clause)**

i) in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and

ii) in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute –

- to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and
- to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves;

e) in the case of a company having a share capital,– (**Capital Clause**)

i) the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount and the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share per subscriber; and

ii) the number of shares each subscriber to the memorandum intends to take, indicated opposite his name;

f) in the case of a One Person Company, the name of the person who, in the event of the death of the subscriber, shall become the member of the company.

According to section 4(7), any provision in the memorandum or articles, in the case of a company limited by guarantee and not having a share capital, purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void.

Form of Memorandum

Section 4(6) provides that the memorandum of a company shall be in respective of forms specified in

Tables A, B, C, D and E in Schedule I as may be applicable to the company.

- Table A – Memorandum of Association of a company limited by shares;
- Table B – Memorandum of Association of a company limited by guarantee and not having share capital;
- Table C – Memorandum of Association of a company limited by guarantee and having a share capital;
- Table D – Memorandum of Association of an unlimited company and not having share capital;
- Table E – Memorandum of Association of an unlimited company and having share capital.

Doctrine of ultravires

The meaning of the term *ultra vires* is simply "beyond (their) powers". The legal phrase "*ultra vires*" is applicable only to acts done in excess of the legal powers of the doers. This presupposes that the powers are in their nature limited. To an ordinary citizen, the law permits whatever does the law not expressly forbid. It is only when the law has called into existence a person for a particular purpose or has recognised its existence-

such as in the case of a limited company - that the power is limited to the authority delegated expressly or by implication and to the objects for which it was created. In the case of such a creation, the ordinary law applicable to an individual is somewhat reversed, whatever is not permitted expressly or by implication, by the constituting instrument, is prohibited not by any express prohibition of the legislature, but by the doctrine of *ultra vires.*

It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act - thus far and no further [Ashbury Railway Company Ltd. vs. Riche]. In consequence, any act done or a contract made by the company which travels beyond the powers not only of the directors but also of the company is wholly void and inoperative in law and is therefore not binding on the company. On this account, a company can be restrained from employing its fund for purposes other than those sanctioned by the memorandum. Likewise, it can be restrained from carrying on a trade different from the one it is authorised to carry on.

The impact of the doctrine of *ultra vires* is that a company can neither be sued on an *ultra vires* transaction, nor can it sue on it. Since the memorandum is a "public document", it is open to public inspection. Therefore, when one deals with a company, one is deemed to know about the powers of the company. If in spite of this you enter into a transaction which is *ultra vires* the company, you cannot enforce it against the company. For example, if you have supplied goods or performed service on such a contract or lent money, you cannot obtain payment or recover the money lent. But if the money advanced to the company has not been expended, the lender may stop the company from parting with it by means of an injunction; this is because the company does not become the owner of the money, which is *ultra vires* the company. As the lender remains the owner, he can take back the property in specie. If the *ultra vires* loan has been utilised in meeting lawful debt of the company then the lender steps into the shoes of the debtor paid off and consequently he would be entitled to recover his loan to that extent from the company.

An act which is *ultra vires* the company being void cannot be ratified by the shareholders of the company. Sometimes, act which is *ultra vires* can be regularised by ratifying it subsequently. For instance, if the act is *ultra vires* the power of the directors, the shareholders can ratify it; if it is *ultra vires* the articles of the company, the company can alter the articles; if the act is within the power of the company but is done irregularly, shareholder can validate it

Articles of Association

Section 5 of the Act deals with the Articles of the Company. The articles of a company shall contain the regulations for management of the company. Table F in Schedule I provides the matters that shall be contained in the Articles of a company limited by shares. These are as follows:

- Interpretation;
- Share capital and variation of rights;
- Lien;
- Calls on shares;
- Transfer of shares;
- Transmission of shares;
- Forfeiture of shares;
- Alteration of capital;
- Capitalization of profits;
- Buy-back of shares;

- General meetings;
- Proceedings at general meetings;
- Adjournment of meeting;
- Voting rights;
- Proxy;
- Board of directors;
- Proceedings of the Board;
- Chief Executive Officer, Manager, Company Secretary or Chief Financial Officer;
- The Seal (now it is optional);
- Dividends and reserve;
- Accounts;
- Winding up;
- Indemnity;

Table G – Articles of Association of a company limited by guarantee and having a share capital;

Table H – Articles of Association of a company limited by guarantee and not having share capital;

Table I – Articles of Association of an unlimited company and having a share capital;

Table J – Articles of Association of an unlimited company and not having a share capital.

Signing of Memorandum and articles

Rule 13 provides for signing of memorandum and articles. The Memorandum and articles shall be signed in the following manner:

- The memorandum and articles of association of the company shall be signed by each subscriber to the memorandum. The name, address, description and occupation, if any, are to be added. One witness shall attest the signature of the subscriber. The witness also is to sign and furnish his full details.
- The witness shall state that –"I witness to subscriber/subscriber(s) who has/have subscribed and signed in my presence (date and place to be given); further I have verified his or their Identity Details for their identification and satisfied myself of his/her/their identification particulars filled in".
- Where a subscriber to the memorandum is illiterate, he shall affix his thumb impression or mark which shall be described as such by the person, writing for him, who shall place the name of the subscriber against or below the mark and authenticate by his own signature and he shall also write against the name of the subscriber, the number of shares taken by him;
- Such person shall also read and explain the contents of the memorandum and articles of association to the subscriber and make an endorsement to that effect on the memorandum and articles of the association;
- Where the subscriber is a body corporate, the memorandum and articles of association shall be signed by director, officer or employee of the body corporate duly authorized in this behalf by a resolution of the board of directors of the body corporate. Where the subscriber is an LLP, it shall be signed by a partner of the LLP, duly authorized by a resolution approved by all the partners of the LLP. In either case, the person so authorized shall not, at the same time, be a subscriber to the memorandum and articles of association;
- Where the subscriber is a foreign national residing outside India-

- in a country in any part of the Commonwealth , his signatures and address on the memorandum and articles of association and proof of identity shall be notarized by a Notary Public in that part of the Commonwealth;
- in a country which is a party to the Hague Apostille Convention, 1961, his signatures and address on the memorandum and articles of association and proof of identity shall be notarized before the Notary Public of the Country of his origin and be duly apostillised in accordance with the Hague Convention;
- in a country outside the commonwealth and not a party to the Hague Apostille Convention, 1961, his signatures and address shall be notarized before the Notary Public of that country and the certificate of the Notary Public shall be authenticated by a Diplomatic or Consular Officer empowered in this behalf
- visited in India and intended to incorporate a company, in such case the incorporation shall be allowed if, he/she is having a valid Business Visa.

Particulars of every subscriber

Rule 16(1) provides that the full details of the every subscriber such as his personal data, address, communication details, identity proof, residential proof, proof for nationality are to be furnished. If the subscriber is already a director or promoter of a company, the particulars relating to his name of the company, CIN number etc., are to be furnished. The promoter or first director shall self attest his signature and latest photograph in Form No. INC-10.

Where the subscriber to the memorandum is a body corporate the details such as name of the body corporate, address of the registered office, place of business, CIN number, certified true copy of the board resolution specifying the authorization to subscribe to the memorandum of association of the proposed company and to make investment in the proposed company, the number of shares proposed to be subscribed by the body corporate, and the name and designation of the person authorized to subscribe to the Memorandum are to be furnished.

If the body corporate is a LLP or partnership firm, certified true copy of the resolution agreed to by all the partners specifying the authorization to subscribe to the memorandum of association of the proposed company and to make investment in the proposed company, the number of shares proposed to be subscribed in the body corporate and the name of the partner authorized to subscribe to the memorandum are to be furnished.

In case of a foreign body corporate the details relating to the copy of certificate of incorporation of the foreign body corporate and the address of the registered office are to be furnished.

Particulars of first directors

Rule 17 provides that the particulars of the persons mentioned in the articles as the first director of the company, their names, including surnames or family names, the Director Identification Number, residential address, nationality and such other particulars including proof of identity as may be prescribed are to be furnished. The interest of the first directors in other firms or body corporate along with their consent to act as directors of the company shall be filed in DIR- 12 along with the fee.

Registration

Section 7(2) provides that the Registrar on the basis of the documents and information filed shall register all documents and information in the register and issue a certificate of incorporation in the Form No. INC-11 to the effect that the proposed company is incorporated under this Act.

Section 7(3) provides that the Registrar shall then allot a Corporate Identity Number on and from the date mentioned in the certificate of incorporation. The CIN shall be a distinct identity for the company and the same shall be included in the certificate.

Obligation of company

Section 7(4) provides that the company shall maintain and preserve at its registered office copies of all documents and information as originally filed with the Registrar till its dissolution under this Act.

Punishment

Section 7(5) provides that if any person furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company he shall be liable for action under Section 447.

Section 7(6) provides that where at any time after the incorporation of the company, it is proved that the company has been got incorporated by furnishing false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating the company, or by fraudulent action, the promoters, persons named as first directors of the company and the persons making declaration shall each be liable for action under Section 447.

Section 7(7) provides that where a company has got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any one of the documents or declarations filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants-

- pass such orders, as it may think fit, for regulation of the management of the company including changes, if any, in its memorandum and articles, in public interest or in the interest of the company and its members and creditors; or
- direct that liability of members shall be unlimited; or
- direct removal of the name of the company from the register of companies; or
- pass an order for the winding up of the company; or
- pass such other orders as it may deem fit.

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

Act to override memorandum, articles etc.

Section 6 provides that the provisions of this Act shall have effect notwithstanding anything to the contrary in the memorandum or articles of a company, or in any agreement executed by it, or in any resolution passed by the company in general meeting or by its Board of Directors, whether the same be registered, executed or passed, before or after the commencement of this Act and any provision contained in the memorandum, articles, agreement or resolution shall, to the extent to which it is repugnant to the provisions to this Act become or be void, as the case may be.

Effect of memorandum and articles

Section 10 provides that once the memorandum and articles are registered, they shall 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. All monies payable by any member to the company under the memorandum or articles shall be a debt due from him to the company.

Procedure of alteration of memorandum

Section 13 of the Companies Act, 2013 provides the provisions that deal with the alteration of the memorandum. These provisions are:-

1. **Alteration by special resolution:** Company may alter the provisions of its memorandum with the approval of the members by a special resolution.
2. **Name Change of the company:** Any change in the name of a company shall be effected only with the approval of Central Government in writing.

   However, no such approval shall be necessary where the change in the name of the company is only the deletion there from, or addition thereto, of the word "Private", consequent on the conversion of any one class of companies to another class.
3. **Entry in register of companies:** On any change in the name of a company, the Registrar shall enter the new name in the register of companies in place of the old name and issue a fresh certificate of incorporation with the new name and the change in the name shall be complete and effective only on the issue of such a certificate
4. **Change in the registered office:** The alteration of the memorandum relating to the place of the registered office from one State to another shall not have any effect unless it is approved by the Central Government on an application in such form and manner as may be prescribed.
5. **Disposal of the application of change of place of the registered office:** The Central Government shall dispose of the application of change of place of the registered office within a period of sixty days. Before passing of order, the Central Government may satisfy itself that-
   - The alteration has the consent of the creditors, debenture-holders and other persons concerned with the company, or
   - that the sufficient provision has been made by the company either for the due discharge of all its debts and obligations, or adequate security has been provided for such discharge.
6. **Filing with Registrar:** A company shall, in relation to any alteration of its memorandum, file with the Registrar–
   - the special resolution passed by the company under sub-section (1) of Section 13;
   - the approval of the Central Government under sub-section (2), if the alteration involves any change in the name of the company.
7. **Filing of the certified copy of the order with the registrar of the states:** Where an alteration of the memorandum results in the transfer of the registered office of a company from one State to another, a certified copy of the order of the Central Government approving the alteration shall be filed by the company with the Registrar of each of the States within such time and in such manner as may be prescribed, who shall register the same.
8. **Issue of fresh certificate of incorporation:** The Registrar of the State where the registered office is being shifted to, shall issue afresh certificate of incorporation indicating the alteration.
9. **Change in the object of the company:** A company, which has raised money from public through prospectus and still has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution through postal ballot is passed by the company and—

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

10. **Registrar to certify the registration on the alteration of the objects:** The Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution.
11. **Alteration to be registered:** No alteration made under this section shall have any effect until it has been registered in accordance with the provisions of this section.
12. **Only member have a right to participate in the divisible profits of the company:** Any alteration of the memorandum, in the case of a company limited by guarantee and not having a share capital, intending to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void.

Restriction in alteration of memorandum

Rule 29 provides that the change of name shall not be allowed to a company which has not filed its annual returns or financial statements due for filing with the Registrar or which has defaulted in repayment of matured deposits or debentures or interest thereon.

An application shall be filed in Form No. INC-24 along with the fee for change in the name of the company and a new certificate of incorporation in Form No. INC-25 shall be issued to the company consequent upon the change.

Alteration of Articles

Section 14 provides for the alteration of articles. The section provides that subject to the provisions of the Act and the conditions contained in the memorandum, if any, a company may by a special resolution, alter its articles including alterations having the effect of conversion of a private company into a public company or a public company into a private company. The application for the said purposes is to be filed in Form No. INC-27.

Where a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under this Act, the company shall, as from the date of such alteration, cease to be a private company. Any alteration having the effect of conversion of a public company into a private company shall not take effect except with the approval of the Tribunal which shall make such order as it may deem fit. A copy of the order of the Tribunal approving the alteration shall be filed with the Registrar, in Form No. INC-27 together with a printed copy of the altered articles, within 15 days from the date of the receipt of the order from the Tribunal. The Registrar shall register the same. Any such alteration shall be valid as if it were originally in the articles.

Alteration to be noted

Section 15 provides that every alteration made in the memorandum or articles of a company shall be noted in every copy of the memorandum or articles, as the case may be. If a company makes in default of this section, the company and every officer who is in default shall be liable to a penalty of ₹1000/- for every copy of the memorandum or articles issued without such alteration.

Copy of documents to members

Section 17(1) of the Act read with Rule 34 provides that a company shall on payment of fee, send copy of each of the following documents to a member within 7 days of the request being made by him-

- the memorandum;
- the articles;
- every agreement and every resolution , if and in so far as they have not been embodied in the memorandum and articles.

Section 17(2) provides that if a company makes any default in complying with the provisions of this section, the company and every officer of the company who is in default shall be liable for each default, to a penalty of ₹1,000 for each day during which such default continues or ₹1 lakh whichever is less.

Rectification of name of company

Section 16(1) provides that if, through inadvertence or otherwise, a company on its first registration or on its registration by a new name, is registered by a name which-

- in the opinion of the Central Government is identical with or too nearly resembles the name by which a company in existence had been previously registered, whether under this Act or any previous Company laws, it may direct the company to change its name or new name within a period of three months from the issue of such direction, after adopting an ordinary resolution for this purpose;
- on an application by a registered proprietor of a trade mark that the name is identical with or too nearly resembles to a registered trade mark of such proprietor under the Trade Marks Act, 1999, made to the Central Government within three years of incorporation or registration or change of name of the company, If in the opinion of the Central Government is identical with or too nearly resembles to an existing trade mark, it may direct the company to change its name or new name within a period of six months from the issue of such direction after adopting an ordinary resolution for this purpose.

Section16 (2) provides that where a company changes its name or obtains a new name, it shall within 15 days from the date of such change give notice of the change to the Registrar along with the order of the Central Government. The Registrar shall carry out necessary changes in the certificate of incorporation and the memorandum.

Section 16(3) provides punishment for contravention of this Section. If a company makes default in complying with any direction, the company shall be punishable with fine of ₹1,000 for every day during which the default continues. Every officer who is in default shall be punishable with fine which shall not be less than ₹5,000 but which may extend to ₹1 lakh.

Subsidiary company not to hold in its holding company

Section 19 provides that no company shall, either by itself or through its nominees, hold any shares in its holding company and no holding company shall allot or transfer its shares to any of its subsidiary companies and any such allotment or transfer of shares of a company to its subsidiary company shall be void. This shall not be applicable to a case-

- where the subsidiary company holds such shares as legal representative of a deceased member of the holding company; or where the subsidiary company holds such shares as a trustee; or
- where the subsidiary company is a shareholder even before it became a subsidiary company of the holding company.

The subsidiary company shall have a right to vote at a meeting of the holding company only in respect of the shares held by it as a legal representative or as a trustee.

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

Service of documents

Section 20 provides that a document may be served on a company or an officer 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 or by leaving it at its registered office or by means of such electronic or other mode as may be prescribed.

A document may be served on the Registrar or any member through electronic transmission. The term 'electronic transmission' means a communication-

a) delivered by-

- facsimile telecommunication or electronic mail when directed to the facsimile number or electronic mail address, respectively, which the Registrar or the member has provided from time to time for sending communications to the Registrar or the number respectively;
- posting of an electronic message board or network that the Registrar or the member has designated for such communications, and which transmission shall be validly delivered upon the posting; or
- other means of electronic communication in respect of which the Registrar or the member has put in place reasonable systems to verify that the sender is the person purporting to send the transmission; and

b) that creates a record that is capable of retention, retrieval and review, and which may thereafter be rendered into clearly legible tangible form.

In case of delivery by post such service shall be deemed to have been effected-

- in the case of a notice of a meeting, at the expiration of 48 hours after the letter containing the same is posted; and
- in any other case, at the time which the letter would be delivered in the ordinary course of post.

Authentication of documents, proceedings and contracts

Section 21 provides that a document or proceeding requiring authentication by a company or contracts made by or on behalf of a company may be signed by any key managerial personnel or an officer of the company duly authorized by the Board in this behalf.

Execution of bills of exchange etc.

Section 22 of the Act provides that a bill of exchange, hundi or promissory note shall be deemed to have been made, accepted, drawn or endorsed on behalf of a company, if made, accepted, drawn or endorsed in the name of, or on behalf of or on account of the company by any person acting under its authority, express or implied.

A company may authorize any person either generally or in respect of any specified matters by writing under its common seal, if any, as its attorney to execute other deeds on its behalf in any place either in or outside India. In case the company does not have a common seal, the authorization shall be made by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.

Integrated process for incorporation

Rule 36 Omitted by the Companies (Incorporation) Fifth Amendment Rules, 2016

12.1.5 Registered Office of a Company

Registered Office

Section 12(1) of the Act requires a company to have a registered office of its own for the purpose of receiving and acknowledging all communications and notices addressed to the office. The Registered office shall be opened within 30 days from the date of incorporation of the company.

Verification of registered office

Section 12(2) of the Act provides that the company shall furnish to the Registrar verification of its registered office within a period of 30 days from the date of its incorporation in Form No. INC-22 along with the fee. The following documents, according to Rule 25, of the Companies (Incorporation) Rules, 2014 shall be attached to the form:

- the registered document of the title of the premises of the registered office in the name of thecompany; or
- the notarized copy of lease or rent authorized in the name of the company along with a copy of rent paid receipt not older than one month;
- the authorization from the owner or authorized occupant of the premises along with the proof of ownership or occupancy authorization, to use the premises by the company as its registered office; and
- the proof of evidence of any utility service like telephone, gas, electricity, etc., depicting the address of the premises in the name of the owner or document, as the case may be, which is not older than two months.

Publication of name by company

Section 12(3) of the Act provides that every company shall publish its name in the following matters-

- The company shall paint or affix its name and the address of the Registered office and keep the same painted or affixed on the outside of every office of the company or place in which the company carries on its business, in a conspicuous position and in legible letters;
- The language of the words shall be of any language but one language shall be of the local language of the that place;
- The company shall have its name engraved in legible characters on its seal, if any (since company seal is not mandatory as under the Companies Act, 1956 and now it is made optional);
- The company shall get its name, address of its registered office, Corporate Identity Number, telephone number, fax number, e-mail id and website addresses printed etc., in all its business letters, invoices, notices etc., and in other official communications;
- The company shall have its name printed on hundis, promissory notes, bills of exchange and such other documents as may be prescribed.

The words 'One Person Company' shall be mentioned in brackets below the name of such company, wherever the name is printed or affixed or engraved.

Change of name of company

The first proviso to Section 12 provides that where a company has changed its name or names during the last two years, it shall paint or affix or print along with the name, the former name or names so changed during the last two years.

Change of situation of the registered office

Section 12(4) provides that the notice of every change of the situation of the registered office, after the date of incorporation, shall be given to the Registrar within 15 days of the change. The Registrar shall record the same. The notice of change of situation of the registered office shall be filed in the Form No. INC-22 along with fee and the required documents.

The company may change its registered from one place to another place within the jurisdiction of the same Registrar or from one place coming under the jurisdiction of the Registrar to the place coming under the jurisdiction of another Registrar or from one State to another State.

Shifting of registered office within the same State

Rule 28 prescribes the procedure for shifting of the registered office within the same State. An application in Form No. INC 23 along with the fee is filed with the Regional Director for seeking confirmation for shifting the registered office within the same State from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies.

The application shall be filed along with the following documents,-

a) Board Resolution for shifting of registered office;

b) Special Resolution of the members of the company approving the shifting of registered office;

c) a declaration given by the Key Managerial Personnel or any two directors authorised by the Board, that the company has not defaulted in payment of dues to its workmen and has either the consent of its creditors for the proposed shifting or has made necessary provision for the payment thereof ;

d) a declaration not to seek change in the jurisdiction of the Court where cases for prosecution are pending;

e) acknowledged copy of intimation to the Chief Secretary of the state as to the proposed shifting and that the employees interest is not adversely affected consequent to proposed shifting.

Section 12(6) provides that the Regional Director shall communicate his confirmation to the company within 30 days of the receipt of the application. The company shall file the confirmation given by the Regional Director with the Registrar of Companies within 60 days. The Registrar shall certify the same within 30 days from the date of filing confirmation of Regional Director by the company.

The certificate issued by the Registrar of Company is the conclusive evidence that all the requirements of the Act with respect to change of the registered office have been complied with and the change shall take effect from the date of the certificate.

The shifting of the registered office shall not be allowed if any inquiry, inspection or investigation has been initiated against the company or any prosecution is pending against the company under the Act.

Shifting of registered office from one State or Union Territory to another State

Rule 30 provides the procedure for shifting of registered office of a company from one State or Union Territory to another State, as under.

1. An application for the purpose of seeking approval for alteration of memorandum with regard to the change of place of the registered office from one State Government or Union territory to another, shall be filed with the Central Government in Form No. lNC.23 along with the fee and shall be accompanied by the following documents, namely:-

a) a copy of Memorandum of Association, with proposed alterations;

b) a copy of the minutes of the general meeting at which the resolution authorising such alteration was passed, giving details of the number of votes cast in favour or against the resolution;

c) a copy of Board Resolution or Power of Attorney or the executed vakalatnama, as the case may be.

2. There shall be attached to the application, a list of creditors and debenture holders, drawn up to the latest practicable date preceding the date of filing of application by not more than one month, setting forth the following details, namely:-

a) the names and address of every creditor and debenture holder of the company;

b) the nature and respective amounts due to them in respect of debts, claims or liabilities

Provided that the list of creditors and debenture holders, accompanied by declaration signed by the Company Secretary of the company, if any, and not less than two directors of the company, one of whom shall be a managing director, where there is one, stating that

i) they have made a full enquiry into the affairs of the company and, having done so, have concluded that the list of creditors is correct, and that the estimated value as given in the list of the debts or claims payable on a contingency or not ascertained are proper estimates of the values of such debts and claims and that there are no other debts of or claims against the company to their knowledge, and

ii) no employee shall be retrenched as a consequence of shifting of the registered office from one state to another state and also there shall be an application filed by the company to the Chief Secretary of the concerned State Government or the Union territory.

3. A duly authenticated copy of the list of creditors shall be kept at the registered office of the company and any person desirous of inspecting the same may, at any time during the ordinary hours of business, inspect and take extracts from the same on payment of a sum not exceeding ten rupees per page to the company.

4. There shall also be attached to the application a copy of the acknowledgment of service of a copy of the application with complete annexures to the Registrar and Chief Secretary of the State Government or Union territory where the registered office is situated at the time of filing the application.

5. The company shall, not more than thirty days before the date of filing the application in Form No. INC.23-

a) advertise in the Form No. INC.26 in the vernacular newspaper in the principal vernacular language in the district and in English language in an English newspaper with the widest circulation in the State in which the registered office of the company is situated:

Provided that a copy of advertisement shall be served on the Central Government immediately on its publication.

b) serve, by registered post with acknowledgement due, individual notice, to the effect set out in clause (a) on each debenture-holder and creditor of the company; and

c) serve, by registered post with acknowledgement due, a notice together with the copy of the application to the Registrar and to the Securities and Exchange Board of India, in the case of listed companies and to the regulatory body, if the company is regulated under any special Act or law for the time being in force.

6. There shall be attached to the application a duly authenticated copy of the advertisement and notices issued under sub-rule (5), a copy each of the objection received by the applicant, and tabulated details of responses along with the counter response from the company received either in the electronic mode or in physical

mode in response to the advertisements and notices issued under sub-rule (5).

7. Where no objection has been received from any person in response to the advertisement or notice under sub-rule (5) or otherwise, the application may be put up for orders without hearing and the order either approving or rejecting the application shall be passed within fifteen days of the receipt of the application.
8. Where an objection has been received,
   i) the Central Government shall hold a hearing or hearings, as required and direct the company to file an affidavit to record the consensus reached at the hearing, upon executing which, the Central Government shall pass an order approving the shifting, within sixty days of filing the application.
   ii) where no consensus is reached at the hearings the company shall file an affidavit specifying the manner in which objection is to be resolved within a definite time frame, duly reserving the original jurisdiction to the objector for pursuing its legal remedies, even after the registered office

   is shifted, upon execution of which the Central Government shall pass an order confirming or rejecting the alteration within sixty days of the filing of application.
9. The order passed by the Central Government confirming the alteration may be on such terms and conditions, if any, as it thinks fit, and may include such order as to costs as it thinks proper:

   Provided that the shifting of registered office shall not be allowed if any inquiry, inspection or investigation has been initiated against the company or any prosecution is pending against the company under the Act.
10. On completion of such inquiry, inspection or investigation as a consequence of which no prosecution is envisaged or no prosecution is pending, shifting of registered office shall be allowed.

Rules 31 provides that the certified copy of the order of the Central Government, approving the alteration of memorandum for transfer of registered office of the company from one State to another State, shall be filed in Form No. INC – 28 along with the fee as with the Registrar of State within 30 days from the date of receipt of certified copy of the order.

Punishment

Section 12(8) provides that if there is any default is made in complying with the requirements of Section 12, the company and every officer who is in default shall be liable to a penalty of ₹ 1,000 for every day during which the default continues but not exceeding ₹ 1 lakh.

12.1.6 Public Offer

Issue of securities by a public company

Section 23(1) provides that a public company may issue securities-

- to public through prospectus by complying with the provisions of Part I of Chapter III of this Act;
- through private placement by complying with the provisions of Part II of Chapter III of this Act;
- through a rights issue or a bonus issue in accordance with the provisions of this Act and in case of listed company or a company which intends to get its securities listed also with the provisions of the SEBI Act, 1992 and the rules and regulations made there under.

Section 23(2) lays down that a private company may issue securities—

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

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

As per explanation to section 23, for the purposes of Chapter III, "public offer" includes initial public offer or

further public offer of securities to the public by a company, or an offer for sale of securities to the public by an existing shareholder, through issue of a prospectus

12.1.7 Prospectus

Section 26 of the Act provides the matters to be stated in a prospectus. Every prospectus issued by or on behalf of a public company shall be dated and signed and shall state such information and set out such reports on financial information as may be specified by the Securities and Exchange Board in consultation with the Central Government:

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

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

No prospectus shall be issued by or on behalf of a company or in relation to an intended company unless on or before the date of its publication, there has been delivered to the Registrar for registration, a copy thereof signed by every person who is named therein as a director or proposed director of the company or by his duly authorised attorney.

No prospectus shall be valid if it is issued more than ninety days after the date on which a copy thereof is delivered to the Registrar.

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

Variation in terms of contract or objects in prospectus

Section 27 of the Act provides that a company shall not, at any time, vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued except subject to the approval of or except subject to an authority given by the company in general meeting by way of special resolution through the postal ballot. The notice of the proposed special resolution, according to Rule 7(1), shall contain the following particulars:

- the original purpose or object of the issue;
- the total money raised the money utilized for the objects of the company stated in the prospectus;
- the extent of achievement of proposed objects;
- the unutilized amount of the money so raised through prospectus;
- the particulars of the proposed variation in terms of contracts referred to in the prospectus or objects for which prospectus was issued;
- the reason and justification for seeking variation;
- the proposed time limit within which the proposed varied objects would be achieved;

- the clause-wise details as specified in Rule 3(3) as was required with respect to the originally proposed objects of the issue;
- the risk factors pertaining to the new objects; and
- the other relevant information which is necessary for the members to take an informed decision on the proposed resolution.

The advertisement of the notice for getting the resolution passed for varying the terms of any contract referred to in the prospectus or altering the objects shall be in Form No. PAS-1. Such advertisement shall be published simultaneously with dispatch of postal ballot notices to shareholders. The notice shall also be placed on the website of the company, if any.

Restriction

The company shall not use any amount raised through the issue of prospectus for buying, trading or otherwise dealing in equity shares of any other listed company.

Dissenting shareholders

The dissenting shareholders who have not agreed to the proposed to vary the terms of contracts or objects, shall be given an exit offer by promoters or controlling shareholders at such exit price and in such manner and conditions as may be specified by SEBI by making regulations in this behalf.

Offer of sale of shares

Section 28 provides that certain members may offer whole or part of their holding of shares to the public, in consultation with the Board of Directors. Any such offer of sale to the public shall be deemed to be prospectus issued by the company. All laws and rules applicable to the prospectus are applicable to this offer, except for the following-

- the provisions relating to minimum subscription;
- the provisions for minimum application value;
- the provisions requiring any statement to be made by the Board of directors in respect of the utilization of money; and
- any other provision or information which cannot be compiled or gathered by the offeror, with detailed justifications for not being able to comply with such provisions.

The prospectus so issued shall disclose the name of the person or persons or entity bearing the cost of making the offer of sale along with reasons.

Dematerialized shares

As per Section 29, every company making public offer; and such other class or classes of public companies as may be prescribed,shall issue the securities only in dematerialised form by complying with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

The promoters of every public company making a public offer of any convertible securities may hold such securities only in dematerialized form. The entire holding of convertible securities of the company by the promoter held in physical form up to the date of the initial public offer shall be converted into dematerialized form before such offer is made and thereafter such promoter shareholding shall be held in dematerialized form only. From December, 2018, MCA has ordered that no transfer of shares, even in case of unlisted shares can be effected other than dematerialised mode.

Advertisement for prospectus

Section 30 provides when an advertisement of any prospectus of a company is published in any manner, it shall be necessary to specify therein the content of its memorandum as regards the objects, the liability of members and the amount of share capital of the company and the names of the signatories to the memorandum and the number of shares subscribed for by them and its capital structure.

Shelf prospectus

The explanation to section 31 defines the term 'shelf prospectuses, 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.

Any class or classes of companies as the SEBI may provide by regulations in this behalf, may file a shelf prospectus with the Registrar at the first time 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 during the period of validity of that prospectus, no further prospectus is required.

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

Where a company or any other person has received applications for allotment of securities along with the advanced payments of subscription before the making of any such change, the company or other person shall intimate the changes to such applicants. If they express a desire to withdraw their application, the company or other person, shall refund all the monies received as subscription within 15 days.

Where an information memorandum is filed, every time an offer of securities is made as aforesaid, such memorandum together with the shelf prospectus shall be deemed to be a prospectus.

Red herring prospectus

The Explanation to Section 32 defines the term 'red herring prospectus' as a prospectus which does not include complete particulars of the quantum or price of the securities included therein.

Section 32 provides that a company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus. The same shall be filed with the Registrar at least three day prior to the opening of the subscription list and the offer. It 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.

At the time of closing of the offer, the prospectus stating the total capital raised, whether by way of debt or share capital and the closing price of the securities and any other detail as are not included in the red herring prospectus shall be filed with the Registrar and the SEBI.

Application form

Section 33(1) provides that no form of application for the purchase of any of the securities of a company shall be issued unless such form is accompanied by an abridged prospectus:

Provided that nothing in this sub-section shall apply if it is shown that the form of application was issued—

a) in connection with a *bona fide* invitation to a person to enter into an underwriting agreement with respect to such securities; or

b) in relation to securities which were not offered to the public.

Section 33(2) provides that a copy of the prospectus shall, on a request being made by any person before the closing of the subscription list and the offer, be furnished to him.

Section 33(3) provides that if a company makes any default in complying with the provisions of this section, it shall be liable to a penalty of ₹ 50,000 for each default.

Liability for mis-statement

If there is any mis-statement in the prospectus, then it would attract the liability on the issuer. The liability may be civil or criminal. Section 34 provides for criminal liability and section 35 provides for civil liability.

Section 34 provides that where a prospectus includes any untrue statement 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 authorize the issue of such prospectus shall be liable under Section 447. The criminal liability will not arise 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 the issue of prospectus believe, that the statement was true or the inclusion or omission was necessary.

Section 35 provides that where a person has subscribed for securities of a company based on the mis- statement in the prospectus and he has sustained any loss or damage as a consequence thereof, the company and every person who-

- is a director of the company at the time of the issue of the prospectus;
- has authorized himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;
- is a promoter of the company;
- ha authorized the issue of the prospectus; and
- is an expert,

shall be liable to pay compensation to every person who has sustained such loss or damage. This liability is without prejudice to any punishment to which any person may be liable under Section 36.

No person shall be liable if he proves-

- that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or
- 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.
- that, as regards every misleading statement purported to be made by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from, the report or valuation; and he had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it and that the said person had given the consent to the issue of the prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration or, to the defendant's knowledge, before allotment thereunder.

Section 35(3) provide that it if it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or any fraudulent purpose, every person as referred above shall be personally responsible without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.

Punishment for fraudulently including persons to invest money

Section 36 provides that any person, who either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading or deliberately conceals any material fact, to include another person to enter into, or to offer to enter into-

- any agreement for, or with a view to acquiring, disposing of, subscribing for, or underwriting securities; or
- any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or
- any agreement for, or with a view to obtaining credit facilities from any bank of financial institution shall be liable for action under Section 447.

Remedy

Section 37 provides that a suit may be filed or any other action may be taken under Section 34 or section 35 or section 36 by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.

Punishment for personating

Section 38(1) provides that any person who-

- makes or abets making of an application in a fictitious name to a company for acquiring or subscribing for its securities; or
- makes or abets making of multiple applications to a company in different names or in different combinations of his name or surname for acquiring or subscribing for its securities; or
- otherwise induces directly or indirectly a company to allot, or register any transfer of securities to him, or to any other person in a fictitious name,

shall be liable for action under Section 447.

The provisions of Section 38(1) shall be prominently reproduced in every prospectus issued by a company and in every form of application for securities.

Where a person has been convicted under this section, the Court may also order disgorgement of gain, if any, made by and seizure and disposal of the securities in possession of, such person. The amount received through disgorgement or disposal of securities shall be credited to the Investor Education and Protection Fund.

12.1.8 Allotment of Securities

Section 39 provides that allotment of securities can be done only if the amount stated in the prospectus as the minimum amount has been subscribed and the sums payable on application for the amount so stated have been paid to and received by the company by cheque or other instrument.

The amount payable on the application on every security shall not be less than 5% of the nominal value of the security or such other percentage or amount, as may be prescribed by SEBI, by making regulations in this behalf.

Refund of application money

If the stated minimum amount has not been subscribed and the sum payable on application is not received within period of 30 days from the date of issue of the prospectus or such period as may be specified by SEBI,

the amount received shall be returned within 15 days from the closure of the issue. If any such money is not paid within such period, the directors of the company who are officers in default shall jointly and severally be liable to repay that money with interest at the rate of 15% per annum. The application money to be refunded shall be credited only to the bank account from which the subscription was remitted.

Any default is made in filing refund of money, the company and every officer, who is in default shall be liable to a penalty, for each default, of ₹ 1,000 for each day during such default continues or ₹ 1 lakh, whichever is less.

Return of Allotment

Section 39(4) provides that whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a return of allotment within 30 days in Form No. PAS-3 along with the fee. A list of allottees stating their names, address, occupation, if any, and number of securities allotted to each of the allottees in Form No.-PAS-3 shall be attached along with the return. The said list shall be certified by the signatory of the said form as being complete and correct as per the records of the company.

Along with the return the following may be attached, as applicable to the company-

- if the securities are allotted for consideration other than cash, a copy of the contract, duly stamped, pursuant to which the securities have been allotted together with contract of sale if relating to a property or an asset, or a contract for services or other consideration;
- if the above said contract is not in written form, the company shall furnish complete particulars of the contract stamped with the same stamp duty as would have been payable if the contract had been reduced to writing and those particulars shall be deemed to be an instrument within the meaning of the Indian Stamp Act, 1899 and the Registrar may, as a condition of filing the particulars, require that the stamp duty payable thereon be adjudicated under Section 31 of the Indian Stamps Act, 1899;
- a report of a registered valuer in respect of valuation of the consideration shall also be attached along with the contract mentioned above;
- in case of bonus shares a copy of the resolution passed in the general meeting authorizing the issue of such shares shall be attached;
- in the case the shares have been issued in pursuance of Section 62 (1)(c) by a company other than a listed company whose equity shares or convertible preference shares are listed on any recognized stock exchange, the valuation report of the registered valuer shall be attached;

Any default is made in filing return of allotment, the company and every officer, who is in default shall be liable to a penalty, for each default, of ₹ 1,000 for each day during such default continues or ₹ 1 lakh, whichever is less.

12.1.9 Payment of Commission

Section 40(6) provides that a company may pay commission to any person in connection with the subscription to its securities subject to such conditions as may be prescribed in the Rules.

Rule 13 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 following conditions:

- the payment of such commission shall be authorized in the company's articles of association;
- the commission may be paid out of proceeds of the issue or the profit of the company or both;

- the rate of commission paid or agreed to be paid shall not exceed, in case of shares, 5% of the price at which the shares are issued or a rate authorized by the articles, whichever is less, and in the case of debentures, shall not exceed 2.5% of the price at which the debentures are issued, or as specified in company's articles, whichever is less;
- the prospectus of the company shall disclose the name of the underwriters, the rate and amount of the commission payable to the underwriter and the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally;
- commission shall not be paid to any underwriter on securities which are not offered to the public for subscription;
- 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.

12.1.10 Securities to be dealt with in stock exchanges

Section 40(1) provides that every company making public offer shall, before making such offer, make an application to one or more recognized stock exchange(s) and obtain permission for the securities to be dealt with in such stock exchange(s). The prospectus shall state the name or names of the stock exchange in which the securities shall be dealt with.

12.1.11 Application money to be deposited in bank

Section 40(3) provides that all monies received on application from the public for subscription to the securities shall be kept in a separate bank account in a schedule bank. The said money shall not be utilized for any purpose other than-

- for adjustment against allotment of securities where the securities have been permitted to be dealt with in the stock exchange(s) specified in the prospectus;
- for the repayment of monies within the time specified by SEBI received from the applicants in pursuance of the prospectus, where the company is for any other reason unable to allot securities.

Void condition

Section 40(4) provides that any condition purporting to require or bind any applicant for securities to waive compliance with any of the requirements of Section 40 is void.

Penalty

Section 40(5) provides that if a default is made in complying with the provisions of Section 40, the company shall be punishable with a fine which shall not be less than ₹5 lakhs but which may extend to ₹50 lakh. 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 ₹50,000 but which may extend to ₹3 lakhs or with both.

12.1.12 Private Placement

Private placement means any offer or invitation to subscribe or issue of securities to a select group of persons by a company (other than by way of public offer) through private placement offer-cum- application, which satisfies the conditions specified in Section 42.

Section 42(1) provides that a company may, subject to the provisions of this section, make a private placement of securities.

Section 42(2) provides that a private placement shall be made only to a select group of persons who have been identified by the Board (herein referred to as "identified persons"), whose number shall not exceed fifty or such

higher number as may be prescribed.

Section 42(3) provides that a company making private placement shall issue private placement offer and application in such form and manner as may be prescribed to identified persons, whose names and addresses are recorded by the company in such manner as may be prescribed.

Section 42(4) provides that every identified person willing to subscribe to the private placement issue shall apply in the private placement and application issued to such person along with subscription money paid either by cheque or demand draft or other banking channel and not by cash:

*Provided that a company shall not utilise monies raised through private placement unless allotment is made and the return of allotment is filed with the Registrar.

Section 42(5) provides that no fresh offer or invitation under this section shall be made unless the allotments with respect to any offer or invitation made earlier have been completed or that offer or invitation has been withdrawn or abandoned by the company.

Section 42(6) provides that a company making an offer or invitation under this section shall allot its securities within 60 days from the date of receipt of the application money for such securities and if the company is not able to allot the securities within that period, it shall repay the application money to the subscribers within 15 days from the expiry of 60 days and if the company fails to repay the application money within the aforesaid period, it shall be liable to repay that money with interest at the rate of 12% per annum from the expiry of the 16 day provided that monies received on application under this section shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than—

a) for adjustment against allotment of securities; or

b) for the repayment of monies where the company is unable to allot securities.

Section 42(7) provides that no company issuing securities under this section shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an issue.

Section 42(8) provides that a company making any allotment of securities under this section, shall file with the Registrar a return of allotment within 15 days from the date of the allotment in such manner as may be prescribed, including a complete list of all allottees, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed.

Section 42(9) provides that if a company defaults in filing the return of allotment within the period prescribed under sub-section (8), the company, its promoters and directors shall be liable to a penalty for each default of one thousand rupees for each day during which such default continues but not exceeding ₹25 lakh.

Section 42(10) provides that if a company makes an offer or accepts monies in contravention of this section, the company, its promoters and directors shall be liable for a penalty which may extend to the amount raised through the private placement or ₹2 crores, whichever is lower, and the company shall also refund all monies with interest as specified in sub-section (6) to subscribers within a period of 30 days of the order imposing the penalty.

Rule 14(1) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 provides that for the purposes of sub-section (2) and sub-section (3) of section 42, a company shall not make an offer or invitation. to subscribe to securities through private placement unless the proposal has been previously approved by the shareholders of the company, by a special resolution. for each of the offers or invitations:

Provided that in the explanatory statement annexed to the notice for shareholders' approval, the following disclosure shall be made:-

a) particulars of the offer including date of passing of Board resolution;

b) kinds of securities offered and the price at which security is being offered;

c) basis or justification for the price (including premium, if any) at which the offer or invitation is being made;

d) name and address of valuer who performed valuation;

e) amount which the company intends to raise by way of such securities;

f) material terms of raising such securities, proposed time schedule, purposes or objects of offer, contribution being made by the promoters or directors either as part of the offer or separately in furtherance of objects; principle terms of assets charged as securities.

Rule 14(2) provides that for the purpose of sub-section (2) of section 42, an offer or invitation to subscribe securities under private placement shall not be made to persons more than two hundred in the aggregate in a financial year.

Rule14 (3) provides that a private placement offer cum application letter shall be in the form of an application in [1][Form PAS-4] serially numbered and addressed specifically to the person to whom the offer is made and shall be sent to him, either in writing or in electronic mode, within thirty days of recording the name of such person pursuant to sub-section (3) of section 42.

Rule 14(4) provides that the company shall maintain a complete record of private placement offers in Form PAS-S.

Rule 14(6) provides that a return of allotment of securities under section 42 shall be filed with the Registrar within fifteen days of allotment in Form PAS-3 and with the fee along with a complete list of all the allottees.

12.1.13 Share Capital

12.1.13.1 Share

Section 2(84) defines the term 'share' as a share in the share capital of a company and includes stock. Section 44 provides that the shares in a company shall be movable property transferable in the manner prescribed by the articles of the company.

Publication of authorized, subscribed and paid up capital

Section 60(1) provides that where any notice, advertisement or other official publication, any business letter, billhead or letter paper of a company contains a statement of the amount of the authorized capital of the company, such notice, advertisement or other official publication, or such letter, billhead or letter paper shall also contain a statement in an equally prominent position and in equally conspicuous characters, of the amount of capital which has been subscribed and the amount paid up.

Section 60(2) provides that if any default is made in complying with the requirements of Section 60(1), the company shall be liable to pay a penalty of ₹10,000. Every officer of the company who is in default shall be liable to pay a penalty of ₹1,000 for each such default.

Kinds of share capital

Section 43 provides that the share capital of a company limited by shares shall be of two kinds namely-

- Equity share capital; and
- Preference share capital.

Equity share capital

The expression 'equity share capital' is defined by Explanation (I) to Section 43(b) with reference to any company limited by shares as all share capital which is not preference share capital. Equity share capital is of two types:

- With voting rights; or
- With differential rights as to dividend, voting.

Equity shares with differential rights

Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014, provides that no company limited by shares shall issue equity shares with differential rights as to dividend, voting or otherwise, unless it complies with the following conditions:

- the articles of association of the company authorizes the issue of shares with differential rights;
- the issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders;
- where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through the postal ballot;
- the shares with differential rights shall not exceed 26% of the total post issue paid up share capital including equity shares with differential rights issued at any point of time;
- the company having consistent track record of distributable profits for the last three years;
- the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;
- the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;
- the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;

  Provided that a company may issue equity shares with differential rights upon the expiry of five years from the end of the financial year in which such default was made good.
- the company has not been penalized by Court or Tribunal during the last three years of any offence under the RBI Act, 1934, SEBI Act, 1992, the Securities Contract Regulation Act, 1956, the FEMA, 1999 or any other special Act, under which such companies being regulated by sectoral regulators.

Explanatory Statement

Rule 4(2) provides that the explanatory statement to be annexed to the notice of the general meeting in pursuance of Section 102 or of a postal ballot in pursuance of Section 110 shall contain the following particulars:

- the total number of shares to be issued with differential rights;
- the details of differential rights;
- the percentage of shares with differential rights to the total post issue paid up equity share capital including equity shares with differential rights issued at any point of time;

- the reasons or justification of the issue;
- the price at which such shares are proposed to be issued either at par or at premium;
- the basis on which the price has been arrived at;
- in case of private placement or preferential issue-
  - details of total number of shares proposed to be allotted to promoters, directors and key managerial personnel;
  - details of total number of shares proposed to be allotted to persons other than promoters, directors and key managerial personnel and their relationship if any with any promoter, director or key managerial personnel;
- in case of public issue – reservation, if any, for different classes of applicants including promoters, directors or key managerial personnel
- the percentage of voting right which the equity share capital with differential voting right shall carry to the total voting right of the aggregate equity share capital;
- the scale or proportion in which the voting rights of such class or type of shares shall vary;
- the change in control, if any, in the company that may occur consequent to the issue of equity shares with differential voting rights;
- the diluted Earnings per Share pursuant to the issue of such shares, calculated in accordance with the applicable accounting standards;
- the pre and post issue shareholding pattern along with the voting rights as per clause 35 of the listing agreement issued by SEBI from time to time.

Conversion

The company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and vice-versa.

Disclosure in the Board's report

Rule 4(4) provides that the Board of Directors shall disclose in the Board's Report for the financial year in which the issue of equity shares with differential rights was completed, the following details:

- the total number of shares allotted with differential rights;
- the details of the differential rights relating to voting rights and dividends;
- the percentage of the shares with differential rights to the total post issue equity share capital with differential rights issued at any point of time and percentage of voting rights which the equity share capital with differential voting right shall carry to the total voting right of the aggregate equity share capital;
- the price at which such shares have been issued;
- the particulars of promoters, directors or key managerial personnel to whom such shares are issued;
- the change in control, if any, in the company consequent to the issue of equity shares with differential voting rights;
- the diluted Earnings Per Share pursuance to the issue of each class of shares, calculated in accordance with applicable accounting standards;
- the pre and post issue shareholding pattern along with voting rights in the format specified.

Privileges

The holders of equity shares with differential rights shall enjoy all the other rights such as bonus shares, rights shares etc., which the holders of equity shares are entitled to, subject, the differential rights with such shares have been issued.

Register of members

Rule 4(6) provides that where a company issues shares with differential rights, the Register of Members maintained under Section 88 shall contain all the relevant particulars of the shares so issued along with details of shareholders.

Certificate of shares

Rule 5(1) provides that where a company issues any share capital, no certificate of any share or shares held in the company shall be issued, except-

- in pursuance of a resolution by the Board; and
- on surrender to the company of the letter of allotment or fractional coupons of requisite value, save in cases of issues against letters of acceptance or of renunciation, or in cases of issue of bonus shares;
- if the letter of allotment is lost or destroyed, the Board may impose such reasonable terms, if any, as to seek supporting evidence and indemnity and the payment of out-of-pocket expenses incurred by the company in investigating evidence, as it may think fit.

Section 45 of the Act provides that every share in a company having a share capital shall be distinguished by its distinctive number. If the shares are in the dematerialized form this numbering is not there.

Section 46(1) provides that a certificate issued under the common seal, if any, of the company or signed by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary, specifying the shares held by any person, shall be the prima facie evidence of title of the person of such shares.

In case a company does not have a common seal, the share certificate shall be signed by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.

A director shall be deemed to have signed the share certificate if his signature is printed thereon as a facsimile signature by means of any machine, equipment or other mechanical means such as engraving in metal or lithography, or digitally signed, but not by means of a rubber stamp, provided the director shall be personally responsible for permitting the affixation o his signature thus and the safe custody of any machine, equipment or other material used for the purpose.

Every certificate of share or shares shall be issued in Form No. SH-1 or as near thereto as possible and specify the name(s) o the person(s) in whose favor the certificate is issued, the shares to which it relates and the amount paid up thereon.

The particulars of every share certificate issued shall be entered in the Register of Members along with the name(s) of person(s) to whom it is issued, indicating the date of issue.

Section 46(4) provides that where a share is held in depository form, the record of the depository is the prima facie evidence of the interest of the beneficial owner.

Issue of renewed share certificate

Rule 6 provides that the certificate of any share(s) shall not be issued either in exchange for those which are sub-divided or consolidated or in replacement of those which are defaced, mutilated, torn or old, decrepit, worn

out or where the pages on the reverse for recording transfers have been duly utilized, unless the certificate in lieu of which it is issued is surrendered to the company.

The company may charge such fees as the Board thinks fit, not exceeding ₹ 50 per certificate issued on splitting or consolidation of share certificate(s) or in replacement of share certificate(s) that are defaced, mutilated, torn or old, decrepit or worn out. In such cases it shall be stated on the face of the share that it is "Issued in lieu of Share Certificate No."

Sub-divided/replaced/on consolidation" and also that no fee shall be payable pursuant to scheme of arrangement sanctioned by the High Court or Central Government.

A company may replace all the existing certificates by new certificates upon sub-division or consolidation of shares or merger or demerger or any reconstitution without requiring old certificates to be surrendered. The details of such nature are to be entered in the Register maintained for this purpose.

Duplicate share

Section 46(2) provides that duplicate certificate of shares may be issued, if such certificate –

- is proved to have been lost or destroyed; or
- has been defaced, mutilated or torn and is surrendered to the company.

The duplicate share certificate shall not be issued in lieu of those that are lost or destroyed, without prior consent of the Board and without payment of such fees as the Board thinks fit, not exceeding ₹ 50 per certificate and on such reasonable terms, such as furnishing supporting evidence and indemnity and the payment of out-of-pocket expenses incurred by the company in investigating the evidence produced.

Where a duplicate certificate is issued, it shall be stated prominently on the face of it and be recorded in the Register maintained for this purpose, "duplicate issued in lieu of share certificate no……..." and the word 'duplicate' shall be stamped or printed prominently on the face of share certificate.

In case of unlisted companies, the duplicate share certificates shall be issued within a period of 3 months and in case of listed companies such certificate shall be issued within 45 days from the date of submission o complete documents with the company respectively.

Punishment

Section 46(5) provides that if a company, with intent to defraud, issues a duplicate certificate of shares, the company shall be punishable with fine which shall not be less than 5 times the face value of the shares involved in the issue of the duplicate certificate but which may extend to 10 times the face value of such shares or ₹ 10 crores whichever is higher. Every officer of the company, who is in default, shall be liable for action under Section 447.

Register of Renewed and Duplicate share certificate

Rule 6(3) provides that the particulars of every share certificate issued shall be entered forthwith in a Register of Renewed and Duplicate Share Certificates maintained in Form No. SH-2. Indicating against the name(s) of the person(s) to whom the certificate is issued, the number and date of issue of the share certificate in lieu of which the new certificate is issued and the necessary changes indicted in the Register of Members by suitable cross reference in the "Remarks" column.

The register shall be kept at the registered office of the company or at such other place where the Register of Members is kept and it shall be preserved permanently and shall be kept in the custody of Company Secretary of the company or any other person authorized by the Board for this purpose.

All entries made in this register shall be authenticated by the Company Secretary or such other person as may be authorized by the Board for the purpose of sealing and signing the share certificate.

Delivery of certificate

Section 56(4) provides that every company shall, unless prohibited by any law or any order of Court, Tribunal or other authority, deliver the certificates of all securities allotted, transferred or transmitted-

- within a period of 2 months from the date of incorporation, in the case of subscribers to memorandum;
- within a period of 2 months from the date of allotment, in the case of any allotment of any of its shares;
- within a period of one month from the date of receipt of the company of the instrument of transfer or of the intimation of transmission, in the case of transfer or transmission of securities;
- within a period of 6 months from the date of allotment in the case of any allotment of debentures.

Issue of sweat equity shares

Section 2(88) defines the expression '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.

For this purpose the term 'employee' means-

- a permanent employee of the company who has been working in India or outside India; or
- a director of the company, whether a whole time director or not; or
- an employee or a director as defined above of a subsidiary, in India or outside India, or of holding company of the company.

The expression 'value additions' means actual or anticipated economic benefits derived or to be derived by the company from an expert or a professional for providing know-how or making available rights in the nature of intellectual property rights, by such person to whom sweat equity is being issued for which the consideration is not paid or included in the normal remuneration payable under the contract of employment, in the case of employee.

Section 54 provides that a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled:

- the issue is authorized by a special resolution passed by the company;
- 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;
- where the equity shares of the company are listed on a recognized stock exchange, the sweat equity shares are issued in accordance with the regulations made by SEBI in this behalf. If they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

Rule 8(1) provides that a company other than a listed company shall not issue sweat equity shares to its directors or employees at a discount or for consideration other than cash, for their providing know-how or making available rights in the nature of intellectual property rights or value additions unless the issue is authorized by a special resolution passed by the company in general meeting.

Explanatory statement

Rule 8(2) provides that the explanatory statement to be annexed to the notice of the general meeting shall contain the following particulars:

- the date of the Board meeting at which the proposal for issue of sweat equity shares was approved;
- the reasons or justification of the issue;

- the class of shares under which sweat equity shares are intended to be issued;
- the total number of shares to be issued;
- the class or classes of directors or employees to whom such sweat equity shares are to be issued;
- the terms and conditions including basis of valuation;
- the time period of association of such person with the company;
- the names of the directors or employees to whom shares will be issued and their relationship with the promoter or/and Key Managerial Personnel;
- the price of the share;
- the consideration including the consideration other than cash, if any to be received for the sweat equity;
- the applicable accounting standards;
- diluted EPS calculated with the applicable accounting standards

The special resolution shall be valid for making the allotment within a period of not more than 12 months from the date of passing of the special resolution. The company shall not issue sweat equity shares for more than 15% of the existing paid up share capital in a year or shares of the issue value of ₹ 5 crores, whichever is higher. The issuance of sweat equity shares shall not exceed 25% of the paid up equity capital o the company at any time. The sweat equity shares shall be locked in for a period of three years from the date of allotment.

A start -up company may issue sweat equity shares not exceeding 50% of its paid up capital upto 5 years from the date of its incorporation or registration.

The Board of Directors shall disclose in the Director's Report for the year in which such shares are issued. The company shall maintain a Register of Sweat Equity Shares in Form No. SH-3 which will be maintained at the registered office of the company or such other place as the Board may be decided. The entries in the register shall be authenticated by the Company Secretary of the company or by any other person authorized by the Board for this purpose.

Section 54(2) provides that 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 and the holders of such shares shall rank *pari passu* with other equity shareholders.

Bonus shares

Section 63 provides for the issue of bonus shares. Section 63(1) provides that a company may issue fully paid up bonus shares to its members out of its-

- free reserves;
- the securities premium account; or
- the capital redemption reserve account.

No bonus shares shall be made by capitalizing reserves created by revaluation of assets.

Section 63(2) provides that no company shall capitalize is profits or reserves for the purpose of issuing fully paid up shares unless-

- it is authorized by its articles;
- it has, on the recommendation of the Board, been authorized in the general meeting of the company;

- it has no defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
- the partly paid up shares, if any outstanding on the date of allotment are made fully paid up;
- it complies with such conditions as may be prescribed;

Section 63(3) provides that the bonus shares shall not be issued in lieu of dividend.

Rule 14 provides that the company which has once announced the decision of the Board recommending a Bonus issue shall not subsequently withdraw the same.

Issue of Employees' stock option

A company, other than listed company shall not offer shares to its employees under a scheme of employee's stock option unless it complies with the following conditions: The issue of Employees Stock Option Scheme has been approved by the shareholders of the company by passing a special resolution;

- The company shall make the following disclosures in the explanatory statement annexed to the notice for passing of the resolution-
  - the total number of stock options to be granted;
  - identification of classes of employees entitled to participate in the Employees Stock Option scheme;
  - the appraisal process for determining the eligibility of employees to the Employees Stock Option Scheme;
  - the requirements of vesting and the period of vesting;
  - the maximum period within which the options shall be vested;
  - the exercise price or the formula for arriving at the same;
  - the lock-in period, if any;
  - the maximum number of options to be granted per employee and in aggregate;
  - the method which the company shall use to value its options;
  - the conditions under which option vested in employees may lapse;
  - the specified time period within which the employee shall exercise the vested options in the events of a proposed termination of employment or resignation of employee; and
  - a statement to the effect that the company shall comply with the applicable accounting standards.

Employee

For the purpose of this rule, the term 'employee' is defined as-

- a permanent employee of the company who has been working in India or outside India; or
- a director of the company, whether a whole time director or not but excluding an independent director; or
- an employee of a subsidiary in India or outside India, or of a holding company of the company

but does not include-

- an employee who is a promoter or a person belonging to the promoter group; or
- a director who either himself or through his relative or through anybody corporate, directly or indirectly, holds more than 10% o the outstanding equity shares of the company.

However, a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

Exercising price

Rule 12 (3) of the Companies (Share Capital and Debenures) Rules, 2014 provides that the companies granting option to its employees pursuance to the Employees Stock option Scheme will have the freedom to determine the exercise price in conformity with the applicable accounting policies, if any.

Special Resolution

Rule 12(4) provides that the approval of shareholders by way of separate resolution shall be obtained by the company in case of-

- grant of option to employees of subsidiary or holding company; or
- grant of option to identified employees, during any one year, equal to or exceeding 1% of the issued capital of the company at the time of grant of option.

Rule 12(5)(a) provides that the company may by special resolution, vary the terms of Employees Stock Option Scheme not yet exercised by the employees provided such variation is not prejudicial to the interest of the option holders. Rule 12(5)(b) provides that the notice for passing special resolution or variation of terms of the scheme shall disclose full of the variation, the rationale therefor, and the details of employees who are beneficiaries of such variation.

Period gap

Rule 12(6)(a) provides that there shall be a minimum period of one year between the grant of options and vesting of option. In case where options are granted by a company under this scheme in lieu of options held by the same person under this scheme in another company, which has merged or amalgamated with the first mentioned company, the period during which the options granted by the merging or amalgamating company were held by him shall be adjusted against the minimum vesting period required under this clause.

Lock in period

Rule 12 (6)(b) provides that the company shall have the freedom to specify the lock-in-period for the shares issued pursuant to exercise of such option.

Other aspects

The employees shall have not the right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to them, till shares are issued on exercise of option.

The amount, if any, payable by the employees at the time of grant of option-

- may be forfeited by the company if the option is not exercised by the employees within the exercise period; or
- the amount may be refunded to the employees if the options are not vested due to non fulfillment of conditions relating to vesting of option as per the Employees Stock Option Scheme;

The options granted shall not be transferable to any other person. The option granted shall not be pledged, hypothecated, mortgaged or otherwise encumbered or alienated in any other manner. No person other than the employees to whom the option is granted shall be entitled to exercise the option. In the event of the death of the employee while in employment, all the options granted to him till such date shall vest in the legal heirs or nominees of the deceased employee.

If the employee suffers a permanent incapacity in employment, all the options granted to him shall vest in him on that day. In case of resignation or termination, all options not vested in the employee on that day shall expire. However, the employee can exercise the option which is vested within the period specified, subject to the terms and conditions under the scheme granting such options as approved by the Board.

Disclosure

Rule 12(9) provides that the Board of Directors, shall, inter alia, disclose in the Directors' Report for the year, the following details of the Employees Stock Option Scheme:

- ptions granted;
- options vested;
- options exercised;
- the total number of shares arising as a result of exercise of option;
- options lapsed;
- the exercise price;
- variation of terms of options;
- money realized by exercise of options;
- total number of options in force;
- employee wise details of options granted to-
  - key managerial personnel;
  - any other employee who receives a grant of options in any one year of option amounting to 5% or more of options granted during that year;
  - identified employees who were granted option, during any one year, equal to or exceeding 1% of the issued capital of the company at the time of grant.

Register

Rule 12(10) provides that the company shall maintain a Register of Employee Stock Options in Form No. SH-6 and shall forthwith enter therein the particulars of options granted. The Register shall be maintained at the registered office of the company or such other place as the Board may decide. The entries in the Register are to be authenticated by the Company Secretary of the Company or by any other person authorized by the Board for this purpose.

Listing Company

Rule 12 (11) provides that where the equity shares of the company are listed on a recognized stock exchange, the Employees Stock Option Scheme shall be issued, in accordance with the regulations made by SEBI.

Voting rights of equity share holders

Section 47(1) provides for voting rights. Every member of a company limited by shares and holding equity share capital shall have a right to vote on every resolution placed before the company. His voting right on a poll shall be in proportion to his share in the paid up equity share capital of the company.

Voting rights of preference share holders

Section 47(2) provides that every member having any preference share has a right to vote only on resolutions placed before the company which directly affects the rights attached to his preference shares and any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital and his voting right on a poll shall be in proportion to his share in the paid up preference share capital of the company.

Where the dividend is not paid to the preference shareholders for a period of 2 years or more, such preference shareholders shall have a right to vote on all the resolutions placed before the company.

Variation of shareholders' rights

Section 48 provides for the variation of shareholders' rights. A company may have different classes of shares. The rights attached to the shares of any class may be varied. The rights may be varied-

- with the consent in writing of the holders of not less than three fourths of the issued shares of that class; or
- by means of a special resolution passed at a separate meeting of the holders of the issued shares of that class.

There shall be a provision in the articles or memorandum of the company with respect to such variation. In the absence of such provision in the articles or memorandum, if such variation is not prohibited by the terms of issue of the shares of that class, then the voting rights may be varied.

Dissent to variation of rights

Section 48 (2) provides that if the holders of not less than 10% of the issued shares of a class did not consent to the variation or vote in favor of the special resolution for the variation, such shareholders may apply to the Tribunal to have the variation cancelled. Such application shall be filed before the

Tribunal within 21 days from the date on which the consent was given or the resolution was passed. Such application may be made on behalf of all the shareholders who dissented by such one or more of their number as they may appoint in writing for the purpose. If an application is made before the Tribunal the variation shall not be effected until it is confirmed by the Tribunal.

Section 48 (3) provides that the decision of the Tribunal shall be binding on the shareholders. The company shall file a copy of the order of the Tribunal with the Registrar of the Company within 30 days from the date of the order.

Penalty

Section 48(5) provides that where any default is made in complying with the provisions of Section 48, the company shall be punishable with fine which shall not be less than ₹25,000 but which may extend to ₹5 lakh. Every officer of the company, who is in default shall be punishable with imprisonment for a term which may extend to 6 months or with fine which shall not be less than ₹25,000 but which may extend to ₹5 lakhs, or with both.

Instrument of transfer

Rule 11(1) of the Companies (Share Capital and Debentures) Rules, 2014 provides that an instrument of transfer of securities, in physical form, shall be filed in Form No. SH-4. Every instrument of transfer with the date of its execution specified thereon shall be delivered to the company within 60 days from the date of such execution.

Rule 11(2) provides that in the case of a company not having share capital, provisions of sub rule (1) shall apply

as if the references therein to securities were references instead to the interest of the member of the company.

Rule 11(3) provides that a company shall not register a transfer of partly paid shares, unless the company has given a notice in Form No. SH -5 to the transferee and the transferee gives no objection to the transfer within 2 weeks from the date of receipt of notice.

Provision of money by company for purchase of its own shares by employees or by trustees for the benefit of employees

Rule 16 provides that the company shall not make a provision for money for the purchase of, or subscription for, shares in the company, if the purchase of, or the subscription for, the shares by trustees is for the shares to be held by or for the benefit of the employees of the companies, unless it complies with the specified conditions.

Preferential Offer

The expression 'preferential offer' means an issue of shares or other securities, by a company to any select person or group of persons on a preferential basis and does not include shares or other securities offered through a public issue, rights issue, employee stock option scheme, employee stock purchase scheme or an issue of sweat equity share or bonus shares or depository receipts issued in a country outside India or foreign securities.

Where the preferential offer of shares or other securities is made by a listed company, then such issue shall be done in accordance with the provisions of the Act and regulations made by SEBI. If the company is an unlisted company then it can be made subject to the compliance of the requirements as specified.

Alteration of share capital

Section 61 provides that a limited company having a share capital may, if so authorized by its articles alter its memorandum in its general meeting to –

- increase its authorized share capital by such amount as it thinks expedient;
- consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares. No consolidation and division which results in change in the voting percentage of the shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner;
- convert all or any of is fully paid up shares into stock and reconvert that stock into fully paid up shares of any denomination;
- sub division of shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived;
- cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

The cancellation of shares shall not be deemed to be a reduction of share capital.

Notice for alteration of capital

Section 64(1) provides that where-

- a company alters its share capital;
- an order made by the Government has the effect of increasing authorized capital of a company; or

- a company redeems any redeemable preference shares, the company shall file a notice in Form No. SH-7 along with fee, with the Registrar within a period of 30 days of such alteration or increase or redemption, along with an altered memorandum.

If a company and any officer, who is in default, contravene the provisions of Section 64(1) it or he shall be punishable with fine which may extend to ₹1,000 for each day during which such default continues, or ₹5 lakhs, whichever is less.

Reduction of share capital

Section 66 (1) provides that a company limited by shares or limited by guarantee and having a share capital may, by a special resolution, reduce the share capital and may-

- extinguish or reduce the liability on any of its shares in respect of the share capital not paid up; or
- either with or without extinguishing or reducing liability on any of its shares-
  - cancel any paid up share capital which is lost or is unrepresented by available assets; or
  - pay off any paid up share capital which is in excess of the wants of the company alter its memorandum by reducing the amount of its share capital and of its shares accordingly. This reduction is subject to the confirmation by the Tribunal on application by the company.

No such reduction shall be made if the company is in arrears in the repayment of any deposits accepted by it, either before or after the commencement of the Act or the interest payable thereon.

Procedure before the Tribunal

On the filing of the application by the company for reduction of share capital, the Tribunal shall give notice of every application to the Central Government, Registrar and to SEBI, in the case of listed companies and the creditors of the company. The Tribunal shall take into consideration the representations, if any, made to it by that Government, Registrar, the SEBI and the creditors within a period of three months from the date of receipt of the notice. Where no representation has been received from any of them within the said period, it shall be presumed that they have no objection to the reduction.

The Tribunal may, if it is satisfied that the debt or claim of every creditor of the company has been discharged or determined or has been secured or his consent is obtained, make an order confirming the reduction of share capital on such terms and conditions as it deems fit. No application for reduction of share capital shall be sanctioned by the Tribunal unless the accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards and a certificate to that effect by the company's auditor has been filed with the Tribunal.

The order of confirmation of the reduction of share capital by the Tribunal shall be published by the company in such manner as the Tribunal may direct.

Filing with Registrar

Section 66(5) provides that the company shall deliver a certified copy of the order of the Tribunal and of a minute approved by the Tribunal showing-

- the amount of share capital;
- the number of shares into which it is to be divided;
- the amount of each share; and

- the amount, if any, at the date of registration deemed to be paid up on each share to the Registrar within 30 days of the receipt of the copy of the order, who shall register the same and issue a certificate to that effect.

Liability of the member

Section 66(7) provides that a member of the company, past or present, shall not be liable to any call or contribution in respect of any share held by him exceeding the amount of difference, if any, between the amount paid on the share, or reduced amount, if any, which is to be deemed to have been paid thereon, as the case may be, and the amount of the share as fixed by the order of reduction.

Objection of creditor

Section 66(8) provides that where the name of any creditor entitled to object to reduction of share capital is, by reason of his ignorance of the proceedings for reduction or of their nature and effect with respect to his debt or claim, not entered on the list of creditors, and after such reduction, the company is unable to pay the debt or claim-

- every person, who was a member of the company on the date of registration of the order for reduction by the Registrar, shall be liable to contribute to the payment of that debt or claim, an amount not exceeding the amount which he would have been liable to contribute if the company had commenced winding up on the date immediately before the said date; and
- if the company is wound up, the Tribunal may, on the application of any such creditor and proof of his ignorance as aforesaid, if it thinks fit, settle a list of persons so liable to contribute and make and enforce calls and orders on the contributors settled on the list, as if they were ordinary contributories in a winding up.

This provision does not affect the rights of the contributories among themselves.

Penalty

Section 66(10) provides that if any officer of the company-

- knowingly conceals the name of any creditor entitled to object to the reduction;
- knowingly misrepresents the nature or amount of the debt or claim of any creditor; or
- abets or is privy to any such concealment or misrepresentation as aforesaid, he shall be liable under Section 447.

If a company fails to comply with the directions of the Tribunal to publish its order, it shall be punishable with fine which shall not be less than ₹5 lakh but which may extend to ₹25 lakh.

Further issue of share capital

Section 62 provides for the further issue of share capital. Where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered-

- to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid up share capital on those shares by sending a letter of offer subject to the following condition-
  - the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than 15 days and not exceeding 30 days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;

- unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favor of any other person and the notice shall contain a statement of this right;
- after the expiry of the time or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not disadvantageous to the shareholders and the company

- to employees under a scheme of Employees' stock option, subject to special resolution passed by the company and subject to such conditions as may be prescribed; or
- to any persons, if it is authorized by a special resolution, whether or not those persons include the persons referred above 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.

The notice is to be dispatched through registered post or speed post or through electronic mode to all the existing shareholders at least 3 days before the opening of the issue.

12.1.13.2 Securities Premium Account

Section 52 provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount o the premium received on those shares shall be transferred to a 'Securities Premium Account; and the provisions of this Act relating to reduction share capital of a company, shall, except as provided in this section, shall apply as if the securities premium account were the paid-up share capital of the company.

The securities premium account may be applied by the company-

- towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
- in writing off the preliminary expenses of the company;
- in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
- in providing for the premium payable on the redemption o any redeemable preference shares or of any debentures of the company; or
- for the purchase of its own shares or other securities.

The securities premium account may be applied by such class of companies, as may be prescribed and whose financial statement complies with the accounting standards prescribed-

- in paying up unissued equity shares of the company to be issued to the members of the company as fully paid bonus shares; or
- in writing off the expenses of or the commission paid of discount allowed on any issued of equity shares of the company; or
- for the purchase of its own shares or other securities.

Prohibition on issue of shares at discount

Section 53 provides that except for the issue of sweat equity shares, a company shall not issue shares at a discount. Any share issued by a company at a discounted price shall be void.

However, a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

Section 53(3) provides that where a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than ₹1 lakh but which may extend to ₹5 lakh. Every officer, who is in default, shall be punishable with imprisonment for a term which may extend to 6 months or with fine which shall not be less than ₹1 lakh but which may extend to ₹5 lakhs, or with both.

Transfer and transmission of shares

Section 56 provides that a company may transfer the shares of a person to another person, provided he applies for the same to the company in the prescribed form duly stamped, dated and executed by or on behalf of the transferor and the transferee specifying the name, address and occupation, if any, of the transferee has been delivered to the company by the transferor or transferee within a period of 60 days from the date of execution. The certificate relating to the securities is also to be sent along with the application. If there is no such certificate, then the letter of allotment of securities is to be attached.

Where the instrument of transfer has been lost or the instrument of transfer has not been delivered within the prescribed time, the company may register the transfer on such terms as to indemnity as the Board may think fit. This shall not prejudice the power of the company 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.

Where an application is made by the transferor alone and relates to partly paid shares, the transfer shall not be registered, unless the company gives notice of the application to the transferee and the transferee gives no objection to the transfer, within 2 weeks from the receipt of notice.

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.

Punishment

Section 56(6) provides that where any default is made in complying with the provisions of Section 56 the company shall be punishable with fine which shall not be less than ₹25,000 but which may extend to ₹5 lakhs. Every officer of the company who is in default shall be punishable with fine which shall not be less than ₹10,000 but which may extend to ₹1 lakh.

Where any depository or depository participant, without prejudice to any liability under the Depositories Act, 1996, with an intention to defraud a person, has transferred shares, it shall be liable under Section 447.

Punishment for personation of shareholder

Section 57 provides that if any person deceitfully personates as an owner of any security or interest in a company, or of any share warrant or coupon issued under this Act and thereby obtains or attempts to obtain any security or interest or any such share warrant or coupon, or receives or attempts to receive any money due to any such owner, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to 3 years and with fine which shall not be less than ₹1 lakh but which may be extend to ₹5 lakhs.

Refusal of registration and appeal against refusal

Section 58(1) provides that if a private company limited by shares refuses, whether in pursuance of any power

of the company under its articles or otherwise, to register the transfer of, or the transmission by operation of law of the right to, any securities or interest of a member in the company, it shall within a period of 30 days from the date of receipt of instrument of transfer or the intimation of such transmission send notice of refusal giving reasons for such refusal.

The transferee may appeal to the Tribunal against the refusal within a period of 30 days from the date of receipt of the notice or in case no notice has been sent by the company, within a period of 60 days from the date on which the instrument of transfer or the intimation of transmission, was delivered to the company.

If a public company without sufficient cause, refuses to register the transfer of securities, within a period of 30 days from the date of receipt of the instrument of transfer or the intimation of transmission delivered to the company, the transferee may, within a period of 60 days of such refusal or where no intimation has been received from the company within 90 days of the delivery of the instrument of transfer or intimation of transmission, appeal to the Tribunal.

The Tribunal while dealing with an appeal may, after hearing the parties, either dismiss the appeal or by order-

- direct that the transfer or transmission shall be registered by the company and the company shall comply with such order within a period of 10 days of the receipt of the order; and
- direct rectification of the register and also direct the company to pay damages, if any, sustained by any party, aggrieved.

Punishment

If a person contravenes the order of Tribunal, he shall be punishable with imprisonment for a term which may extend to 3 years and with fine which shall not be less than ₹1 lakh but which may extend to ₹5 lakh.

Rectification of register of members

Section 59(1) provides that if the name of any person is, without sufficient cause, entered in the register of members of a company, or after having been entered in the register is, without sufficient cause, omitted therefrom or if a default is made, or unnecessary delay takes place in entering in the register, the fact of any person having become or ceased to be a member, the person aggrieved, or any member of the company, or the company may appeal in prescribed form to the tribunal, or to a competent court outside India, specified by the Central Government by notification, in respect of foreign members or debenture holders residing outside India, for rectification of the register

Section 59(2) provides that the Tribunal may, after hearing the parties concerned, either dismiss the appeal or direct that the transfer or transmission shall be registered by the company within a period of 10 days of the receipt of the order or direct rectification of the records of the depository or the register and in the latter case, direct the company to pay damages, if any, sustained by the aggrieved party.

Section 59(3) provides that this section shall not restrict the right of a holder of securities to transfer such securities and any person acquiring such securities shall be entitled to voting right unless the voting rights have been suspended by an order of the Tribunal.

Punishment

Section 59(5) provides that if any default is made in complying with the order of the Tribunal the company shall be punishable with fine which shall not be less than ₹1 lakh but which may extend to ₹5 lakh. 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 ₹1 lakh but which may extend to ₹3 lakhs, or with both.

12.1.13.3 Preference share capital

Explanation (ii) to Section 43 defines the expression 'preference share capital' with reference to any company limited by shares, as that part of the issued share capital of the company which carries or would carry a preferential rights with respect to-

- payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income tax; and
- repayment, in the case of winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid up whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company.

Explanation (iii) to Section 43 provides that capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:–

a) that in respect of dividends, in addition to the preferential rights, it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;

b) that in respect of capital, in addition to the preferential right to the repayment, on a winding up, it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

Issue of preference shares

Rule 9 of Companies (Share Capital and Debentures) Rules, 2014, provides that a company having a share capital may, if so authorized by articles, issue preference shares subject to the following conditions:

- the issue should be authorized by passing a special resolution in the general meeting of the company;
- the company, at the time of such issue of preference shares, has no subsisting default in the redemption of preference shares issued earlier either before or after the commencement of this Act or in payment of dividend due on any preference shares.

In the resolution, the company shall set out the following:

- the priority with respect to payment of dividend or repayment of capital vis-à-vis equity shares; the participation in surplus fund;
- the participation in surplus assets and profits, on winding up which may remain after the entire capital has been repaid;
- the payment of dividend on cumulative or non cumulative basis;
- the conversion of preference shares into equity shares;
- the voting rights;
- the redemption of preference shares.

The explanatory statement to be annexed to the notice of the general meeting shall provide the complete material facts concerned with and relevant to the issue of such shares, including-

- the size of the issue and number of preference shares to be issued and nominal value of each share;
- the nature of such shares i.e., cumulative or non-cumulative, participating or non-participating, convertible or non-convertible;

- the objectives of the issue;
- the manner of issue of shares;
- the price at which such shares are proposed to be issued;
- the basis on which the price has been arrived at;
- the terms of issue, including terms and rate of dividend on each share, etc.,
- the terms of redemption, including the tenure of redemption, redemption of shares at premium and if the preference shares are convertible, the terms of conversion;
- the manner and modes of redemption;
- the current shareholding pattern of the company;
- the expected dilution in equity share capital upon conversion of preference shares.

The particulars of the issue of the preference shares shall be noted in the Register of Members. If a company wants to list its preference shares on a recognized stock exchange, it shall issue the preference shares in accordance with the regulations made by SEBI.

Issue and redemption of preference shares

Section 55(1) provides that no company limited by shares shall, after the commencement of this Act, issue any preference shares which irredeemable.

Section 55(2) provides that a company limited by shares may, if so authorized by its articles, issue preference shares which are liable to be redeemed within a period not exceeding 20 years from the date of their issue subject to the terms and conditions prescribed.

Rule 10 states that a company engaged in the setting up and dealing with of infrastructural projects may issue preference shares for a period exceeding twenty years but not exceeding 30 years, subject to the redemption of a minimum 10% of such preference shares per year from the 21st year onwards or earlier, on proportionate basis, at the option of the preference shareholders.

Period of redemption

Rule 9(6) provides that a company may redeem its preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders under Section 48 of the Act. The preference shares may be redeemed-

- at a fixed time or on the happening o a particular event;
- any time at the company's option; or
- any time at the shareholder's option.

Conditions for redemption of Preference Shares

Proviso to Section 55(2) states that

a) no such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption;

b) no such shares shall be redeemed unless they are fully paid;

c) where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve Account, and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the Capital Redemption Reserve Account were paid-up share capital of the company; and

d) i) in case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed. Premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by any such company shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

ii) in a case not falling under sub-clause (i) above, the premium, if any, payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

Further issue of redeemable preference shares

Section 55(3) provides that where a company is not in a position to redeem any preference shares or to pay dividend, if any, on such preference shares in accordance with the terms of the issue, it may, with the consent of the shareholders of three fourths in value of such preference shares and with the approval of the Tribunal on a petition made by it in this behalf, issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed preference share shall be deemed to have been redeemed.

The Tribunal shall, while giving the approval, order the redemption forthwith of preference shares held by such persons who have not consented to the issue of further redeemable preference shares.

Increase of reduction of capital

The issue of further redeemable preference shares or the redemption of preference shares under this section shall not be deemed to be an increase or a reduction, in the share capital of the company.

12.1.14 Buy back of Shares

Section 68(2) provides that a company shall purchase is own shares or other specified securities if-

- the buy-back is authorized by its articles;
- a special resolution has been passed at a general meeting of the company authorizing the buy back. This shall not apply to a case where-
  - the buy-back is, 10% or less of the total paid up equity capital and free reserves of the company; and
  - such buy-back has been authorized by the Board by means of a resolution passed at its meeting.
- the buy-back is 25% or less of the aggregate of paid-up capital and free reserves of the company.
- In respect of the buy-back of equity shares in any financial year, the reference to 25% shall be construed with respect to its total paid-up equity capital in that financial year.
- the ratio of the aggregate of secured and unsecured debts owed by the company after buy- back is not more than twice the paid up capital and free reserves. The Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies;

- all the shares or other specified securities for buy-back are fully paid up;
- the buy-back of shares or other specified securities in a listed company is done in accordance with the regulations made by SEBI; and
- the buy-back in respect of shares or other specified securities of a unlisted company is to be in accordance with the rules as may be prescribed.

Time gap

No offer of buy-back shall be made within a period of 1 year reckoned from the date of closure of the preceding offer of buy back, if any.

Special Resolution

Section 68(3) provides that the notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement stating-

- a full and complete disclosure of all material facts;
- the necessity for buy-back;
- the class of shares or securities intended to be purchased under the buy-back;
- the amount to be invested under the buy-back; and
- the time limit for completion of buy-back.

Buy back by private and unlisted companies

Rule 17 of the Companies (Share Capital and Debentures) Rules, 2014 provides that unless stated otherwise, the explanatory statement annexed to the notice for general meeting, in respect of private companies and unlisted companies for buy-back of their securities, shall contain the following disclosures-

- the date of the board meeting at which the proposal for buy-back was approved by the board of directors of the company;
- the objective of the buy-back;
- the class of shares or other securities intended to be purchased under the buy-back;
- the number of securities that the company proposes to buy-back;
- the method to be adopted for the buy-back;
- the price at which the buy-back of shares or other securities shall be made;
- the basis for arriving at the buy-back price;
- the maximum amount to be paid for the buy-back and the sources of funds from which the buy- back would be financed;
- the time limit for the completion of buy-back;
- the aggregate shareholding of the promoters and of the directors of the promoter, where promoter is a company and of the directors and KMP as on the date of notice convening the general meeting;
- a confirmation that there is no default subsisting in repayment of deposits, interest payment, redemption of debentures or payment of interest or redemption of preference shares or payment of dividend due to any shareholder or any term loans or interest payable to any financial institution or banking company;

- a confirmation that the Board of Directors have made a full enquiry into the affairs and prospects of the company and that they have formed the opinion-
  - there shall be no grounds that the company could be found unable to pay its debts;
  - the company shall able to meet its liabilities as and when they fall due and shall not be rendered insolvent within a period of 1 year from the date an which the general meeting is convened and ;
  - the directors have taken into account the liabilities (including prospective and contingent liabilities), as if the company were being wound up;
- a report addressed to the Board of directors by the company's auditors stating that-
  - they have inquired into the company's state of affairs;
  - the amount of the permissible capital payment for the securities in question is in their view properly determined;
  - that the audited accounts on the basis of which calculation with reference to buy-back is done is not more than six months old from the date of offer documents; Provided that where the audited accounts are more than 6 months old, the calculations with reference to buy back shall be on the basis of un-audited accounts not older than six months from the date of offer document which are subjected to limited review by the auditors of the company and
  - the Board of Directors have formed the opinion on reasonable grounds and that the company, having regard to its state of affairs, shall not be rendered insolvent within a period of 1 year from that date.

12.1.15 Letter of offer

Rule 17(2) provides that the company which has been authorized by a special resolution shall, before the buyback of shares, file with the Registrar of Companies a letter of offer in Form No. SH-8 along with the fee. Such letter of offer shall be dated and signed on behalf of the Board of directors of the company by not less than two directors, one of whom shall be the Managing Director, where there is one.

The letter of offer shall be dispatched to the shareholders or security holders immediately after filing the same with the Registrar of Companies but not later than 20 days from its filing with the Registrar of Companies. Rule 17(5) provides that the offer for buy-back shall remain open for a period of not less than 15 days and not exceeding 30 days from the date of dispatch of offer letter provided that where all members of a company agree, the offer for buy-back may remain open for a period less than 15 days.

Rule 17(6) provides that in case the number of shares or other specified securities offered by the shareholders or security holders is more than the total number of shares or securities to be bought back by the company, the acceptance per shareholder shall be on proportionate basis out of the total shares offered for being bought back.

Verification of offer

Rule 17(7) provides that the company shall complete the verifications of the offer received within 15 days from the date of closure of the offer and the shares or other securities lodged shall be deemed to be accepted unless a communication of rejection is made within 21 days from the date of closure of the offer.

Bank account

Rule 17(8) provides that the company shall immediately after the date of closure of the offer, open a separate bank account and deposit therein, such sum, as would make up the entire sum due and payable as consideration for the shares tendered for buy back in terms of these rules.

Rule 17(9) provides that the company shall within seven days from 21 days from the date of closure of the offer-

- make payment of consideration in cash to those shareholders or security holders whose securities have been accepted; or
- return the share certificates to the shareholders or security holders whose securities have not been accepted at all or the balance of securities in case of part acceptance.

Time limit

Section 68(4) provides that every buy-back shall be completed within a period of one year from the date of passing of the special resolution or the resolution passed by the Board

Source

Section 68(5) provides that the buy-back may be-

- from the existing shareholders or security holders on a proportionate basis;
- from the open market;
- by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

Solvency certificate

Section 68 (6) provides that a listed company before making a buy back, shall file with the Registrar and SEBI, a declaration of solvency in From No. SH-9. This has to be signed by at least two directors of the company, one of whom shall be the Managing Director, if any, and verified by an affidavit to the effect that the Board of Directors of the company has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year from the date of declaration adopted by the Board. An unlisted company is not required to file the declaration of solvency with SEBI.

Destroying physical certificates

Section 68(7) provides that where a company buys back its own shares or other specified securities, it shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy back.

Prohibition

Section 68(8) provides that where a company completes a buy-back of its shares or other specified securities, it shall not make a further issue of the same kind of shares or other securities, including allotment of new shares or other specified securities within a period of 6 months except by way of a bonus share or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

Register

Section 68(9) provides that where a company buys back its shares or other specified securities, it shall maintain a register of the shares so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities

and such other particulars as may be prescribed. The Register shall be in Form No. SH-10. The register shall be maintained at the registered office of the company and shall be kept in the custody of the secretary of the company or any other person authorized by the Board in this behalf. The entries in the register shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose.

Return

Section 68(10) provides that a listed company shall, after the completion of the buy back, file with the Registrar and SEBI a return in Form No. SH-11, along with the fee, containing such particulars relating to the buy back within 30 days of such completion, as may be prescribed. No such return is required to be filed with SEBI by an unlisted company. There shall be annexed to the return filed with the Registrar in Form No. SH-11, a certificate in Form No. SH-15 signed by two directors of the company including the managing director, if any, certifying that the buy-back of securities has been made in compliance with the provisions of this Act and the rules made there under.

Punishment

Section 68(11) provides that if a company makes any default in complying with the provisions of this section or any regulation made by SEBI, the company shall be punishable with fine which shall not be less than ₹1 lakh but which may extend to ₹3 lakhs. Every Officer of the company, who is in default, shall be punishable with imprisonment for a term which may extend to 3 years or with fine which shall not be less than ₹1 lakh but which may extend to ₹3 lakhs or with both.

Obligations of Company

Rule 17(10) provides that the company shall ensure that-

- the letter of offer shall contain true, factual and material information and shall not contain any misleading information and must state that the directors of the company accept the responsibility for the information contained in such document.
- the company shall not issue any new shares including by way of bonus shares from the date of passing of special resolution authorizing the buy-back till the date of closure of the offer under these rules, except those arising out of any outstanding convertible instruments;
- the company shall confirm in its offer the opening of a separate bank account adequately funded for this purpose and to pay the consideration by way of cash;
- the company shall not withdraw the offer once it has announced the offer to the shareholders;
- the company shall not utilize any money borrowed from banks or financial institutions for the purpose of buying the company shall not utilize the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities for the buy-back.

Prohibition of buy back in certain circumstances

Section 70 provides that no company shall directly or indirectly purchase its own shares or other specified securities-

- through any subsidiary company including its own subsidiary companies;
- through any investment company or group of investment companies; or

- if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of this Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company. The buy back is not prohibited if the default is remedied and a period of three years has lapsed after such default ceased to subsist.

12.1.16 Debentures

Section 2(30) of the Act defines the term 'debentures' as including debenture, stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of a company or not. Section 44 provides that the debentures shall be the movable property transferable in the manner provided in the articles of the company.

Section 71(1) of the Act provides that a company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. The issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting.

Section 71(2) provides that no company shall issue any debentures carrying any voting rights.

Secured debentures

Section 71(3) provides that secured debentures may be issued by a company subject to such terms and conditions as may be prescribed. Rule 18(1) of Companies (Share Capital and Debentures) Rules, 2014 provides the conditions for the issue of secured debentures. The conditions are as follows:

- The date of redemption of secured debentures shall not exceed 10 years;
- The following classes of companies may issue secured debentures for a period exceeding 10 years but not exceeding 30 years:
  - Companies engaged in infrastructure projects;
  - Infrastructure Finance Companies
  - Infrastructure Debt Fund Non Banking Financial Companies;
- The issue shall be secured by the creation of charge, on the properties or assets of the company, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon;
- The company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than 60 days after the allotment of debentures;
- A debenture deed shall be executed to protect the interest of debenture holders; and
- The security for the debentures by way of a charge or mortgage shall be created in favor of the debenture trustee on-
  - any specific movable property of the company; and
  - any specific immovable property wherever situate, or any interest therein.

  In case of a non banking financial company, the charge or mortgage may be created on any movable property.

  In case any issue of debentures by a Government company which is fully secured by the guarantee given by

the Central Government or one or more State Government or by both, the requirement of creation of charge shall not apply.

Debenture Trustee

Rule 18(2) provides that the company shall appoint the debenture trustees after complying with the following conditions:

- the names of the debenture trustees shall be stated in letter of offer inviting subscription for debentures and also in all the subsequent notices or other communications sent to the debenture holders;
- a written consent shall be obtained from such debenture trustee or trustees proposed to be appointed;
- a statement to the effect of obtaining consent letter shall appear in the letter of offer issued for inviting the subscription of the debentures;

Who may not be appointed as debenture trustee?

Rule 18 (2) (c) provides that a person shall not be appointed as a debenture trustee, if he-

- beneficially holds shares in the company;
- 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;
- is beneficially entitled to moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;
- is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;
- has any pecuniary relationship with the company amounting to 2% or more of its gross turnover or total income or ₹50 lakh or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
- is relative of any promoter or any person who is in the employment of the company as a director or key managerial personnel.

Vacancy

The board may fill any casual vacancy in the office of the trustee but while any such vacancy continues, the remaining trustee or trustees, if any, may act. If the vacancy is caused by the resignation of the debenture trustee, the vacancy shall only be filled with the written consent of the majority of the debenture holders.

Removal of debenture trustee

Any debenture trustee may be removed from office before the expiry of his term only if it is approved by the holders of not less than three fourth in value of the debentures outstanding at their meeting

Duties of Debenture trustee

Rule 18(3) prescribes the duties of debenture trustee. The debenture trustee is to-

- satisfy himself that the letter of offer does not contain any matte which is inconsistent with the terms of the issue of debentures or with the trust deed;
- satisfy himself that the covenants in the trust deed are not prejudicial to the interest of debenture holders;

- call for periodical status or performance reports from the company;
- communicate promptly to the debenture holders defaults, if any, with regard to payment of interest or redemption of debentures and action taken by the trustee therefor;
- appoint a nominee director on the Board of the company in the event of-
  - two consecutive defaults in payment of interest to the debenture holders; or
  - default in creation of security for debentures; or
  - default in redemption of debentures.
- ensure that the company does not commit any breach of the terms of issue of debentures or covenants of the trust deed and take such reasonable steps as may be necessary to remedy any such breach;
- inform the debenture holders immediately of any breach of the terms of the issue of debentures or covenants of the trust deed;
- ensure the implementation of the conditions regarding creation of security for debentures, if any, and debenture redemption reserve;
- ensure that the assets of the company issuing debentures and of the guarantors, if any, are sufficient to discharge the interest and principal amount at all times and that such assets are free from any other encumbrances except those which are specifically agreed to by the debenture holders;
- do such acts as are necessary in the event the security becomes enforceable;
- call for reports on the utilization of funds raised by the raised by the issue of debentures;
- take steps to convene a meeting of the holders of debentures as and when such meeting is required to be held;
- ensure that the debentures have been converted or redeemed in accordance with the terms of issue of debentures;
- perform such acts as are necessary for the protection of the interest of the debenture holders and do all other acts as are necessary in order to resolve the grievances of the debenture holders.

Meeting of debenture holders

Rule 18(4) provides that the meeting of all the debenture holders shall be convened by the debenture trustees on-

- requisition in writing signed by debenture holders holding at least once tenth in value of the debentures for the time being outstanding;
- the happening of any event, which constitutes a breach, default or which in the opinion of the debenture trustees affects the interest of the debenture holders.

Debenture Redemption Reserve

Section 71(4) provides that where the debentures are issued by a company, the company shall create a debenture redemption reserve account. This reserve should be formed out of the profits of the company available for the payment of dividend. The amount credited to such amount shall not be utilized by the company except for the redemption of debentures.

Rule 18(7) provides that the debenture reserve account shall be created 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;

c) every company required to create Debenture Redemption Reserve shall on or before the 30th day of April in each year, invest or deposit, as the case may be, a sum which shall not be less than fifteen percent, of the amount of its debentures maturing during the year ending on the 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 of any State Government.

   iii) in unencumbered securities mentioned in sub-clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;

   iv) in unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts 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 fifteen percent 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

Trust deed

A trust deed in Form No. SH-12 shall be executed by the company issuing debenture in favor of the debenture trustees within three months of closure of the issue or offer. A trust deed for securing any issue of debentures shall be open for inspection to any member of debenture holder of the company, in the same manner, to the same extent and on the payment of the same fees, as if it were the register of members of the company. A copy of the trust deed shall be forwarded to any member or debenture holder of the company, at his request, within 7 days of the making, on payment of fee.

Liability of debenture trustee

Section 71(7) provides that any provision contained in a trust deed or in any contract with the debenture holders secured by a trust deed, shall be void in so far as it would have the effect of exempting a trustee from or indemnifying him against any liability for breach of trust, where he fails to show the degree of care and due diligence required of him as a trustee, having regard to the provisions of the trust deed conferring on him any power, authority or discretion.

The liability of the debenture trustee shall be subject to such exemptions as may be agreed upon by a majority of debenture holders holding not less than three fourths in value of the total debentures at a meeting held for this purpose.

Redemption of debentures

Section 71(8) provides that a company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

Section 71(9) provides that where at any time the debenture trustee comes to a conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, the debenture trustee may file a petition before the Tribunal. The Tribunal may, after hearing the company and any other person interested in the matter, by order, impose such restrictions on the incurring of any further liabilities by the company as the Tribunal may consider necessary in the interests of debenture holders.

Failure to redeem

Section 71(10) provides that where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the Tribunal may, on the application of any or all of the debenture holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.

Default in complying with the order of Tribunal

Section 71 (11) provides that if any default is made in complying with the order of the Tribunal, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 3 years or with fine which shall not be less than ₹2 lakhs but which may extend to ₹5 lakh or with both.

Further issue of share capital

The increase of the subscribed capital of a company caused by the exercise of an option as a term attached to the debentures issued or loan raised by the company to convert such debentures or loans into the shares of the company would not amount to further issue of share capital.

This shall be subject to the condition that the terms of issue of such debentures or loan containing such an option have been approved before the issue of such debentures or the raising of loan by a special resolution passed by the company in general meeting.

Conversion

Where any debentures have been issued, or loan has been obtained from any Government by a company, and if that Government considers it necessary in the public interest so to do, it may, by order, direct that such debentures or loans or any part thereof shall be converted into shares in the company on such terms and conditions as appear to the Government to be reasonable in the circumstances of the case even if terms of the issue of such debentures or the raising of such loans do not include a term for providing for an option for such conversion.

If the terms and conditions of such conversion are not acceptable to the company, it may, within 60 days from the date of communication of such order, appeal to the Tribunal which shall after hearing the company and the Government pass such order as it deems fit.

In determining the terms and conditions of conversion, the Government shall have due regard to the financial position of the company, the terms of issue of debentures or loans, as the case may be, the rate of interest payable on such debentures or loans and such other matters as it may consider necessary.

Where the Government has, by an order directed that any debenture or loan or any part thereof shall be converted into shares in a company and where no appeal has been preferred to the Tribunal or where such appeal has been dismissed, the memorandum of such company shall, where such order has the effect of increasing the authorised share capital of the company, stand altered and the authorised share capital of such company shall stand increased by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into

12.1.17 Acceptance of Deposits by Companies

Deposit

Section 2(31) of the Act defines the term 'deposit' as including any receipt of money by way of deposit or loan or in any other form by company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India.

Rule 2(c) of Companies (Acceptance of Deposits) Rules, 2014, defines the term 'deposit' as including any receipt of money by way of deposit or loan or in any form by a company, but does not include-

- any amount received from the Central Government or a State Government or any amount received from any other source, whose repayment is guaranteed by the Central Government or a State Government;
- any amount received from the local authority or statutory authority;
- any amount received from foreign Governments, foreign or international banks, multilateral financial institutions, foreign Governments owned development financial institutions, foreign export credit agencies, foreign collaborators, foreign bodies corporate and foreign citizens, foreign authorities or persons resident outside India subject to the provisions of FEMA, 1999 and rules made there under;
- any amount received as a loan or facility from any bank;
- any amount received as a loan o financial assistance from Public Financial Institutions notified by the Central Government;
- any amount received by a company from another company;
- any amount received towards an offer of securities; if the securities cannot be allotted and the said amount has not been refunded within 60 days it would amount to deposit;
- any amount received from a director of the company;
- any amount received by issue of bond or debenture;
- any amount received from the employee in the nature of non interest bearing security deposit;
- any non-interest bearing amount received and held in trust;
- any amount received in the course of the business of the company;
- an advance received under an agreement or arrangement;
- any amount received as security deposit;
- any amount received as advance under long term projects for supply of capital goods;
- any amount brought in by the promoters of the company;
- any amount accepted by a Nidhi company;

Depositor

Rule 2(d) defines the term 'depositor' as-

- any member of the company who has made a deposit with the company in accordance with the provisions of Section 73 (2) of the Act; or
- any person who has made a deposit with a public company in accordance with the provisions of Section 76 of the Act.

Eligible company

Rule 2(e) provides that "eligible company" means a public company as referred to in Section 76(1) of the Act, having a net worth of not less than ₹100 crore or a turnover of not less than ₹500 crores and which has obtained the prior consent of the company in general meeting by means of a special resolution and also filed the said

resolution with the Registrar of Companies before making any invitation to the public for acceptance of deposits.

An eligible company, which is accepting deposits within the limits specified under Section 180(1)(c)of the Act may accept the deposits by means of an ordinary resolution.

Prohibition on acceptance of deposits from Public

Section 73 (1) provides that on and after commencement of this Act, no company shall invite, accept or renew deposits under this Act from public except in a manner provided under Chapter V.

Non applicability

Section 73(1) will not be applicable to a banking company and non banking financial company as defined under the Reserve Bank of India Act, 1934 and to such other company as the Central Government may, after consultation with the RBI, specify in this behalf.

Acceptance of deposits

Section 73(2) provides that a company may, subject to the passing of a resolution in general meeting and subject to such rules as may be prescribed, in consultation with the RBI, accept deposits from its members on such terms and conditions, including the provision of security, if any, or for the repayment of such deposits with interest, as may be agreed upon between the company and its members, subject to fulfillment of the following conditions-

- issuance of a circular to its members including a statement showing-
  - the financial position of the company;
  - the credit rating obtained;
  - the total number of depositors; and
  - the amount due towards deposits in respect of any previous deposits accepted by the company; and
  - such other particulars as may be prescribed
- file a copy of the circular along with such statement with Registrar within 30 days before the date of issue of circular;
- deposit on or before the thirtieth day of April each year, such sum which shall not be less than twenty per cent. of the amount of its deposits maturing during the following financial year and kept in a scheduled bank in a separate bank account to be called deposit repayment reserve account;
- certify that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits and where a default had occured, the company made good the default and a period of 5 years had elapsed since the date of making good the default and;
- provide security, if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company.

Acceptance of deposits from public by certain companies

Section 76 provides that notwithstanding anything contained in Section 73, a public company, having such net worth or turnover as may be prescribed, may accept deposits from persons other than its members subject to compliance with the requirements under Section 73(2) and subject to such rules as the Central Government may, in consultation with RBI, prescribe.

Such company shall be required to obtain the rating from a recognized rating agency for informing the public the rating given to the company at the time of invitation of deposits from the public which ensures adequate safety and the rating shall be obtained for every year during the tenure of deposits.

Every company accepting secured deposits from the public shall within 30 days of such acceptance, create a charge on its assets of an amount not less than the amount of deposits accepted in favor of the deposit holders in accordance with such rules as may be prescribed.

Repayment of deposits

Section 73(3) provides that every deposit accepted by the company shall be repaid with interest in accordance with the terms and conditions of the agreement. If a company fails to repay the deposit or part thereof or any interest, the depositor may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit.

Repayment of deposits accepted before commencement of this Act

Section 74(1) provides that if any deposit is accepted before the commencement of the Companies Act, 2013 and the amount of such deposit or part thereof or any interest due thereon remains unpaid, on such commencement or becomes and at any time thereafter the company shall within a period of 3 months from such commencement or from the date on which such payments due –

- file with the Registrar a statement of all deposits accepted by the company and the sums remaining unpaid on such amount with interest thereon along with the arrangements made for such repayment; and
- repay within 3 years from such commencement or on or before the expiry of the period, for which deposits were accepted, whichever is earlier.

Section 74(2) provides that the Tribunal may, on an application made by the company, after considering the financial condition of the company, the amount of deposit o part thereof and the interest payable thereon and such other matters allow further time as considered reasonable to the company to repay the deposit.

Punishment

Section 74(3) provides that if a company fails to repay the deposit or part thereof or any interest thereon within the specified time or on extended time as may be allowed by the Tribunal, the company shall, in addition to the payment of the amount of the deposit or part thereof and the interest due, be punishable with fine which shall not be less than ₹1 crore but which may extend to ₹10 crores. Every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than ₹25 lakh but which may extend to ₹2 crores, or with both.

Damages for fraud

Section 75 provides that where a company fails to repay the deposit or part thereof or any interest within the specified time or such further time as allowed by the Tribunal, and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company, who was responsible for the acceptance of such deposit shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.

Any suit, proceedings or other action may be taken by any person, group of persons or any association of persons who had incurred any loss as a result of the failure of the company to repay the deposits or part thereof or any interest thereon.

Punishment for contravention of Section 73 or Section 76

Section 76A provides that where a company accepts deposits or invites or allows or causes any other person to accept or invite on its behalf any deposit in contravention of the manner or the conditions prescribed under Section 73 or Section 76 or rules made there under or if a company fails to repay the deposit within the time specified under those sections or rules made thereunder or such further time as may be allowed by the Tribunal– the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due,

be punishable with fine which shall not be less than ₹1 crore or twice the amount of deposit accepted by the company, whichever is lower but which may extend to ₹10 crores; and every officer of the company, who is in default, shall be punishable with imprisonment which may extend to seven years and with fine which shall not be less than ₹25 lakhs but which may extend to ₹2 crores

GLOBAL DEPOSITORY RECEIPT

Section 41 of the Act provides for the issue of global depository receipt. A company may issue depository receipts in any foreign currency. For this purpose, special resolution is to be passed in the General Meeting. The procedure for issuing global depository receipt is prescribed in 'Companies (Issue of Global Depository Receipts) Rules, 2014 which was issued vide Notification No. GSR 252 (E), dated 31.03.2014. These Rules came into effect from 01.04.2014.

Scheme

Rule 2(c) defines the term 'scheme' as the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 or any modification or re-enactment thereof.

Eligibility

Rule 3 provides the eligibility criteria to issue global depository receipts. A company may issue depository receipts provided it is eligible to do so in terms of the Scheme and relevant provisions of Foreign Exchange Management Rules and Regulations.

Conditions

Rule 4 provides the conditions in issuing global depository receipts. The following are the conditions-

- The Board of Directors of the company shall pass a resolution authorizing the company to do so;
- The Company shall take prior approval of its shareholders by a special resolution to be passed at a general meeting. A special resolution passed under Section 62 for issue of shares underlying the depository receipts, shall be deemed to be a special resolution for this purpose;
- The depository receipts shall be issued by an overseas depository bank appointed by the company;
- The underlying shares shall be kept in the custody of a domestic custodian bank;
- 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 the issue of depository receipts;
- The company shall appoint-
  - A merchant banker; or
  - A practising Chartered Accountant; or
  - A practising Cost Accountant; or
  - A practising Company Secretary

  to oversee all the compliances relating to issue of depository receipts;

The compliance report taken from the above professionals shall be placed at the meeting of the Board of Directors of the Company or of the committee of the Board of Directors authorized by the Board in this regard to be held immediately after closure of all formalities of the issue of depository receipts. The committee of the Board of Directors shall have at least one independent director, if the company requires to have independent director;

Issue of depository

Rule 5 provides the manner and form of depository receipts. 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. 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 Reserve Bank of India may prescribe or specify from time to time. 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.

Voting right

Rule 6 provides that a holder of depository receipts may become a member of the company. He shall be entitled to vote as such only on conversion of the depository receipts to the underlying shares after following the procedure provided in the Scheme and the provisions of this Act.

The overseas depository shall be entitled to vote on behalf of the holders of depository receipts until the conversion of depository receipts to shares is taken place. For this purpose, there would be an agreement entered into between the overseas depository, holders of depository receipts and the company.

Proceeds of the issue

Rule 7 provides that the proceeds of issues of depository receipts shall either be remitted to a bank account in India or deposited in an Indian Bank operating abroad or any foreign bank, which is a Scheduled Bank under the Reserve Bank of India Act, 1934, having operations in India with an agreement that the foreign bank having operations in India shall take responsibility for furnishing all the information which may be required and in the event of a sponsored issue of depository receipts, the proceeds of the sale shall be credited to the respective bank account of the shareholders.

Depository receipts prior to this Act

Rule 8 provides that a company which has issued depository receipts prior to commencement of these rules i.e., 01.04.2014, shall comply with the requirements within six months of such commencement.

Non applicability of certain provisions

Rule 9 provides that certain provisions of the Companies Act, 2013 are not applicable to the issue of global depository receipts as detailed below:

- The provisions of the Act and rules issued thereunder for the public issue of shares or debentures;
- The provisions as applicable to a prospectus or an offer document;

12.1.18 Charges

Charge

Section 2(16) defines the term 'charge' as an interest or lien created on the property or assets of a company or any of its undertakings or both as security and including a mortgage.

Registration of charges

Section 77(1) provides that once the charge is created by the company, it shall be the duty of the company to register the charge with the Registrar of Companies. The charge may be within India or outside India on the properties of the company or assets or any of its undertakings and situated in or outside India. The properties may be tangible or intangible. The company is 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. The time limit for registration is thirty days from the date of creation of charge. This section shall not apply to such charges as may be prescribed in consultation with the RBI.

Rule 3(1) provides that the charge to be registered is to be in the Form No. CHG – 1 (for other than debentures) and Form No. CHG – 9 for debentures.

Condonation of delay

Rule 4(1) provides that the Register may, if he is satisfied that the company had sufficient cause for not filing the particulars and instrument of charge within the period of 30 days of the date of creation of charge, allow the registration another thirty days but within a period of 120 days of the creation of charge or modification of charge on payment of additional fee.

The application for condonation of delay shall be made in Form No. CHG-1 supported by a declaration from the company signed by his Secretary or director that such belated filing shall not adversely affect the rights of any other intervening creditors of the company.

Extension of time limit

The Registrar may, on an application by the company, allow registration to be made within a period of 300 days of such creation on payment of additional fees as may be prescribed. If the registration is not made within a period of 300 days of such creation, the company shall seek extension of time.

Any subsequent registration of a charge shall not prejudice any right acquired in respect of any property before the charge is actually registered.

Certificate of registration

Section 77(2) of the Act provides that where a charge is registered with the Registrar, he shall issue a certificate of registration of such charge in such form and in such manner as may be prescribed to the company or to the person in whose favor the charge is created. Rule 6(1) provides that the certificate of registration shall be in Form – CHG - 2.

Section 77(3) provides that no charge created by a company shall be taken into account by the liquidator or any other creditor unless it is duly registered and a certificate of registration is given by the Registrar.

Section 77(4) provides that Section 77(3) shall not prejudice any contract or obligation for the repayment of the money secured by a charge.

Conclusive evidence

Rule 6(3) provides that the certificate of registration shall be conclusive evidence that the requirements of Chapter VI of the Act and the rules made there under as to registration of creation of modification of the charge, has been complied with.

Modification of charge

Section 79 provides that the provisions of Section 77 relating to registration of charges shall, so far as may be, apply to-

- a company acquiring any property subject to a charge within the meaning of Section 77; or
- any modification in the terms and conditions or the extent or operation of any charge registered under that Section.

Rule 6(2) provides that where the particulars of modification of charge are registered under Section 79, the Registrar shall issue a certificate of modification of charge in Form No. CHG-3.

Notice of charge

Section 80 provides that where any charge on any property or assets of a company or any of its undertakings is registered, any person acquiring such property, assets, undertakings or part thereof or any share or interest therein shall be deemed to have notice of the charge from the date of such registration.

Registration by holder of charge

Section 78 provides that if a company fails to register the charge within the prescribed period, the person

in whose favor the charge is created may apply to the Registrar for registration of the charge along with the instrument created for the charge. The Registrar on receipt of such application shall issue a notice to the company giving 14 days time. In the said notice, it should be mentioned that unless the company itself registers the charge or shows sufficient cause why the charge should not be registered, the Registrar may allow such registration on payment of prescribed fees.

The charge holder, who registered the charge, is entitled to recover the amount of any fees or additional fees paid by him for the purpose of registration from the company.

Register of charges

Section 81(1) provides that the Registrar shall, in respect of every company, keep a register containing particulars of the charges registered in such form and in such manner as may be prescribed.

Rule 7(1) provides that the particulars of charges maintained on the Ministry of Corporate Affairs portal (www.mca.gov.in) shall be deemed to be register of charges for the purposes of Section 81(1).

Section 81(2) provides that a register kept by the Registrar shall be open to inspection by any person on payment of such fees as may be prescribed.

Satisfaction of charge

Rule 8(1) provides that a company or charge holder shall within a period of 300 days from the date of the payment or satisfaction in full of any charge registered under Chapter VI, give intimation of the same to the Registrar in Form No.CHG-4 along with the fee.

Section 82(2) provisions that the Registrar on intimation from the company shall give a notice to the holder of the charge to show cause within such time not exceeding 14 days, as may be specified in the notice, as to why payment or satisfaction in full should not be recorded. 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 kept by him and inform the company that he has done so in Form CHG-5. If any cause is shown the Registrar shall record a note to that effect in the Register of Charges and shall inform the company.

The notice as mentioned above shall not be required to be sent to the holder of charge, if the holder of charge signed in the intimation to the Registrar.

Powers of Registrar

Section 82(3) provides that Section 82 shall not affect the powers of Registrar to make an entry in the register of charges under Section 83 or otherwise than on receipt of an intimation from the company.

Section 83(1) provides that the Registrar may, on evidence given to his satisfaction with respect to any registered charge-

- That the debt for which the charge was given has been paid or satisfied in whole or in part; or
- That 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, notwithstanding the fact that no intimation has been received by him from the company.

Section 83(2) provides that the Registrar shall inform the affected parties within 30 days of making the entry in the register of charges.

Intimation of appointment of receiver or manager

Section 84 provides that if any person obtains an order for the appointment of a receiver of, or a person to manage, the property subject to a charge, he shall give notice within 30 days from the date of passing of the

order to the company and the Registrar along with a copy of the order or instrument. The person who appoints a receiver or an authorized person shall also to give notice within 30 days from the date of passing of the order to the company and the Registrar along with a copy of the order or instrument. The required form is Form No. CHG-6.

The Registrar, on payment of prescribed fees, shall register the particulars of the receiver, person or instrument in the register of charges.

The receiver or the manager shall, on ceasing to hold such appointment, give to the company and the Registrar a notice to that effect. The Registrar shall register such notice.

Company's Register of charges

Section 85 provides that every company shall keep at its registered office a register of charges in Form No.CHG-7 and in such manner as prescribed. The register shall include all charges and floating charges affecting any property or assets of the company or any of its undertakings, indicating in each case such particulars as may be prescribed. A copy of the instrument creating the charge shall also be kept at the registered office of the company along with the register of charges.

The register of charges shall be open for inspection during business hours-

- by any member or creditor without any payment of fees; or
- by any other person on payment of such fees as may be prescribed subject to such reasonable restrictions as the company may, by its articles impose.

Rectification by Government in register of charges

Rule 12(1) provides that-

- where the instrument creating or modifying a charge is not filed within a period of 300 days from the date of its creation or modification; and
- where the satisfaction of charges is not filed within 30 days from the date on which such payment of satisfaction the Registrar shall not register the same unless the delay is condoned by the Government. The application for condonation of delay is to be filed in Form No. CHG-8 along with the fee.

Section 87(1) provides that the Central Government on being satisfied that-

- the omission to file with the Registrar the particulars of any charge created by a company or any charge subject to which any property has been acquired by a company or any modification of such charge; or
- the omission to register any charge within the time required or the omission to give intimation to the Registrar of the payment or the satisfaction of a charge within the stipulated time; or
- the omission or mis-statement of any particular with respect to any such charge or modification or with respect to any memorandum of satisfaction or other entry made in pursuance of Section 82 or 83 was accidental or due to inadvertence or some other sufficient cause or it is not of a nature to prejudice the position of creditors or shareholders of the company; or
- on any other grounds, it is just and equitable to grant relief, it may, on application of the company or any person interested, direct that the time for filing of the particulars or for the registration of the charge or for the giving of intimation of payment or satisfaction shall be extended or the omission or mis-statement shall be rectified.

Section 87(2) provides that where the Central Government extends the time for the registration of a charge, the order shall not prejudice any rights acquired in respect of the property concerned before the charge is actually registered.

Rule 12(3) provides that the order passed by the Central Government shall be required to be filed with the

Registrar in Form No. INC-28 along with fees as per the conditions stipulated in the order.

Punishment

Section 86 provides that if any company contravenes any provisions of Chapter VI, the company shall be punishable with fine which shall not be less than ₹1 lakh but which may extend to ₹10 lakh. Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 6 months or with fine which shall not be less than ₹25,000 but which may extend to ₹1 lakh, or with both.

Forms

1. Form No. CHG – 1;
2. Form No. CHG – 2;
3. Form No. CHG – 3;
4. Form No. CHG – 4;
5. Form No. CHG – 5;
6. Form No. CHG – 6;
7. Form No CHG – 7;
8. Form No. CHG – 8;
9. Form No. CHG – 9;
10. Form No. INC – 28.

12.1.19 Registers

Register of members

Section 88 requires every company to keep and maintain the following Registers along with the Index thereof:

- Register of members for each class of equity and preference shares (separately.
- Register of debenture holders;
- Register of any other security holders; and
- Foreign register of members and debenture holders etc.

Every company shall, from the date of its registration, keep and maintain a register of its members in one or more books in Form No. MGT.1. [Rules 3(1) of Companies (Management and Administration) Rules, 2014.

Provided that in the case of a company existing on the commencement of the Act, the particulars as available in the register of members maintained under the Companies Ac t, 1956 shall be transferred to the new register of members in Form No.MGT-1 and in case additional information, required as per provisions of the Act and these rules, is provided by the members, such information may also be added in the register as and when provided.

Rule 3(2) – In the case of a company not having share capital, the register of members shall contain the following particulars in respect of each member -

- Name of the member, address, (registered office address in case the member is a body corporate), email address, PAN or CIN, Unique Identification Number, if any, etc.,
- Date of becoming member;
- Date of cessation;
- Amount of guarantee, if any,
- Any other interest if any, and
- Instructions, if any given by the member with regard to sending of notices etc.,

Register of debenture holders and or any other security holders

Rule 4 of Companies (Management and Administration) Rules, 2014, provides that every company which issues or allots debentures or any other security shall maintain a separate register of debenture holders or security holders for each type of debentures or other securities in Form No. MGT-2.

Index

Section 88(2) provides that every register maintained for members, debenture holders or other securities shall include an index of the names included therein.

Depository

Section 88(3) provides that the register and index of beneficial owners maintained by a depository under Section 11 of the Depositories Act, 1996 shall be deemed to be the corresponding register and index for the purposes of this Act.

Foreign register

Section 88(4) provides that a company may, if so authorized by its articles, keep in any country outside India, a part of the register of members or debenture holders or other securities or beneficial owners, called "foreign register" containing the names and particulars of the members, debenture holders, other security holders or beneficial owners residing outside India.

Rule 7(2) provides that the company shall, within thirty days from the date of opening of any foreign register, file with Registrar notice of the situation of the office in Form No. MGT -3 along with the fee where such registers is kept. In the event of any change in the situation of office or of its discontinuance, it shall within 30 days of such change or discontinuance file notice in Form No. MGT – 3 with the Registrar of such change or discontinuance.

Rule 7(3) provides that the register kept at the registered office is called as the principal register and the foreign register shall be deemed to be the part of the principal register. The foreign register shall be maintained in the same format as the principal register.

Rule 7(5) provides that a foreign register shall be open to inspection and may be closed and extracts may be taken and copies may be required in the same manner, *mutatis mutandis*, as is applicable to the principal register, except that the advertisement before closing the register shall be inserted in at least two newspapers circulating in the place wherein the foreign register is maintained.

Rule 7(6) provides that if a foreign register is kept by a company in any country outside India, the decision of appropriate competent authority in regard to the rectification of register shall be binding.

Rule 7(7) provides that the entries in the foreign register shall be made simultaneously after the Board of Directors or its duly constituted committee approves for allotment or transfer of shares, debentures or any other securities.

The company shall transmit to its registered office in India, a copy of every entry in any foreign register within 15 days after the entry is made and keep at such office a duplicate register of every foreign register duly entered up from time to time. Such duplicate register shall be deemed to be part of the principal register. The company may discontinue the keeping of any foreign register and thereupon all entries in the register shall be transferred to some other foreign register kept by the company outside India or to the principal register.

Maintenance of Register of members etc.,

Rule 5 provides that every company shall maintain the registers under Section 88 in the following manner:

- The entries in the registered shall be made within 7 days after the Board of Directors or its duly authorized committee approves the allotment or transfer of shares, debentures or any other securities;
- The registers shall be maintained at the registered office of the company unless a special resolution is

passed in a general meeting authorizing the keeping of the register at any other place within the city, town or village in which the registered office is situated or any other place in India in which more than one-tenth of the total members entered in the register of members reside;

- Consequent upon the buyback of shares, reduction in share capital, sub division, consolidation of shares, issue of sweat equity shares, transmission of shares etc., the entries shall be made within 7 days after approval of the Board or Committee, in the register of members or in the respective registers;
- If any change occurs in the status of a member or a debenture holder or any other security holder whether due to death or insolvency or change of name or due to transfer to Investor Education Protection Fund or due to any other reason, entries thereof explaining the change shall be made in the respective register;
- If any rectification is made by the company pursuant to any order passed by the competent authority under the Act, the necessary reference of such order shall be indicated in the respective register;
- If any order is passed by any judicial or revenue authority or by SEBI or competent authority, attaching shares, debentures or other securities and giving directions for remittance of dividend or interest, the necessary reference of such order shall be indicated in the respective register;
- In case of a listed company, the particulars of pledge, charge, lien or hypothecation created by the promoters in respect of any securities and other details in this regard shall be entered in the register within 15 days from such an event;
- If promoters of any listed company, having a joint venture company with another company have pledged or hypothecated or created charge or lien in respect of any security of the company in connection with such joint venture company, the particulars of such pledge, hypothecation, charge and lien shall be entered in the register of members within 15 days from such an event.

Authentication

Rule 8 provides that the entries in the registers maintained and index included therein shall be authenticated by the Company Secretary of the company or by any other person authorized by the Board for the purpose, and the date of the board resolution authorizing the same shall be mentioned.

The entries in the foreign company shall be authenticated by the Company Secretary of the Company or by any other person authorized by the Board by appending his signature to each entry.

Declaration of beneficial interest in any share

Rule 9 provides that a person whose name is entered in the register of members of a company as a holder of the shares but who does not hold the beneficial interest in such shares, shall file with a company a declaration to that effect in Form No. MGT-4 within 30 days from the date on which his name is entered in the register of members of such company. Where any change occurs in the beneficial interest in such shares, the registered owner shall within 30 days make a declaration in Form No. MGT-4.

Every person holding and exempted from furnishing declaration or acquiring a beneficial interest in shares of a company not registered in his name, shall file with the company a declaration disclosing such interest in Form No. MGT-5 within 30 days after acquiring such beneficial interest in the shares of the company. Where any change occurs in the beneficial interest in such shares, the beneficial owner shall within 30 days from the date of such change, make a declaration to the company in Form MGT-5.

The company shall make a note of such declaration in the register of members and shall file within 30 days from the date of receipt of such declaration a return in Form No. MGT-6 with the Registrar in respect of such declaration with fee.

No right in relation to any share in respect of which a declaration is required to be made but not made by the beneficial owner, shall be enforceable b him or by any person claiming through him.

Nothing in Section 89 shall be deemed to be prejudice the obligation of a company to pay dividend to its members and the said obligation shall on such payment, stand discharged.

Section 90(1) provides that every individual, who holds beneficial interests, of not less than twenty-five per cent. or such other percentage as may be prescribed, in shares of a company, referred to as "significant beneficial owner" shall make a declaration to the company, specifying the nature of his interest and other particulars, in such manner and within such period, as may be prescribed:

Provided that the Central Government may prescribe a class or classes of persons who shall not be required to make declaration under this sub-section.

Section 90(2) provides that every company shall maintain a register of the interest declared by individuals under sub-section (1) and changes therein which shall include the name of individual, his date of birth, address, details of ownership in the company and such other details as may be prescribed.

Closure of registers

Section 91 provides that a company may close the register of members or the register of debenture holders or other security holders for any period not exceeding in the aggregate of 45 days in each year, but not exceeding 30 days at any one time subject to giving of previous notice of at least. 7 days or such lesser period as may be specified by SEBI, if such a company is a listed company. These provisions will not be applicable to private companies provided that the notice has been served on all the members not less than 7 days prior to the closure of the registers.

Inspection of Registers

Rule 14 provides that the registers and indices maintained shall be open for inspection during the business hours at such reasonable time (not less than two hours) on every working day as the board may decide, by any member, debenture holder, other security holder or beneficial owner without payment of fee and by any other person on payment of such fee as may be specified by the Articles of Association of the company but not exceeding ₹ 50 for each inspection.

A person concerned may require a copy of any such register or entries therein on payment of such fee as may be specified in the articles of the association but not exceeding ₹ 10 for each page. Such copies or entries shall be supplied within 7 days of deposit of such fee.

Preservation of Registers

Rule 15 provides that the register of members along with the index shall be preserved permanently and shall be kept under the custody of the Company Secretary or any other person authorized by the Board. The register of debenture holders or any other security holders along with the index shall be preserved for a period of 8 years from the date of redemption of debentures or securities and shall be kept in the custody of Company Secretary or any other person duly authorized by the Board.

The foreign register of members shall be preserved permanently unless it is discontinued and all the entries are transferred to any other foreign register or to the principal register. Foreign register of debenture holders or any other security holders shall be preserved for a period of 8 years from the date of redemption of such debentures of securities. The foreign registers shall be kept in the custody of the Company Secretary or person authorized by the board.

Registers etc., to be evidence

Section 95 provides that the register, their indices shall be prima facie evidence of any matter directed or authorized to be inserted therein by or under the Act.

Penalties

Section 88(5) provides that if a company does not maintain a register of members or debenture holders or other security holders or fails to maintain them in accordance with the provisions of the Act and Rules, the company and every officer of the company, who is in default, shall be punishable with fine which shall not be less than ₹50,000 but which may extend to ₹3 lakhs and where the failure is a continuing one, with a further fine which may extend to ₹1,000 for every day, after its first during which the failure continues.

Section 89(5) provides that if any person fails to make a declaration in respect of beneficial interest in any share, without any reasonable cause, he shall be punishable with fine which may extend to ₹50,000 and where the failure is a continuing one, with a further fine which may extend to ₹1,000 for every day after the first during which the failure continues.

Section 89(7) provides that if a company required to file the declaration with the Registrar, fails to do so, before the expiry of the time specified, the company and every officer of the company, who is in default, shall be punishable with fine which shall not be less than ₹500 but which may extend to ₹1,000 and where the failure is a continuous one, with a further fine which may extend to ₹1,000 for every day after the first during which the failure continues.

Section 91(2) provides that if the register of members or debenture holders or other security holders is closed without giving the notice as required or after giving shorter notice than that so provided, or for a continuous or an aggregate period in excess of the limits specified, the company and every officer of the company, who is in default, shall be liable to a penalty of ₹5,000 for every day subject to a maximum of ₹1 lakh during which the register is kept closed.

12.1.20 Annual Return

Section 92 of the Act requires a company to file Annual Return. This section provides that every company shall prepare a Annual Return in Form No. MGT-7. The Annual Return shall contain the following particulars as they stood at the end of the financial year-

- its registered office, its principal business activities, particulars of its holding, subsidiary and associate companies;
- its shares, debentures and other securities and shareholding pattern;
- its indebtedness;
- its members and debenture holders along with changes therein since the close of the previous financial year;
- its promoters, directors, key managerial personnel along with changes therein since the close of the previous financial year;
- meetings of members or a class thereof, Board and its various committees along with attendance details;
- remuneration paid to Directors and Key Managerial Personnel;
- penalty and punishment imposed on the company, its directors or officers and details of compounding of offences and appeals made against such penalty or punishment;
- matters relating to certification of companies, disclosures as may be prescribed;
- details in respect of shares held by or on behalf of the Foreign Institutional Investors; and
- such other matters as may be prescribed.

The return shall be signed by a director and the Company Secretary. Where there is no company secretary, then it shall be signed by a Company Secretary in practice.

The proviso to Section 92(1) provides that the annual return of a OPC and small company, shall be signed by the Company Secretary or where there is no Company Secretary by the director of the Company.

Certificate for Annual Return

Section 92(2) provides that the annual return filed by a listed company or, by a company having paid up share capital of ₹10 crores or more or turnover of ₹50 crores or more, shall be certified by a Company Secretary in practice in the Form No. MGT-8, stating that the annual return discloses the facts correctly and adequately and that the company has complied with all the provisions of the Act.

Extract of Annual Return

Section 92(3) provides that every company shall place a copy of the annual return on the website of the company, if any, and the web-link of such annual return shall be disclosed in the Board's report.

Filing of annual return

Section 92(4) provides that every company shall file with the Registrar a copy of the annual return, within 60 days from the date on which the Annual General Meeting is held or where no annual general meeting is held in any year within 60 days from the date on which the Annual General Meeting should have been held together with the statement specifying the reasons for not holding the annual general meeting with such fees or additional fees as may be prescribed.

Penalty for non filing of annual return

Section 92(5) provides that if a company fails to file its annual return before the expiry of the specified period, the company shall be punishable with fine which shall not be less than ₹50,000 but which may extend to ₹5 lakhs, Every Officer, who is in default, shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than ₹50,000 but which may extend to ₹5 lakhs, or with both.

Section 92(6) provides that if a Company Secretary in practice certifies the annual return otherwise than in conformity with the requirements of Section 92 or the rules made there under, he shall be punishable with fine which shall not be less than ₹50,000 but which may extend to ₹5 lakhs.

Place of keeping returns

Section 94 provides that the copies of annual return shall be kept at the registered office of the company. Such returns may also be kept at any other place in India in which more than one tenth of the total number of members entered in the Register of members reside, if approved by a special resolution passed at a general meeting of the company.

Preservation period

Section 94 read with Rule 15(3) provides that copies of annual returns prepared and copies of all certificates and documents required to be annexed thereto shall be preserved for a period of 8 years from the date of filing with the Registrar.

Copies of return to be furnished

Rule 16 provides that copies of annual return filed under Section 92 shall be furnished to any member or any other person on payment of such fees as may be specified in the Articles of Association of the Company but not exceeding ₹10 for each page. Such copy shall be supplied by the company within a period of 7 days from the date of deposit of fee to the company.

Inspection of returns

Rule 14(1) provides that the copies of returns prepared under Section 92 shall be open for inspection during business hours at such a reasonable time (not less than two hours) on every working day as the board may decide, by any member without payment of fee and by any other person on payment of such fee as may be specified in

the articles of association of the company but not exceeding ₹50 for each inspection. Section 94(5) provides that the Central Government may also, by order, direct an immediate inspection of the document, or direct that the extract required shall forthwith be allowed to be taken by the person requiring it.

Section 94(4) provides that if any inspection or the making of any extract or copy required is refused, the company and every officer of the company, who is in default, shall be liable, for each such default, to a penalty of ₹1,000 for every day subject to a maximum of ₹1 lakh during which the default continues.

Conclusive evidence

Section 95 provides that copies of annual returns maintained under Section 94 shall be prima facie evidence of any matter directed or authorized to be inserted therein by or under this Act.

12.1.21 Meetings of a Company

Notice

Section 101 provides that a general meeting may be called by giving not less than clear 21 days notice either in writing or through electronic mode.

Provided that a general meeting may be called after giving shorter notice than that specified in this sub-section if consent, in writing or by electronic mode, is accorded thereto—

i) in the case of an annual general meeting, by not less than 95%. of the members entitled to vote thereat; and

ii) in the case of any other general meeting, by members of the company—

a) holding, if the company has a share capital, majority in number of members entitled to vote and who represent not less than ninety-five per cent. of such part of the paid-up share capital of the company as gives a right to vote at the meeting; or

b) having, if the company has no share capital, not less than 95%. of the total voting power exercisable at that meeting.

Contents of the notice

Section 101(2) provides that every notice of a meeting shall specify the place, date, day and the hour of the meeting. It shall contain a statement of the business to be transacted at the meeting.

Section 102(1) provides that a statement to be annexed to the notice. It provides that 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 —

- The nature of concern of interest, financial or otherwise, if any in respect of each items of-
  - every director and the manager, if any;
  - every other key managerial personnel; and
  - relatives of the persons mentioned above;
- 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.

Notice to whom to be issued

Section 101(3) provides that the notice of every meeting of the company shall be given to-

- every member of the company, legal representative of any deceased member or the assignee of an insolvent member;
- the auditor or auditors of the company; and
- every director of the company

Notice by electronic mode

Rule 18 provides the procedure for issue of notice through electronic mode. The term 'electronic mode' shall mean any communication sent by a company through its authorized and secured computer program which is capable of producing confirmation and keeping record of such communication addressed to the person entitled to receive such communication at the last electronic mail address provided by the member.

The procedure of sending notice through electronic mode is discussed as detailed below:

- A notice may be sent through email as a text or as an attachment to email or as a notification providing electronic link or Uniform Resource Locator for accessing such notice;
- The email shall be addressed to the person entitled to receive such email as per the records of the company or as provided by the depository;
- The subject shall state the name of the company, notice of the type of meeting, place and date on which the meeting is scheduled;
- The attachment shall in a PDF or in a non-editable format together with a link or instructions for recipient for downloading relevant version of the software;
- The company should ensure that it uses a system which produces confirmation of the total number of recipients mailed and a record of each recipient to whom the notice has been sent and copy of such record and any notices of any failed transmissions and subsequent re-sending shall be retained by or on behalf of the company as 'proof of sending';
- The company is not responsible for the failure in transmission beyond its control;
- If a member fails to provide or update relevant e-mail address to the company or to the depository participant, the company shall not be in default for not delivering notice via e-mail;
- The company may send e-mail through in-house facility or its registrar and transfer agent or authorize any third party agency providing bulk e-mail facility;
- The notice made through electronic mode shall be readable and the recipient should be able to obtain and retain copies and the company shall give the complete Uniform Resource Locator or address of the website and full details of how to access the document or information;
- The notice of the general meeting of the company shall be simultaneously placed on the website of the company, if any and on the website as may be notified by the Government.

Deemed Special Business

Section 102(2) provides that for the purpose of Section 102(1), in the case of an annual general meeting, all business to be transacted thereat shall be deemed special, other than-

- the consideration of financial statements and the reports of the Board of Directors and auditors;
- the declaration of any dividend;
- the appointment of directors in place of those retiring;
- the appointment of and the fixing of the remuneration of, the auditors; and

In the case of any other meeting, all business shall be deemed to be special.

Special business

Where any item of special business to be transacted at a meeting of a company relates to or affects any other company, the extent of shareholding interest in that other company of every promoter, director, manager, if any, and of every other key managerial personnel of the first mentioned company shall, if the extent of such shareholding is not less than 2% of the paid up share capital of that company, also be set out in the statement.

Inspection of documents

Section102(3) provides that where any item of business refers to any document, which is to be considered at the meeting, the time and place where such document can be inspected shall be specified in the statement under sub-Section (1).

Non disclosure in statement

Section 102(4) provides that where as a result of non-disclosure or insufficient disclosure in any statement under sub-Section (1), made by a promoter, director, manager, if any, or other key managerial personnel, any benefit accrues to such of the persons mentioned above or their relatives, either directly or indirectly, such persons shall hold the benefit in trust for the company. Such persons are liable to compensate the company to the extent of the benefit received by them.

Penalty

Section 102 (5) provides that if any default is made in complying with the provisions of Section 102, every promoter, director, manager or other key managerial personnel who is in default shall be punishable with fine which may extend to ₹50,000 or five times the benefit accruing to the promoter, director, manager or other key managerial personnel or any of his relatives, whichever is more.

Quorum for meetings

It is usual to calculate a quorum for a meeting for the validity of the transactions taken place in the meeting. Section 103(1) provides that unless the Articles of the company provide for a large number-

- In case of a public company-
  - 5 members personally present if the number of members as on the date of meeting is not more than 1000;
  - 15 members personally present if the number of members as on the date of meeting is more than 1000 but up to 5000;
  - 30 members personally present if the number of members as on the date of the meeting exceeds 5000;
- In case of a private company 2 members personally present shall be the quorum for a meeting of the company.

The articles of the company shall indicate the quorum more than this number or otherwise the above will be applicable.

Section 103(2) provides that if the quorum is not there 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 meeting, if called by requisitionists shall stand cancelled.

In the case of an adjourned meeting, the company shall give not less than 3 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. 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.

Chairman of meetings

Section 104(1) provides that unless the Articles of the Company provide otherwise, the members personally present at the meeting shall elect one of themselves to be the Chairman thereof on a show of hands.

Section 104(2) provides that if a poll is demanded on the election of the Chairman, it shall be taken forthwith in accordance with the provisions of this Act. The Chairman elected on a show of hands shall continue to be the Chairman of the meeting until some other person is elected as Chairman as a result of the poll. Such other person shall be the Chairman for the rest of the meeting.

Proxies

Section 105(1) provides that any member of a company, entitled to attend a meeting and vote, shall be entitled to appoint another person as a proxy to attend and vote at the meeting on his behalf. Section 105(1) is not applicable to a company not having a share capital unless the articles of that company provide for the appointment of proxy. A member of company registered under Section 8 shall not be entitled to appoint any other person as his proxy unless such other person is also a member of such company.

Section 105(6) provides that the instrument appointing a proxy shall be in writing and be signed by the appointer or his attorney duly authorized in writing or, if the appointer is a body corporate, be under its seal or be signed by an officer or an attorney duly authorized by it. The proxy shall be in the Form No. MGT-11.

A person can act as proxy on behalf of members not exceeding 50 and holding in the aggregate not more than 10% of the total share capital of the company carrying voting rights. A member holding more than 10% of the total share capital of the company carrying voting rights may appoint a single person as proxy and such person shall not act as proxy for any other person or shareholder. The instrument appointing proxy shall not be questioned on the ground that it fails to comply with any special requirements specified for such instruments by the articles of a company.

Section 105(2) provides that in every notice for a meeting, there shall appear with reasonable prominence a statement that a member entitled to attend and vote is entitled to appoint a proxy, or where that is allowed, one or more proxies, to attend and vote instead of him and that a proxy need not be a member. If there is a default in complying with this provision, every officer of the company who is in default shall be punishable with fine which may extend to ₹5,000.

The instrument of proxy shall be deposited with the registered office of the company 48 hours before the conduct of the meeting. Section 105(5) provides that if for the purpose of any meeting of a company, invitations to appoint as proxy a person or one of a number of persons specified in the invitations are issued at the company's expense to any member entitled to have notice of the meeting sent to him and to vote thereat by proxy, every officer of the company who knowingly issues the invitations as aforesaid or willfully authorizes or permits their issue shall be punishable with fine which may extend to ₹1 lakh. An officer shall not be punishable by reason only of the issue to a member at his request in writing of a form of appointment naming the proxy, or of a list of persons willing to act as proxies, if the form or list is available on request in writing to every member entitled to vote at the meeting by proxy.

Inspection of instrument of proxy

Section 105(8) provides that every member entitled to vote at a meeting 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 any time during the business hours o the company, provided not less than 3 days' notice in writing of the intention to inspect is given to the company.

Representation of President and Governors in meetings

Section 112 provides that the President of India or the Governor of the State, if he is a member of the company, may appoint such person as he thinks fit to act his representative at any meeting of the company or at any meeting of any class of members of the company. A person so appointed shall be deemed to be a member of such company. He shall be entitled to exercise the same rights and powers, including the right to vote by proxy and

postal ballot, as the President or, as the case may be, the Governor could exercise as a member of the company.

Representation of Corporations at meeting of companies and creditors

In terms of Section 113, where a body corporate is a member or a creditor including a holder of debentures of the company and it authorises any person as its representative at any meeting of the company or any class of members of the company or at any meeting of creditors of the company, such representative shall be entitled to exercise the same rights and powers including right to vote by proxy and by postal ballot on behalf of the body corporate which he represents.

Restrictions on voting rights

Section 106(1) provides that the articles of a company may provide that no member shall exercise any voting right in respect o 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. Section 106(2) provides that a company shall not prohibit any member from exercising his voting right on any other ground except mentioned in Section 106(1). Section 106(3) provides that on a poll taken at a meeting of a company, a member entitled to more than one vote, or his proxy, where allowed, or other person entitled to vote for him, need not, if he votes, use all his votes or cast in the same way all the votes he uses.

Method of voting

The methods of voting in a meeting of a company are as follows:

- Voting by show of hands;
- Voting through electronic means;
- Voting by poll;
- Postal ballot;

Voting by show of hands

Section 107 provides that at any general meeting, a resolution put to the vote of the meeting shall be decided on a show of hands. This process is carried out only when there is no demand of poll or the voting is carried out electronically. A declaration by the Chairman of the meeting of passing of a resolution or otherwise by show of hands and an entry to that effect in the books containing the minutes of the meeting of the company shall be conclusive evidence of the fact o passing of such resolution.

Demand for poll

Section 109(1) provides that before or on the declaration of the result of the voting on any resolution on show of hands, a poll may be ordered to be taken by the Chairman of the meeting-

- On his motion; or
- On a demand in this behalf-
  - in the case a company having a share capital, by the members present in person or by proxy, where allowed, and having not less than one tenth of the total voting power or holding shares on which an aggregate of sum of not less than ₹5 lakhs or such higher amount as may be prescribed has been paid up;
  - in the case of any other company, by any member or members present in person or by proxy, where allowed, and having not less than one tenth of the total voting power.

Section 109(2) provides that a demand for poll may be withdrawn at any time by the persons who made the demand. Section 109(3) provides that a poll demanded for adjournment of the meeting or appointment of Chairman shall be taken immediately. A poll demanded on any other question shall be taken at such time, not being later than 48 hours from the time when the demand was made, as the Chairman of the meeting may direct.

Procedure for poll

Section 109 (5) provides that where a poll is to be taken, the Chairman of the meeting shall appoint such number of persons, as he deems necessary, to scrutinize the poll process and votes given on the poll and to report thereon to him. Section 108(6) provides that the Chairman of the meeting shall have power to regulate the manner in which the poll shall be taken.

Rule 21 provides that Chairman of a meeting shall, in the poll process, ensure that-

- The Scrutinizers are provided with the Register of Members, specimen signatures of the Members, Attendance Register and Register of proxies;
- The Scrutinizers are provided with all documents received by the company;
- The Scrutinizers shall arrange for polling papers and distribute them to the members and proxies present at the meeting;
- In case of joint shareholders, the polling paper shall be given to the first named holder or in his absence to the joint holder attending the meeting as appearing in the chronological order in the folio;
- The polling shall be in Form No. MGT-12;
- The Scrutinizers shall keep a record of the polling papers received in response to poll by initializing it;
- The Scrutinizers shall lock and seal and empty polling box in the presence of members and proxies;
- The Scrutinizers shall open the polling box in the presence of two persons as witnesses after the voting process is over;
- In case of ambiguity about the validity of a proxy, the Scrutinizer shall decide the validity in consultation with the Chairman;
- The Scrutinizers shall ensure that if a member who has appointed in a proxy, has voted in person, the proxy's vote shall be disregarded;
- The Scrutinizers shall count the votes cast on poll and prepare a report thereon addressed to Chairman;
- The Scrutinizer shall submit the report to the Chairman who shall countersign the same;
- The Chairman shall declare the result of voting on poll. The result may either be announced by him or a person authorized by him in writing.

The Scrutinizers shall submit a report to the Chairman of the meeting in Form No. MGT-13. The report shall be signed by the scrutinizer(s) and the same shall be submitted by them to the Chairman within 7 days from the date of the poll is taken.

Voting through electronic means

Section 108 provides that the Central Government may prescribe the class or classes or companies and manner in which a member may exercise his right to vote by the electronic means.

Rule 20 prescribes the procedure of voting through electronic means. 'Electronic voting system' is defined as a secured system based process of display of electronic ballots, recording votes of members and the number of votes polled in favor or against, in such a manner 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 notice of the meeting shall clearly state-

- that the company is providing facility for voting by electronic means and the business may be transacted through such voting;
- that the facility for voting either through electronic voting or ballot or polling paper shall also be made available at the meeting and the members attending the meeting who have not already cast their votes by

remote e-voting shall be able to exercise their right at the meeting;

- that the members who have cast their vote by remote e-voting prior to the meeting may alsoattend the meeting but shall not be entitled to cast their vote again.

The notice shall-

- indicate the process and manner by voting by electronic means;
- indicate the time schedule including the time period during which the votes may be cast by remote e-voting;
- provide the details about login id;
- specify the process and manner for generating or receiving the password and for casting of vote in a secure manner.

The company shall cause a public notice by means of an advertisement to be published immediately on completion of dispatch of notices for the meeting but at least 21 days before the date of general meeting. The advertisement shall be given once in a vernacular newspaper in the District in which the registered office of the company is situated and having a wide circulation and at least once in English language in a newspaper having country wide circulation. The advertisement shall state the following-

- statement that the business may be transacted through voting by electronic means;
- the date and time of commencement of remove e-voting;
- the date and time of end of remote e-voting;
- cut-off date;
- the manner in which persons who have acquired shares and become members of the company after the dispatch of notice may obtain the log ID and the password;
- website address of the company;
- name, designation, address, e-mail id and phone number of the person responsible to address the grievances connected with facility for voting by electronic means.

The e-voting shall remain open for not less than 3 days and shall close at 5.00 p.m., on the date preceding the date of general meeting. After that the facility will be blocked. If a company opts to provide e-voting during the general meeting, the facility shall be in operation till all the resolutions are considered and voted upon in the meeting and may be used for voting only by the members attending the meeting and who have not exercised their right to vote through remote e-voting.

The member may opt for e-voting. Once the resolution is cast by the member through e-voting, he is not allowed to vote again.

The Board of Directors shall appoint one or more scrutinizers, who may be the Chartered Accountant in practice, Cost Accountant in practice, or Company Secretary in practice or an Advocate or any other person who is not in employment of the company and is a person of repute who, in the opinion of the Board, can scrutinize the voting and remote e-voting process in a fair and transparent manner.

The Scrutinizers shall, immediately after the conclusion of voting at the general meeting, first count the votes cast at the meeting, thereafter unblock the votes cast through remote e-voting in the presence of at least two witnesses not in the employment of the company and make, not later than 3 days of the conclusion of the meeting, a consolidated report of the total votes cast in favor or against, if any, to the Chairman or a person authorized by him in writing who shall countersign the same.

A resolution proposed to be considered through voting by electronic means shall not be withdrawn.

Postal ballot

As per section 2(65) "postal ballot" means voting by post or through any electronic mode. It includes voting by shareholders by postal or electronic mode instead of voting personally for transacting businesses in a general meeting of the company.

Business to be transacted through postal ballot

Rule 22(16) provides that pursuant Section 110(1) (a) of the Act, the following items of business shall be transacted only by means of voting through a postal ballot:

- alteration of objects clause of the memorandum and in the case of company in existence immediately before the commencement of the Act, alteration of the main objects of memorandum;
- alteration of articles of association in relation to insertion or removal of provisions in order to constitute a private company;
- change in place of registered office outside the local limits of any city, town or village;
- change in objects for which a company has raised money from public through prospectus and still has any unutilized amount out of the money so raised;
- issue of shares with differential rights as to voting or dividend or otherwise;
- variation in the rights attached to a class of shares or debentures or other securities;
- buy back of shares by a company;
- election of a director;
- sale of the whole or substantially the whole of an undertaking of a company;
- giving loans or extending guarantee or providing security in excess of the limit specified;

One Person Company and other companies having up to 200 members are not required to transact any business through postal ballot.

Section 110(1) provides that a company-

- shall, in respect of such items of business as the Central Government may notify to be transacted only by means of postal ballot; and
- may, in respect of any item of business, other than ordinary businesses 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, instead of transacting such business at a general meeting.

Procedure

Rule 22 provides the procedure for the conducting business through postal ballot as detailed below:

- The company shall send a notice to all shareholders, along with a draft resolution explaining the reasons therefor and requesting them to send their assent or dissent in writing on a postal ballot within a period of 30 days from the date of dispatch of the notice;
- The notice shall be sent either-
  - by registered post or speed post; or
  - through electronic means like registered e-mail id; or
  - through courier service

  for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period of 30 days;

- An advertisement shall be published at least once in a vernacular language of the District in which the registered office of the company is situated and at least once in English Language informing about the dispatch of ballot papers and specifying therein the following matters-
  - a statement to the effect that the business is to be transacted by postal ballot which includes voting by electronic means;
  - the date of completion of dispatch of notices;
  - the date of commencement of voting;
  - the date of ending of voting;
  - the statement that any postal ballot received from the member beyond the said date will not be valid and voting whether by post or by electronic means shall not be allowed beyond the said date;
  - a statement to the effect that members, who
  - have not received postal ballot forms may apply to the company and obtain a duplicate thereof; and
  - contact details of the person responsible to the address the grievances connected with the voting by postal ballot including voting by electronic means.

The notice of the postal ballot shall also be placed on the website of the company forthwith after the notice is sent to the members and such notice shall remain on such website till the last date for receipt of the postal ballots from the members.

- The Board shall appoint one Scrutinizer;
- Postal ballot received back from the shareholders shall be kept in the safe custody of the Scrutinizer;
- No postal ballot shall be defaced or destroyed or declare the identity of the shareholders;
- The Scrutinizer shall submit his report as soon as possible after the last date of receipt of postal ballots but not later than 7 days thereof;
- The Scrutinizer shall maintain register either manually or electronically;
- The postal ballot and all other papers shall be under the safe custody of the Scrutinizer till the Chairman considers, approves and signs the minutes;
- The Scrutinizer shall return the ballot papers and other related papers or register to the company;
- The company shall preserve such records safely;
- The assent or dissent received after 30 days from the date of issue notice shall be treated as if reply from the member has not been received;
- The results shall be declared by placing it, along with the Scrutinizer's report, on the website of the company;

Resolutions

Every decision of the company either in the board or in the general meeting is taken by means of resolutions. Resolution is of two types – ordinary resolution and special resolution.

Ordinary resolution

Section 114(1) provides that a resolution shall be an ordinary resolution if the notice required has been duly given and it is required to be passed by the votes cast, whether on a show of hands, or electronically or on a poll, in favor of the resolution, including the casting vote, if any, of the Chairman, by members, who, being entitled so to do, vote in person, or where proxies are allowed, by proxy or by postal ballot, exceed the votes, if any, cast against the resolutions by members, so entitled and voting.

Special resolution

Section 114(2) provides that a resolution shall be a special resolution when-

- the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting or other intimation given to its members, of the resolution;
- the notice required under the Act has been duly given; and
- the votes cast in favor of the resolution, whether on a show of hands or electronically or on a poll, by members, who, being entitled so to do, vote in person or by proxy or by postal ballot, are required to be not less than 3 times the number of the votes, if any, cast against the resolution by members so entitled and voting.

Resolutions requiring special notice

Section 115 provides that where by any provision contained in the 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 1% of the total voting power or holding shares on which such aggregate sum not exceeding ₹5 lakh, as may be prescribed, has been paid up. The company shall give its members notice of the resolution in such manner as may be prescribed.

Resolutions passed at adjourned meeting

Section 116 provides that where a resolution is passed at the adjourned meeting of-

- a company; or
- the holders of any class of shares in a company; or
- the Board of Directors of a company, the resolution shall, for all purposes, be treated as having been passed on the date on which it was in fact passed, and shall not be deemed to have been passed on any earlier date.

Resolutions and agreements to be filed

Section 117 provides hat a copy of every resolution or any agreement mentioned below together with the explanatory statement, if any, annexed to the notice calling the meeting in which the resolution is proposed, shall be filed with the Registrar within 30 days of the passing or making thereof in Form N. MGT -14 with such fees as may be prescribed.

The copy of every resolution which has the effect of altering the articles and the copy of every agreement shall be embodied or annexed to every copy of articles issued after passing of the resolution or making the agreement.

This provision is applicable to the following-

- special resolutions;
- resolutions which have been agreed to by all the members of a company, but which, if not so agreed to, would not have been effective for their purpose unless they had been passed as special resolutions;
- any resolution of the Board of Directors or agreement executed by a company, relating to appointment, re-appointment or renewal of the appointment, or variation of the terms of appointment, of a managing director;
- resolutions or agreements which have been agreed to by any class of members but which, if not so agreed to, would not have been effective for their purpose unless they had been passed by a special majority or otherwise in some particular manner and all resolutions or agreements which effectively bind such class of members though not agreed to by all those members;
- resolutions requiring a company to be wound up voluntarily passed in pursuance of Section 59 of the IBC, 2016.

- resolutions passed in pursuance of sub-section (3) of section 179 provided that no person shall be entitled under section 399 to inspect or obtain copies of such resolutions;
- any other resolution or agreement as may be prescribed and placed in the public domain.

Minutes

Rule 25(1)(a) provides that a distinct minute book shall be maintained for each type of meeting, namely general meetings of members, meetings of creditors, meetings of the Board and meetings of each of the committees of the Board.

Procedure

- The minutes of proceedings of each meeting shall be entered in the books maintained for that purpose along with date of such entry within 30 days of the conclusion of the meeting;
- In case of every resolution passed by postal ballot, a brief report on the postal ballot conducted including the resolution proposed, the result of the voting thereon and the summary of the Scrutinizer's report shall be entered in the minutes book of general meetings along with the date of such entry within 30 days from the date of passing of resolution;
- Each page of every such book shall be initiated or signed and the last page of record of proceedings of each meeting or each report in such books shall be dated and signed-
  - **Board meeting or Committee meeting –** by the Chairman of the meeting or the Chairman of the next succeeding meeting;
  - **General meeting –** by the Chairman of the meeting within the period of 30 days or in the event of death or inability of that Chairman, within that period, by a director duly authorized by the Board for this purpose;
  - **Postal ballot –** by the Chairman of the Board within 30 days or in the event of there being no Chairman of the Board or the death or inability of that Chairman within that period, by a director duly authorized by the Board for the purpose;
- The minute books shall be consecutively numbered;
- The minutes of each meeting shall contain a fair and correct summary of the proceedings thereat;
- All appointments made at any of the meeting shall be included in the minutes of the meeting;
- In case of the meeting of the Board or of a Committee of the Board, the minutes shall also contain-
  - The names of the directors present at the meeting; and
  - In case of each resolution passed at the meeting, the names of the directors, if any, dissenting from, or not concurring with the resolution;
- There shall not be included in the minutes, any matter which, in the opinion of the Chairman of the meeting-
  - is or could reasonably be regarded as defamatory of any person; or
  - is irrelevant or immaterial to the proceedings; or
  - is detrimental to the interests of the company
- The Chairman shall exercise absolute discretion in regard to the inclusion of any matter in the minutes on the grounds specified above;
- The minutes kept shall be evidence of the proceedings recorded therein;
- Where the minutes have been kept, then until the contrary is proved, the meeting shall be deemed to have been duly called and held and all the proceedings thereat to have duly taken place and the resolutions

passed by postal ballot to have been duly passed and in particular, all appointments of directors, key managerial personnel, auditors, or the company secretary in practice shall be deemed to be valid;

- No document purporting to be a report of the proceedings of any general meeting of the company shall be circulated or advertised at the expense of the company, unless it includes the matters required by this section to be contained in the minutes of the proceedings of such meeting;
- Every company shall observe Secretarial Standards with respect to general and Board meetings specified by the Institute of Company Secretaries of India and approved as such by the Central Government;
- The minute books of general meeting shall be kept at the registered office of the company;
- The same shall be preserved permanently and kept in the custody of the Company Secretary or any director or duly authorized by the Board.
- The minute books of the Board and Committee meeting shall be preserved permanently and kept in the custody of the Company Secretary of the company or any director duly authorized by the Board for the purpose and shall be kept in the registered office or such place as the Board may decide.

Penalty

Section 118(11) provides that if any default is made in complying with the provisions of this section in respect of any meeting, the company shall be liable to a penalty of ₹25,000. Every officer of the company who is in default shall be liable to a penalty of ₹5,000.

Section 118 (12) provides that if a person is found guilty of tampering with the minutes of the proceedings of meeting, he shall be punishable with imprisonment for a term which may extend to 2 years and with fine which shall not be less than ₹25,000 but which may extend to ₹1 lakh.

Inspection of minute books of general meeting

Section 119(1) provides that the books containing the minutes of the proceedings of any general meeting or a resolution passed by postal ballot shall be kept at the registered office of the company and be open, during business hours, to the inspection by 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 2 hours in each business day are allowed for inspection.

Any member shall be entitled to be furnished, within 7 working days of the request and on payment of such fees as may be prescribed, with a copy of any minutes referred to in sub-Section (1).

If any inspection is refused or if any copy required is not furnished within the specified time, the company shall be liable to a penalty of ₹25,000. Every officer of the company who is in default shall be liable to a penalty of ₹5,000 for each such refusal or default, as the case may be.

Annual General Meeting

Section 96(1) provides that every company other than an OPC shall in each year hold a general meeting as its Annual General Meeting. The time gap between one annual general meeting and the next the annual general meeting shall not be more than 15 months. The notice for the calling of Annual General Meeting shall specify the meeting as the Annual General Meeting. The Annual General meeting shall be conducted within 6 months from the close of the financial year. If the AGM could not be conducted within the time stipulated the Registrar, for any special reason, may extend the time by a period not exceeding 3 months but not in the case of first AGM.

First AGM

After incorporation of the company, the first Annual General Meeting is to be conducted within 9 months from the close of the first financial year of the company. If a company holds its first annual general meeting as such, it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation. No

further extension of time shall be given by the Registrar if the First AGM is not held within the specified period.

Conduct of AGM

Section 96(2) provides that every annual general meeting shall be held during the business hours of the company i.e., from 9 a.m., to 6 p.m. on any day that is not a National Holiday. The AGM 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 exempt any company from the provisions of Section 96(2) subject to such conditions as it may impose. The annual general meeting of an unlisted company may be held at any place in India if consent is given in writing or by electronic mode by all the members in advance.

Power of Tribunal to call annual general meeting

Section 97 provides that if any default is made in holding the annual general meeting of a company under Section 96, the Tribunal may notwithstanding anything contained in the Act or the articles of the company, on the application of any member of the company, call, or direct the calling of, an annual general meeting of the company and give such ancillary or consequential directions as the Tribunal thinks expedient. Such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting. A general meeting held as above shall, subject to any directions of the Tribunal, be deemed to be an Annual General Meeting of the company under this Act.

Report of Annual General Meeting

Rule 31 provides that the report in pursuance of Section 121(1) shall be prepared in the following manner-

- the report shall be prepared in addition to the minutes of the general meeting;
- the report shall be signed and dated by the Chairman of the meeting or in case of his inability to sign, by any two directors of the company, one of whom shall be the Managing Director, if there is one and company Secretary of the company;
- the report shall contain the details in respect of the following-
  - the day, date, hour and venue of the annual general meeting;
  - confirmation with respect to appointment of chairman of the meeting;
  - number of members attending the meeting;
  - confirmation of quorum;
  - confirmation with respect to compliance of the Act and the Rules, Secretarial Standards made business transacted at the meeting and the result thereof;
  - particulars with respect to any adjournment, postponement of meeting, change in venue; and
  - any other points relevant for inclusion in the report.

The report shall contain fair and correct summary of the proceedings of the meeting. The copy of the report shall be filed with the Registrar in Form No. MGT-15 within 30 days of the conclusion of the AGM along with the fee.

Punishment

Section 99 provides that if any default is made in holding a meeting of the company or in complying with any directions of the Tribunal, the company and every officer of the company who is in default shall be punishable with fine which may extend to ₹1 lakh. In case of a continuing default, the punishment will be addition of fine which may extend to ₹5,000 for every day during which such default continues.

Extra Ordinary General Meeting

Section 100 of the Act provides that the Board may, whenever it deems fit, call an extraordinary general meeting of the company. An extraordinary general meeting of the company, other than of the wholly owned subsidiary of a company incorporated outside India, shall be held at a place within India. The Board shall call the extra Ordinary general meeting at the requisition made by-

- in the case of a company having share capital, such number of members, who hold, on the date of receipt of requisition, not less than one tenth of such of the paid-up share capital of the company as on that date carries the right of voting;
- in the case of a company not having a share capital, such number of members who have, on the date of receipt of the requisition, not less than one-tenth of the total voting power of all the members having on the said date a right to vote.

The requisition shall set out the matters for the consideration of which the meeting is to be held. Rule 17 of Companies (Management and Administration) Rules, 2014, provides the procedure for the same as follows:

- the requisition shall be in writing or through electronic mode and at least clear 21 days prior to the proposed date of such extra Ordinary general meeting;
- the notice shall specify the place, date, day and hour of the meeting;
- the notice shall contain the business to be transacted at the meeting;
- if the resolution is proposed as a special resolution, the notice shall be given as required under Section 114(2);
- the notice shall be signed by all the requisitionists or by a requsitionists duly authorized in writing by all other requisitionists on their behalf or by sending an electronic request attaching therewith a scanned copy of such duly signed requisition.
- the notice shall be sent to the registered office of the company;

Section 100(4) provides that the Board is to proceed to call a meeting for the consideration of the matter within 21 days of the receipt of a valid requisition. The meeting shall be conducted within 45 days from the date of receipt of a valid requisition. The notice of the meeting shall be given to those members whose names appear in the Register of members of the company within 3 days on which requisitionists deposit with the company a valid requisition for calling an extraordinary general meeting.

If the Board does not conduct the meeting within the stipulated time, the requsitionists themselves conduct the meeting within three months from the date of requisition. The requisitionists shall have a right to receive the list of members together with their registered address and number of shares held. The company is bound to give the list of members together with their registered address made as on 21st day from the date of receipt of valid requisition together with such changes, if any, before the expiry of 45 days from the date of receipt of a valid requisition.

The notice of the meeting shall be given by speed post or registered post or through electronic mode. Any accidental omission to give notice to or the non-receipt of such notice by, any member shall not invalidate the proceedings of the meeting.

Section 100(6) provides that any reasonable expenses incurred by the requisitionists in calling a meeting shall be reimbursed to the requisitionists by the company and the sums so paid shall be deducted from any fee or other remuneration payable to such directors, who were in default in calling the meeting.

Director - Role, Responsibilities, Qualification, Disqualification, Appointment, Retirement, Resignation, Removal, Remuneration and Powers, Directors Identification Number

12.2

12.2.1 Role

Section 2(34) of the Companies Act, 2013 defines a 'director' to mean a director appointed to the Board of a company. Under the scheme of the Companies Act, the company itself and its directors or the Board of directors are primary age nts of the company to transact its operation. The Companies Act specifies where the company itself is to act both as principal and the agent and where the Board of directors is to act on its behalf. In respect of the properties and assets of the company the directors or the Board of directors act as Trustees. Therefore, the directors have different attributes in relation to the company depending upon the facts of each case.

As stated earlier, directors apart from being trustees for the assets and propertied of the company are also the agents of the company as it is the directors, collectively as Board, act on behalf of the company on all matters except those specifically reserved for company to act. However, it may be noted that even though the directors for certain purposes can be considered as the agent of the company, yet to take a decision, the company in any manner, including in the general meeting cannot direct the directors to take a particular decision. For example, allotment of shares, transfer of shares, investments etc. If the body of the shareholders did not approve the decision, they are free to change the directors in manner given in the Act. As stated elsewhere in the chapter a director apart from being the agents from being the agent and trustee of the company, can also be treated as officer of the company, hence an employees for purpose specified in the Act. The articles of a company may designate its directors as governors, members of the governing council or the board of management, or give them any other title, but so far as the law is concerned they are simply directors.

Similarly, in the case of associations or other bodies registered as companies under Section 8 of Companies Act, 2013, the members of the executive committee or the governing body are directors for purpose of the Act, though they may not be called by that name.

A manager or any other managerial personnel, is however, not a director as was held by the Andhra Pradesh High Court in Deen Dayalu v. Sri B.P.Reddy [1984] 2 Comp LJ396.

According to section 2(59) of the Act, the definition of an "officer" includes a director as well as any person under whose directions or instructions the Board or any one or more of the directors are accustomed to act. Section 149 of the Companies Act, 2013 provides that only an individual can be appointed as director. Thus, no body corporate, association or firm can be appointed director of a company.

12.2.2 Responsibilities

The duties and responsibilities of directors stipulated by the Indian Companies Act of 2013, has been laid down under Section 166 among other provisions. The duties and liabilities which encourage and promote the sincerest investment of the best efforts of directors in the efficient and prudent corporate management, in providing elegant

and swift resolutions of various business-related issues and in taking wise decisions to avert unnecessary risks to the company. Fiduciary duties which ensure and secure that the directors of companies always keep the interests of the company and its stakeholders, above their own personal interests.

The following duties and liabilities have been imposed on the directors of companies, by the Indian Companies Act of 2013, under its Section 166:-

- A director of a company shall act in accordance with the Articles of Association of the company.
- A director of the company shall act in good faith, in order to promote the objects of the company, for the benefits of the company as a whole, and in the best interests of the stakeholders of the company.
- A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.
- A director of a company shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.
- A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.
- A director of a company shall not assign his office and any assignment so made shall be void.

12.2.3 Director's Identification Number

However, no person shall be appointed as a director of the company unless he has been allotted a Director Identification Number (DIN) or such other number as may be prescribed under section 153. Section 153, as amended by the Amendment Act, 2017 provides that the Central Government may prescribe any identification number which shall be treated as Director Identification Number for the purposes of this Act. Section 153 requires that every individual intending to be appointed as director of a company shall make an application for allotment of Director Identification Number to the Central Government in such form and manner and along with such fees as may be prescribed. However, the Central Government may prescribe any other identification number as a DIN.

12.2.4 Qualifications

The Companies Act does not prescribe any academic or professional qualifications for directors. There is also no mandatory share qualification as per the Act, unless the Articles of Association of the company prescribes for the same. Therefore, a director neither needs any minimum professional qualification nor any share qualification unless the articles of a company suggest for the same.

12.2.5 Disqualifications

Section 164 (1) of the Companies Act, 2013 provides that a person shall not be eligible for appointment as a director of a company if:

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

b) he is an undischarged insolvent;

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

d) he has been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced in respect thereof to imprisonment for not less than six months and a period of five years has

not elapsed from the date of expiry of the sentence. Provided that if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be appointed as a director in any company;

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

f) he has not paid any calls in respect of any shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call;

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

h) he has not complied with sub-section (*3*) of section 152.

i) he has not complied with the provisions of sub-section (1) of section 165

No person who is or has been a director of a company which –

a) has not filed financial statements or annual returns for any continuous period of three financial years ; or

b) has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debenture on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more, shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

Provided that where a person is appointed as a director of a company which is in default of clause (a) or clause (b), he shall not incur the disqualification for a period of six months from the date of his appointment.

In addition to the aforementioned, private companies can include other disqualifications within their articles of association if they so wish.

12.2.6 Appointment

Appointment of directors can take place in multiple ways. The maximum and minimum number of directors has been laid down under Section 149 (1) of the Companies Act, 2013. This section provides that every company shall have a board of directors consisting of individuals as directors and shall have a minimum of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company and a maximum of 15 directors. However, a company may appoint more than fifteen directors after passing a special resolution. In addition to the aforementioned, certain classes of companies may be prescribed to have at least one woman director.

Appointment of directors can happen when first directors are appointed to the company, when directors are appointed at general meeting, when directors are appointed by the Board of Directors, when a resident director is appointed and when independent directors are appointed. Board of Directors can appoint additional directors, alternate directors, nominee directors and can even fill up casual vacancies.

12.2.7 Retirement and Rotation of Directors

If the articles of association provided for retirement of all directors in the annual general meeting, then all the directors are liable to directors. According to sec 152(6) of the Companies Act, 2013, 2/3rd of the total number of directors are liable to retire by rotation and those directors are called as retiring directors. Out of the retiring directors (2/3rd of total number of directors) 1/3rd of directors is liable to vacate the office. The directors who were in the office for the longer period is liable to retire first. However, if the two or more directors have been

appointed on the same day then directors will retire based on the mutual understanding between them and when mutual understanding is not available then they retire based on draw by lots.

Section 152(6) provides that unless the articles provides otherwise for the retirement of all directors at every annual general meeting, not less the two-third (2/3rd) of the total number of directors (excluding independent directors, whether appointed under this act or under any other law) of a public company shall:

1. be persons whose period of office is liable to determination by retirement of directors by rotation; and
2. save as otherwise expressly provided in this Act, be appointed by the company in general meeting.

The remaining directors (i.e. non-rotational/non-retiring/permanent directors) in the case of public company shall be appointed as per provisions contained in the articles of the company.

Where a director retires by rotation at the annual general meeting of a company, the company at the same meeting may appoint: i. the retiring director; or ii. some other person in the vacancy.

12.2.7.1 Resignation

A director may resign from his office by giving a notice in writing to the company as per Section 168 (1) of the Companies Act, 2013. On receipt of such notice, the Board shall take note of the same and the company shall intimate the Registrar in such manner, within such time and in such form as may be prescribed and shall also place the fact of such resignation in the report of directors laid in the immediately following general meeting by the company.

The director may also forward a copy of his resignation along with detailed reasons for the resignation to the Registrar within thirty days of resignation in such manner as may be prescribed.

The resignation of a director shall take effect from the date on which the notice is received by the company or the date, if any, specified by the director in the notice, whichever is later. However, under Section 168 (2) of the Companies Act, 2013, the director who has resigned shall be liable even after his resignation for the offences which occurred during his tenure.

In Saumil Dilip Mehta vs. State of Maharashtra [2002], it was held that a director can resign just by sending in writing a letter informing either chairman or secretary of company, his intention to resign from post of director of said company. He can tender his resignation unilaterally and without sending a notice to Registrar of Companies. In Mother Care (India) Ltd. vs. Prof. Ramaswamy P. Aiyar [2004], it was held that once a resignation letter is submitted to the board, the date on which the intention to relinquish post is communicated to board would be the date from which the director ceases to be a director of the company.

12.2.7.2 Removal

Directors can be either removed by shareholders or by Tribunal. Under Section 169 of Companies Act, 2013, shareholders have been given the inherent right to remove the directors appointed by them. It is not necessary that there should be proof of mismanagement, breach of trust, misfeasance or other misconduct on the part of the directors. Where the shareholders feel the policies pursued by the directors or any of them are not to their liking, they have the option to remove the directors by passing an ordinary resolution in the same way as they have the right to appoint directors by passing an ordinary resolution.

A company may, by ordinary resolution, remove a director, not being a director appointed by the Tribunal under section 242, before the expiry of the period of his office after giving him a reasonable opportunity of being heard. The vacancy is created under this section after the removal of the director then in the same meeting of the removal another director is being appointed for time being, and a special notice of the intended appointment is

provided. The newly appointed director has to hold the post until the duration up to the new formal appointment of the director is made. 9. When a director is removed as aforementioned, his office vacates automatically u/s 167. The removed director is liable for the damages and compensation which is required to be payable to him in lieu of his removal or termination according to the prescribed terms and conditions of the appointment.

In Queen Kuries & Loans (p.) Ltd. vs Sheena Jose [1993], it was held that the notice must disclose the ground on which the director is proposed to be removed.

Under Section 242 of the Companies Act, 2013, where an application has been made to the Tribunal under Section 241, against oppression and mismanagement of a company's affairs, the Tribunal may order for the termination or setting aside of an agreement which the company might have made with any of its directors. It may also order the removal of any of the directors of the company. A director so removed shall not be entitled to claim any compensation from the company for the loss of office under Section 243. Additionally such a director shall not be entitled to serve as a manger, managing director or director of the company without leave of the Tribunal for a period of five years from the date of Tribunal's order terminating or setting aside his contract with the company.

12.2.8 Remuneration

The remuneration payable to the directors of a company, including any managing or whole-time director, shall be determined, in accordance with the provisions of Companies Act either by the articles of the company, or by a resolution (special resolution if the articles so require), passed by the company in general meeting and the remuneration payable to any such director determined as per the said provisions shall be inclusive of the remuneration payable to such director for services rendered by him in any other capacity.

Section 198 lays down the overall maximum of managerial remuneration which can be paid by public company or a subsidiary of a public company. The total managerial remuneration payable to directors or manager in respect of a financial year shall not exceed eleven per cent of the net profits of the company. But sometimes a company may make no or inadequate profits in a financial year. This does not mean that its directors shall remain unpaid. In such a case, the company may, with the previous approval of the Central Government, pay by way of minimum remuneration any sum as may be authorized.

It may be noted that the remuneration of directors can be determined only by the articles of a company or a resolution of the general body or a special resolution if the articles so require. The directors cannot themselves fix the remuneration of all or any one of themselves. A managing or whole-time director may be paid either on a monthly basis or a specified percentage of the net profits of the company or partly by one way and partly by the other. But a managing director or whole-time director is not entitled to draw more than five per cent or where there is more than one such director, ten per cent of net profits by way of remuneration, except subject to conditions specified in Schedule XIII or with the approval of the Central Government.

As per Section 2(78) of the companies Act, 2013 'Remuneration' defined as any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under income tax Act, 1961. As per Section 197 of the Act, the total managerial remuneration payable by a public company, to its directors, including managing director, whole time director and its manager, in respect of any financial year shall not exceed 11% of the net profits of that company. Accordingly, a public company can pay remuneration to its directors including executive directors and non-executive directors within the limits of 11% of the net profits and this limits can only be exceeded with the prior approval of the members of the company by an ordinary resolution. The remuneration payable to a director shall be inclusive of the remuneration payable to him for the services rendered by him in any other capacity.

So, even if a director is paid remuneration for special services apart from directorial services, such amount

must also be included in the total remuneration in order to ascertain the limits of 11% of net profits as prescribed under Section 197(1) of the Act. However, the only exception is when remuneration paid for professional services rendered by a director to the company without any limit is not included in the limit, if the following two conditions are satisfied: The services rendered are of a professional nature and; In the opinion of the Nomination and Remuneration Committee the director possesses the requisite qualification for the practice of the profession. If the company does not require to have such a committee under section 178, the board can form this opinion.

12.2.9 Powers

The Board of Directors of a company shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to exercise and do provided that in exercising such power or doing such act or thing, the Board shall be subject to the provisions contained in that behalf in this Act, or in the memorandum or articles, or in any regulations not inconsistent therewith and duly made thereunder, including regulations made by the company in general meeting:

Provided further that the Board shall not exercise any power or do any act or thing which is directed or required, whether under this Act or by the memorandum or articles of the company or otherwise, to be exercised or done by the company in general meeting.

But, no regulation made by the company in general meeting shall invalidate any prior act of the Board which would have been valid if that regulation had not been made. Moreover, the Board of Directors of a company shall exercise the following powers on behalf of the company by means of resolutions passed at meetings of the Board, namely:

a) to make calls on shareholders in respect of money unpaid on their shares;

b) to authorize buy-back of securities under Section 68;

c) to issue securities, including debenture, whether in or outside India;

d) to borrow monies;

e) to invest the funds of the company;

f) to grant loans or give guarantee or provide security in respect of loans;

g) to approve financial statement and the Board's report;

h) to diversify the business of the company;

i) to approve amalgamation, merger or reconstruction;

j) to take over a company or acquire a controlling or substantial stake in another company;

k) any other matter which may be prescribed:

Provided that the Board may, by a resolution passed at a meeting, delegate to any committee of directors, the managing director, the manager or any principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office, the powers specified in clauses (d) to (f) on such conditions as it may specify.

Operational and Financial Control

12.3

A financial controller is responsible for the financial function of an overall organization. An operational controller job title specifies the responsibilities for a particular part of a company, so those duties vary from business to business depending on its operations. While there are some similarities of an operations or business controller versus financial controller, they are definitely two distinct roles within an organization. Both positions usually involve budgeting, forecasting and financial reporting. The financial control deals with the organization's daily accounting operations. It includes overseeing accounting, payroll, accounts payable and accounts receivable departments. By managing the organizational budget and the preparation and publishing of regulatory and monthly financial reporting, the financial controller gauges fiscal efficacy. Unlike a financial controller, the role of operation control includes reporting and budgeting responsibilities including fiscal reporting for a particular unit within the larger company.

Internal Financial Control for Financial Reporting [Section 134, 143 and 177]

12.4

Section 134 of the Companies Act, 21013 lays down provisions relating to Board's report, Directors Report-Financial Statement, Board's Report, etc.

It says that the financial statement, including consolidated financial statement shall be approved by the Board of Directors before they are signed on behalf of the Board by the chairperson of the company where he is authorised by the Board or by two directors out of which one shall be managing director, if any, and the Chief Executive Officer, the Chief Financial Officer and the company secretary of the company, wherever they are appointed, or in the case of One Person Company, only by one director, for submission to the auditor for his report thereon.

To this board's report, the auditors' report would be attached to every financial statement whereby the contents would include: a report by its Board of Directors, which shall include: the web address, number of meetings of the Board; Directors' Responsibility Statement; details in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government; a statement on declaration given by independent directors under sub-section (6) of section 149; in case of a company covered under sub-section (1) of section 178, company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (3) of section 178; explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report; and by the company secretary in practice in his secretarial audit report; particulars of loans, guarantees or investments under section 186; particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the prescribed form; the state of the company's affairs; the amounts, if any, which it proposes to carry to any reserves; the amount, if any, which it recommends should be paid by way of dividend; material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report; the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed; a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company; the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year; in case of a listed company and every other public company having such paid-up share capital as may be prescribed, a statement indicating the manner in which formal annual evaluation of the performance of the Board, its Committees and of individual directors has been made, among other things.

12.4.1 Duties of the Auditor

The duties of an auditor have been laid down by the Companies Act, 2013, provided in Section 143. The Act explains the duties in a simplified manner, although the list given is not exhaustive.

1. Every auditor of a company shall have a right of access at all times to the books of account and vouchers of

the company, whether kept at the registered office of the company or at any other place and shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor and amongst other matters inquire into the following matters, namely: –

a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its member;

b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;

c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares , debenture and other securities have been sold at a price less than that at which they were purchased by the company;

d) whether loans and advances made by the company have been shown as deposits;

e) whether personal expenses have been charged to revenue account;

f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading:

Provided that the auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries its subsidiaries and associate companies insofar as it relates to the consolidation of its financial statement with that of its subsidiaries its subsidiaries and associate companies .

2. The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statement or other document which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made there under or under any order made under sub-section (11) and to the best of his information and knowledge, the said accounts, financial statement or other document give a true and fair view of the state of the company's affairs as at the end of its financial year and such other matters as may be prescribed.

3. The auditor's report shall also state–

a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit;

b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

c) whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;

d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;

e) whether, in his opinion, the financial statements comply with the accounting standards;

f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

g) whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;

h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

i) whether the company has adequate internal financial controls system internal financial controls with reference to financial statements in place and the operating effectiveness of such controls;

j) such other matters as may be prescribed.

4. Where any of the matters required to be included in the audit report under this section is answered in the negative or with a qualification, the report shall state the reasons therefor.

5. In the case of a Government company, the Comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 and direct such auditor the manner in which the accounts of the Government company are required to be audited and In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 and direct such auditor the manner in which the accounts of the company are required to be audited an thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

6. The Comptroller and Auditor-General of India shall within sixty days from the date of receipt of the audit report under sub-section (5) have a right to—

a) comment upon or supplement such audit report, and

b) conduct any supplementary audit of the company's accounts by himself or by such person or persons as he may authorise in this behalf and such person or persons shall have the same rights and obligations as the auditor who has submitted the report :

Provided that any comments given by the Comptroller and Auditor-General on the report of the supplementary audit conducted by him shall be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

7. Without prejudice to the provisions of this Chapter, the Comptroller and Auditor-General of India may, in case of any company covered under sub-section (2) of section 123, if he so deems necessary, by an order, cause test audit to be conducted of the accounts of such company. The provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971 (56 of 1971), shall apply to the report of such test audit.

8. Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (hereafter in this section referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed.

Provided that the branch auditor shall prepare a report on the accounts of the branch examined by him and

send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

9. Every auditor shall comply with the auditing standards.
10. The Central Government may, after consultation with the National Advisory Committee on Accounting and Auditing Standards, by notification, lay down auditing standards:

    Provided that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.
11. The Central Government may, after consultation with the Advisory Committee, by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein.

    Provided that until the National Financial Reporting Authority is constituted under section 132, the Central Government may hold consultation required under this sub-section with the Committee chaired by an officer of the rank of Joint Secretary or equivalent in the Ministry of corporate Affairs and the committee shall have the representatives from the Institute of Chartered Accountants of India and Industry Chambers and also special invitees from the National Advisory Committee on Accounting Standards and the office of the Comptroller and Auditor General. (Effective from 10th April,2015)
12. Notwithstanding anything contained in this section, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within such time and in such manner as may be prescribed.
13. Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed:

    Provided that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed:

    Provided further that the companies, whose auditors have reported frauds under this subsection to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.
14. No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section
15. if it is done in good faith.
16. The provisions of this section shall mutatis mutandis apply to—
    a) the cost accountant in practice cost accountant conducting cost audit under section 148; or
    b) the conducting secretarial audit under section 204.
17. If any auditor, cost accountant, or company secretary in practice does not comply with the provisions of sub-section (12), he shall,–
    a) in case of a listed company, be liable to a penalty of five lakh rupees; and
    b) in case of any other company, be liable to a penalty of one lakh rupees.

Prepare an Audit Report

An audit report, in simple terms, is an appraisal of a business's financial position. The auditor is responsible for preparing an audit report based on the financial statements of the company. The books of accounts so examined by him should be maintained in accordance with the relevant laws.

He must ensure that the financial statements comply with the relevant provisions of the Companies Act 2013, relevant Accounting Standards etc. In addition to this, it is imperative that he ensures that the entity's financial statements depict a true and fair view of the company's financial position. Auditor is allowed to form a negative opinion, wherever necessary.

The auditor's report has a high degree of assurance and reliability because it contains the auditor's opinion on the financial statements. Where the auditor feels that the statements do not depict a true and fair view of the financial position of the business, he is also entitled to form an adverse opinion on the same.

Additionally, where he finds that he is dissatisfied with the information provided and finds that he cannot express a proper opinion on the statements, he will issue a disclaimer of opinion. A disclaimer of opinion basically indicates that due to the lack of information available, the financial status of the entity cannot be determined. However, it is to be noted that the reasons for such negative opinion is also to be specified in the report.

Make inquiries

One of the auditor's important duties is to make inquiries, as and when he finds it necessary. A few of the inquiries include: loans and advances made on the basis of security which are properly secured and the terms relating to the same, any personal expenses charged to the Revenue Account, loans and advances made, shown as deposits, compliance of financial statements with the relevant accounting standards

Lend assistance in case of a branch audit

Where the auditor is the branch auditor and not the auditor of the company, he will lend assistance in the completion of the branch audit. He shall prepare a report based on the accounts of the branch as examined by him and then send it across to the company auditor. The company auditor will then incorporate this report into the main audit report of the company. In addition to this, on request, if he wishes to, he may provide excerpts of his working papers to the company auditor to aid in the audit.

Comply with Auditing Standards

The Auditing Standards are issued by the Central Government in consultation with the National Financial Reporting Authority. These standards aid the auditor in performing his audit duties with relevant ease and accuracy. It is the duty of the auditor to comply with the standards while performing his duties as this increases his efficiency comparatively.

Reporting of fraud

Generally, in the course of performing his duties, the auditor may have certain suspicions with regard to fraud that's taking place within the company, certain situations where the financial statements and the figures contained therein don't quite add up. When he finds himself to be in such situations, he will have to report the matter to the Central Government immediately and in the manner prescribed by the Act.

Adhere to the Code of Ethics and Code of Professional Conduct

The auditor, being a professional, must adhere to the Code of Ethics and the Code of Professional Conduct. Part of this involves confidentiality and due care in the performance of his duties. Another important requisite is professional skepticism. In simple words, the auditor must have a questioning mind, must be alert to possible mishaps, errors and frauds in the financial statements.

Assistance in an investigation

In the case where the company is under the scope of an investigation, it is the duty of the auditor to provide assistance to the officers as required for the same. Hence, it can be seen that the duties of the auditor are pretty diverse, it has an all-round and far-reaching impact. The level of assurance provided by a set of audited financial statements is comparatively far higher as compared to regular unaudited financial statements.

12.4.2 Audit Committee (Section 177)

1. The Board of Directors of 1[every listed public company] and such other class or classes of companies, as may be prescribed, shall constitute an Audit Committee.
2. The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority:

   Provided that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement.
3. Every Audit Committee of a company existing immediately before the commencement of this Act shall, within one year of such commencement, be reconstituted in accordance with sub-section (2).
4. Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include,–
   i) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;
   ii) review and monitor the auditor's independence and performance, and effectiveness of audit process;
   iii) examination of the financial statement and the auditors' report thereon;
   iv) approval or any subsequent modification of transactions of the company with related parties;

   Provided that the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as may be prescribed;

   Provided further that in case of transaction, other than transactions referred to in section 188, and where Audit Committee does not approve the transaction, it shall make its recommendations to the Board:

   Provided also that in case any transaction involving any amount not exceeding one crore rupees is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and it is not ratified by the Audit Committee within three months from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee and if the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it:

   Provided also that the provisions of this clause shall not apply to a transaction, other than a transaction referred to in section 188, between a holding company and its wholly owned subsidiary company.
   v) scrutiny of inter-corporate loans and investments;
   vi) valuation of undertakings or assets of the company, wherever it is necessary;
   vii) evaluation of internal financial controls and risk management systems;
   viii) monitoring the end use of funds raised through public offers and related matters.
5. The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.

6. The Audit Committee shall have authority to investigate into any matter in relation to the items specified in sub-section (4) or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company.
7. The auditors of a company and the key managerial personnel shall have a right to be heard in the meetings of the Audit Committee when it considers the auditor's report but shall not have the right to vote.
8. The Board's report under sub-section (3) of section 134 shall disclose the composition of an Audit Committee and where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in such report along with the reasons therefor.
9. Every listed company or such class or classes of companies, as may be prescribed, shall establish a vigil mechanism for directors and employees to report genuine concerns in such manner as may be prescribed.
10. The vigil mechanism under sub-section (9) shall provide for adequate safeguards against victimisation of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases:

Provided that the details of establishment of such mechanism shall be disclosed by the company on its website, if any, and in the Board's report.

The Board of Directors of every listed public company and such other class or classes of companies, as may be prescribed, shall constitute an Audit Committee. The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority:

Provided that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement.

Every Audit Committee of a company existing immediately before the commencement of this Act shall, within one year of such commencement, be reconstituted in accordance with section 177 (2).

Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, among other things, include, the recommendation for appointment, remuneration and terms of appointment of auditors of the company; review and monitor the auditor's independence and performance, and effectiveness of audit process; examination of the financial statement and the auditors' report thereon; approval or any subsequent modification of transactions of the company with related parties; scrutiny of inter-corporate loans and investments; valuation of undertakings or assets of the company, wherever it is necessary; evaluation of internal financial controls and risk management systems; monitoring the end use of funds raised through public offers and related matters.

However, the Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.

Additionally, the Audit Committee shall have authority to investigate into any matter in relation to the items specified in sub-section (4) or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company.

The auditors of a company and the key managerial personnel shall have a right to be heard in the meetings of the Audit Committee when it considers the auditor's report but shall not have the right to vote.

Moreover, every listed company or such class or classes of companies, as may be prescribed, shall establish a vigil mechanism for directors and employees to report genuine concerns in such manner as may be prescribed. The vigil mechanism shall provide for adequate safeguards against victimisation of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases.

Rights of Shareholders

12.5

Section 2(55) of the Companies Act,2013 defines a member as:

1. The Subscribers to the Memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration, shall be entered as member in its register of members.
2. Every other person who agrees in writing to become a member of a company and whose name is entered in its register of members, shall be a member of the company.

   In Herdilia Unimers Ltd. v. Renu Jain [1995], it was held that the moment the shares were allotted and share certificate signed and the name entered in the Register of members, the allottee became the shareholder, irrespective of the allottee receiving the shares or not.

   A person whose name is not entered into register of members of company cannot be treated as member or deemed member-Sant Chemicals (P) Ltd. v. Aviat Chemicals (P.) Ltd. [2000].
3. Every person holding shares of the company and whose name is entered as beneficial owner in the records of a depository.

On this basis, apart from signing of the memorandum two pre- requisites for a person to become a member of a company are:

i) The agreement in writing to take shares of the company; and

ii) The registration of his name in its register of members.

Besides, a person may also become a member of a company through the depository system.

Thus, a person can agree to take shares of a company either as the subscriber to the memorandum at the initial stage of its formation or in any of the following manner:

a) by subscribing to its further or new shares;

b) on transfer of its shares from an existing member;

c) on acquisition or purchase of its share(for example, take-over bid, renunciation of right s by an existing members);

d) on acquisition of its shares by devolution (for example, transmission of shares to legal of a deceased member, on insolvency, upon merger/amalgamation through the Tribunal's order); and

e) on conversion of convertible debentures or loans pursuant to the terms of issue of such debentures or loan agreement respectively.

The fundamental difference between the subscribers who agree to take shares at the time of formation of

the company and persons who agree to take shares later is that the former become members immediately on incorporation of the company, that is, they automatically become members. The latter, through having agreed to take shares, become members only after their names are entered in the register of members of the company.

A member by virtue of the contract with the company and any other members via the Memorandum and Articles is entitled to have his name on the Register of members, to vote at the meeting of members, to receive dividends when declared, to exercise the right of pre-emption, return of capital on winding-up or on reduction of share capital of the company.

As a member he also has certain other rights which may or may not arise out of a contract. In exercise of such rights he is entitled of such rights he is entitled to bring action to restrain the company from doing an *ultra vires* act, to attend and take part in the proceeding of meetings of the company and to move amendments.

A person who is a shareholder of a company has many rights under the Act. Some of them are:

i) The right to vote at all meetings [Sec.47];

ii) The right to requisition an extraordinary general meeting of the compay [Sec.100];

iii) The right to receive notice of a general meeting [Sec.101];

iv) The right to appoint proxy and inspect proxy register [Sec.105]

v) In the case of a body corporate which is a member, the right to appoint a representative to attend a general meeting on its behalf [Sec.113]; and

vi) The right to require the company to circulate resolution [Sec.111].

vii) To have certificate of share held ready for delivery to him within two months from the date of allotment [Sec.56]

viii) To Transfer shares subject to the provisions of the Act and Article of Association [Sec.44].

ix) To inspect the Register of members and Register of debenture-holders and get extracts therefrom [Sec.94].

x) To obtain, on request, minutes of proceedings at general meetings as also to inspect the minutes [Sec.119].

xi) To apply to the Tribunal to have any variation of shareholders rights set aside [Sec.48].

xii) To participate in the removal of directors by passing an ordinary resolution [Sec.169]

Certain other rights of a member spelt out by the Supreme Court in Life Insurance Corporation of India v. Escorts Ltd. [1986] are:

i) To elect directors and thus to participate in the management through them;

ii) To enjoy the profits of the company in the shape of dividends;

iii) To apply to the court (now Tribunal) for relief in case of oppression;

iv) To apply to the court (now Tribunal) for relief in case of mismanagement;

v) To apply to the court (now Tribunal) for winding-up of the company; and

vi) To share in the surplus on winding-up

Key Managerial Personnel

12.6

Section 2(51) of the Companies Act, 2013, key managerial personnel, in relation to a company has been defined as:

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

ii) the company secretary;

iii) the whole-time director;

iv) the Chief Financial Officer

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

vi) such other officer as may be prescribed.

EXERCISE

Multiple Choice Question:

1. Which one of the following is not correct in regard to share certificate?
   a) The Company Secretary shall issue the share certificate.
   b) The share certificate shall be issued in pursuance of a resolution of the Board;
   c) Every share certificate shall be distinguished to its distinctive number.
   d) The shares may be in the dematerialized form.
2. If a company does not have a common seal, the share certificate shall be signed by-
   a) Two directors;
   b) One director and Company Secretary;
   c) Either (a) or (b);
   d) None of the above.
3. In case of unlisted company the duplicate share certificate shall be issued within a period of-
   a) 45 days
   b) 3 months
   c) 6 months
   d) None of the above.
4. The Bonus shares may be issued out of the-
   a) Free reserves;
   b) Securities premium account;
   c) Capital redemption reserve account;
   d) Any of the above.
5. For which purposes securities premium account can be utilized?
   a) In writing off the preliminary expenses;
   b) Buy back of shares;
   c) Issue of bonus shares;
   d) Any of the above.
6. The quorum for a public company having the number of members more than 5000 is-
   a) 2
   b) 5
   c) 15
   d) 30
7. An instrument of the proxy shall be deposited with the registered office of the company _____before the conduct of the meeting.
   a) 7 hours
   b) 21 hours
   c) 48 hours
   d) 60 hours.
8. In case of e-voting notice shall be sent as attachment in –
   a) PDF
   b) word file
   c) excel
   d) access
9. In the case of an adjourned meeting the company shall give not less than _____ notice to themembers.
   a) 1 days
   b) 3 days
   c) 7 days
   d) None of the above.

10. Which one of the following is not correct?
    a) The articles of the company shall provide for the appointment of Chairman in a meeting;
    b) The members personally present at the meeting shall elect one of themselves to be Chairman on a show of hands, if the article does not provide for the same;
    c) Managing Director is the Chairman of the meeting.
    d) The member selected as Chairman as a result of poll, continue the Chairman, who is elected by show of hands.
11. Which of the following is the method of voting?
    a) Voting by show of hands;
    b) Voting through electronic means;
    c) Voting by poll;
    d) All of the above;
12. A poll demanded on any question shall be taken within ____ from the time when the demand was made.
    a) Immediately;
    b) 12 hours;
    c) 24 hours;
    d) 48 hours.
13. Which one cannot be transacted through postal ballot?
    a) Appointment of auditor;
    b) Election of a Director;
    c) Buy back of shares by a company;
    d) Change in place of registered office outside the local limits of any city, town or village.
14. The assent or dissent received after _____ days in postal ballot, from the date of issue of notice, shall be treated as if no reply has been received from the member.
    a) 3;
    b) 7;
    c) 30;
    d) 45.
15. If any inspection is refused or if any copy required is not furnished within the specified time, the company shall be liable to a penalty of `____
    a) ₹10000;
    b) ₹25000;
    c) ₹50000;
    d) ₹1 lakh.
16. The minimum number of directors for a public company is-
    a) 1;
    b) 2;
    c) 3;
    d) 7.
17. What is the paid up share capital fixed for the appointment of a woman director?
    a) ₹100 crores;
    b) ₹300 crores;
    c) ₹500 crores;
    d) None of the above.
18. The appointment of an independent director shall be approved by the-
    a) Board meeting;
    b) General meeting;
    c) Registrar of Companies;
    d) Central Government.
19. The tenure of director appointed by small share holders shall be-
    a) Up to the date of next AGM;
    b) 1 year;
    c) 3 years;
    d) 5 years.

20. No independent director shall hold office for more than ____ consecutive terms.
    a) 2;
    b) 3;
    c) 4;
    d) 5.
21. Which public company is required to appoint independent director"
    a) The public company having turnover of ₹100 crores or more;
    b) The public company having paid up share capital of ₹10 crores or more;
    c) The public companies which have, in aggregate, outstanding loans, debentures and deposits exceeding ₹50 crores;
    d) Any of the above.
22. Which one of the following is not the criterion for the appointment of independent director?
    a) He shall not be a promoter of the company.
    b) He shall relate to the promoters of the company;
    c) He shall not have any pecuniary relationship with the company or their promoters or directors during two immediately preceding financial year.
    d) His relatives have not held any pecuniary relationship with the company amounting to 2% or more of its gross turnover.
23. A director may be elected by small share holders upon a notice by-
    a) Not less than 1000 small shareholders;
    b) One tenth of the total number of shareholders;
    c) Not less than 1000 small shareholders or one tenth of such shareholders, whichever is lower;
    d) None of the above.
24. At every AGM, not less than _____ of the total number of directors shall retire by rotation.
    a) One third;
    b) Two third;
    c) Three fourths;
    d) Half.
25. The minimum age prescribed for the appointament of Managing Director is-
    a) 18 years;
    b) 21 years;
    c) 30 years;
    d) 70 years.

⊙ **State TRUE or FALSE**

1. The company shall not convert its existing equity shares with voting rights into equity sharecapital carrying differential voting rights and vice versa.
2. The Board of Directors is not required to disclose in the Board's Report about the issue of equity shares with differential rights.
3. The holders of equity shares with differential rights shall have the rights of getting bonus shares,rights issue etc.,
4. A company can issue a share at discount.
5. The securities premium account can be utilized for the purchase of its own shares of securities.
6. No reduction of capital shall be made if the company is in arrears in repayment of any depositsaccepted by it.
7. A company limited by shares or limited by guarantee and having a share capital may, by ordinary resolution, reduce its capital.

8. The cancellation of shares shall not be deemed to reduction of share capital.
9. Where the dividend is not paid to the preference shareholders for a period of 3 years or more,they shall have a right to vote on all the resolutions placed before the company.
10. Bonus shares shall be issued by capitalizing reserves created by revaluation of assets.
11. Where there is no Company Secretary, the Annual Return shall be signed by a practicing Company Secretary.
12. Annual Return filed by the listed company shall be certified by a practicing Company Secretarystating the Annual Return discloses the facts correctly and adequately and that the companyhas complied with all the provisions of the Act.
13. Annual Return is not required to attach with the Board's Report.
14. Copies of Annual Return may be furnished to any member or other person on payment of feespecified in the Articles, subject to a maximum of ₹5/- per page.
15. Annual Returns shall be prima facie evidence of any matter directed or authorized to be insertedtherein by or under this Act.
16. A general meeting may be called after giving a shorter notice if consent is given in writing bynot less than 50% of members entitled to vote at such meeting.
17. Notice of every meeting of the company shall be given to the auditor of the company.
18. The Articles of the company shall provide the quorum for a meeting.
19. If the quorum is not there within half an hour in a meeting called by requisitionists, shall standadjourned to the same day in the next week at the same time and place.
20. A member of a company, not having share capital is entitled to appoint a proxy.
21. President of India may appoint such person as he thinks fit to act as his representative at anymeeting of the company.
22. A demand for poll may be withdrawn at any time by the persons who made the demand.
23. The e-voting shall remain open for not less than 3 days and shall close at 5.00 p.m. on the datepreceding the date of general meeting.
24. Once the resolution is cast by the member by e-voting, he is again allowed to vote in the meeting.
25. OPC and other companies having up to 200 members are not required to transact any business through postal ballot.
26. A company may appoint more than 15 directors after passing a resolution.
27. All companies are required to appoint one woman director.
28. An independent director shall not be entitled to any stock option.
29. Whole time director is not the employee of the company.
30. Additional director shall hold office up to the date of next AGM.
31. The DIN allotted to a director before the commencement of this Act shall be deemed to be the DIN allotted under the new Act.
32. Non obtaining of DIN does not amount to disqualification of a director.
33. The Board may accept the resignation of a Director on his submission of his application for resignation.
34. The removed directors shall not be reappointed as director by the Board of Directors.

35. In any financial year, if a company has no profits or its profits are inadequate, the company shall not pay. remuneration to its directors.

Fill in the blanks

1. The minimum number of members required for a public listed company is_____.
2. The maximum number of members for a private limited company is _____.
3. _____ provides the memorandum of association of an unlimited company and not having share capital.
4. _____ provides the Articles of Association of a company limited by guarantee and having share capital.
5. A company shall send copy of each of the document such as memorandum etc., to a member within ____ days of the request made by him.
6. The company is to file a copy of the order of the Tribunal approving the alteration of articles together with a printed copy of altered articles within _____ days.
7. Any alteration in the memorandum, in the case of company limited by guarantee and not having a share capital purporting to any person a right to participate in the divisible profits of the company, otherwise than as a member, shall be _____.
8. The Registrar on registering a company shall allot _____ on and from the date mentioned in the certificate of incorporation.
9. The _____ of the company shall contain the regulations for management of the company.
10. Table _____ in Schedule _____ provides the matters that shall be considered in the Articles.
11. The registered office shall be opened within _____ from the date of incorporation of the company.
12. The notice of every change in the situation of registered office shall be given to the Registrar of Companies within _____ of the change.
13. An application in _____ is to be filed with _____for seeking confirmation for shifting the registered office within the same State from the jurisdiction of Registrar of Companies to the jurisdiction of another Registrar of Companies.
14. The Regional Director shall communicate the confirmation of shifting of registered office within _____ of receipt of the application.
15. The company shall furnish to the Registrar, verification of its registered office within _____ from the date of its incorporation in _____ along with fee.
16. The prospectus shall contain a report by a Chartered Accountant upon the profits or losses for each of _____ financial years immediately preceding the date of issue of prospectus.
17. The promoters of every public company making a public offer of any convertible securities may hold such securities only in _____ form.
18. A company filing a Shelf prospectus is required to file an Information Memorandum in Form No. _____ with the Registrar within _____ prior to the issue of second or subsequent offer of securities under the issue of Shelf prospectus.
19. The Information Memorandum shall be deemed to be a _____.

20. _____ is a prospectus which does not include complete particulars of the quantum or price of the securities included therein.
21. The private placement shall be made, not more than _____ persons in aggregate in a financial year.
22. The value of such offer of invitation per person shall be with an investment size of not less than ₹_____ of face value of the securities.
23. The company making an offer or invitation shall allot securities within _____ from the date of receipt of the application money for such securities.
24. If the company is not able to allot securities, the application money shall be refunded within _____ days from the date of completion of _____ days.
25. If the application money is not refunded within the specified time, the company shall be liable to pay that money with interest at _____ per annum from the expiry of 60th day.
26. A share capital of the company includes _____.
27. The share capital of a company limited by shares shall be of two kinds namely, _____ and _____.
28. Equity share capital is of two types, _____, and _____.
29. The company shall maintain a Register of Employee Stock Option in Form No.._____.
30. If the shareholders not less than _____ of the issued shares of class did not consent to the variation or vote in favor of the special resolution for the variation, such shareholders may apply to the Tribunal to have the variation cancelled.
31. The company shall file the notice with the Registrar within a period of _____ in case of alteration or increase of redemption along with an altered memorandum.
32. Any share issued by a company at a discounted price shall be _____.
33. The share certificate shall be delivered by a company within a period of _____ from the date of allotment.
34. An instrument of transfer of securities, in physical form shall be filed in Form No. _____.
35. The company shall not issue sweat equity shares for more than _____ of the existing paid up share capital in a year.
36. Preference share capital is not entitled to _____ and_____.
37. A preference share shall be redeemed within a period not exceeding _____ from the date of their issue.
38. The issue of further redeemable share or redemption of preference shares shall not be deemed to be an _____ or _____ in the share capital.
39. The particulars of the issue of preference share holders shall be noted in the _____.
40. The resolution for issue of preference share shall indicatre the payment of dividend on _____or _____ basis.
41. No offer of buy back shall be made within a period of _____ reckoned from the date of closure of the preceding offer of buy back, if any.
42. The company shall file with the Registrar of Companies a letter of offer in Form No. _____ before the buyback of shares.

43. Every buy back shall be completed within a period of _____ from the date of passing special resolution in the general meeting or resolution passed by the Board.
44. The company shall destroy the share or securities bought back within _____ of the last date of completion of buy back.
45. After buy back a company shall not make a further issue of shares within a period of _____.
46. No company shall issue any debenture carrying _____.
47. Debentures shall be the _____ property.
48. A debenture trustee may be removed from the office before the expiry of his term only if it is approved by the holders of not less than _____ in value of the debenture outstanding at their meeting.
49. Every company required to create Debenture Redemption Reserve on or before _____ in each year.
50. For unlisted companies issuing debentures on private placement basis, the Debenture Redemption Reserve will be _____ of the value of the debentures.
51. A public company, having a net worth of not less than `_____ or a turnover of `_____ is eligible for making any invitation to the public for acceptance of deposits.
52. Every company accepting secured deposits from the public shall within _____ days on such acceptance create a _____ on its assets of amount not less than the amount of deposits accepted.
53. The minimum investment rating grate to be obtained from Brickwork Ratings India Private Limited is _____.
54. The company shall execute a deposit _____ in Form No. _____ at least 7 days before issuing circular or circular in the form of an advertisement.
55. The company on acceptance or renewal of a deposit is to furnish to the depositor or his agent a receipt for the amount received within a period of _____ days from the date of receipt of money.
56. On the request of the depositor after the expiry of _____ months from the date of such receipt but before the expiry of the period, the rate of interest shall be reduced by _____ from the fixed rate.
57. For issue of global depository receipt, a company is to pass _____ resolution in the general meeting.
58. The issue of depository receipts shall either be remitted to a bank account in _____ or deposited in an _____ bank operating abroad or any foreign bank, which is a scheduled bank under Reserve Bank of India Act, 1934.
59. The provisions relating to _____ is not applicable to global depository receipt issue.
60. The charge may be within _____ or _____ on the properties of the companies situated outside India.
61. The time limit for registration of charge is _____ days from the date of creation of charge.
62. The Registrar may, if he is satisfied that the company had sufficient cause for not filing the particulars within 30 days allow the registration after 30 days but within a period of _____ days of the creation of the charge.
63. The application for condonation of delay shall be made in Form No. _____.
64. The company shall, on payment or satisfaction full or any charge registered, give intimation to the Registrar

in Form No. _____ within _____ from the date of such satisfaction.

65. Every company limited by shares shall keep and maintain the Register of Members in Form No. _____.
66. The Registration shall be preserved for a period of _____.
67. A company may close the Register of Members/Debentures etc., for any period not exceeding in the aggregate of _____ days in each year.
68. Declaration of beneficial interest in any share shall be filed by a person with a company in _____ within ____ days from the date of the entry of his name in the Register.
69. The existing companies shall comply with the particulars within _____ from the date of commencement of the Rules.
70. Every company shall prepare Annual Return in Form _____.
71. The Annual Return shall be signed by _____ and _____,
72. Every company shall file the Annual Return with the Registrar within _____ from the date on which Annual General Meeting is held.
73. The Annual Return along with copies of all certificates and documents shall be kept for a period of _____ from the date of filing with the Registrar.
74. Every company shall file a return in Form No. _____ in respect of charges relating to either increase or decrease of 2% or more in the shareholding pattern within _____ days of such change.
75. A general meeting may be called by giving not less than clear _____ days notice either in writing or through electronic mode.
76. In case of a private company ____ members personally present shall be the quorum for a meeting of a company.
77. A person can act as proxy on behalf of members not exceeding _____ and holding in the aggregate note more than ____ of the total share capital of the company carrying voting rights.
78. At any general meeting, a resolution put to the vote of the meeting shall be decided on _____.
79. _____ shall be appointed to scrutinize the poll process.
80. The polling form shall be in Form No. _____.
81. The report of the scrutinizers shall be submitted to the Chairman within _____ from the date of poll is taken.
82. Postal ballot means voting by post within a period of _____ days from the date of dispatch of letter.
83. A copy of every resolution is to be filed with Registrar within _____ of the passing of the resolution.
84. Any member shall be entitled to be furnished within _____ of the request on payment of fee, with a copy of minutes.
85. Every company other than an _____ shall in each year held a general meeting as its AGM.
86. First AGM is to be conducted within _____from the date of the first financial year of the company.
87. The report of AGM shall be filed with the Registrar within _____ of the conclusion of AGM.

88. AGM is not to be conducted on a _____.

89. The Board shall conduct the EGM at the requisition made by not less than ____ of such of _____ of the company, if the company is having share capital.

90. The Board is to proceed to call a EGM within _____ days of the receipt of a valid requisition.

91. The EGM shall be conducted by the Board within _____ from the date of receipt of a valid requisition.

92. If the Board does not conduct the EGM, the requisitionists themselves conduct the meeting within _____ from the date of requisition.

93. The company is bound to give the list of members with their registered addresses before the expiry of _____ from the date of receipt of a valid requisition.

94. The Board shall have a minimum number of _____ directors in the case of private company.

95. The maximum number of directors shall be _____.

96. Small shareholder means a share holder holding shares of nominal value not more than `_____. 97. The company shall, within _____ days of the appointment of a director, file consent of director with the Registrar.

98. DIN stands for _____.

99. A return containing the appointment of directors and KMP and changes therein shall be filed with the Registrar within _____ days of such appointment or change by the company.

100. The maximum age limit of Managing Director is _____ years.

101. The total managerial remuneration payable by a public company to its directors, including Managing Director and Whole Time Director in respect of a financial year shall not exceed _____ of the net profits of the company.

102. Sitting fees shall not exceed _____ per meeting of the Board or Committee.

103. The office of a Director shall become vacant in case he absent himself from all the meeting of the Board of Directors held during a period of _____ with or without seeking leave of absence of Board.

⊙ Short Essay Type Questions

1. What are the salient features of One Person Company?
2. What are the features of companies registered under Section 8 of the Companies Act, 2013?
3. What are the information to be stated in a prospectus?
4. What is the liability for mis-statement in the prospectus?
5. What are the requirements for private placement?
6. What are the duties of debenture trustee?
7. What are the powers of Registrar in registering the charges?
8. What are the various types of meeting of a company?

9. What are the duties of a director in a company?

10. Write notes on-

a) Memorandum of Association;

b) Articles of Association.

c) Shelf prospectus

d) Red herring prospectus.

e) Deemed Public Offer

f) Employees Stock Option

g) Alteration of share capital

h) Solvency certificate

i) Letter of offer.

j) Debenture Redemption Reserve

k) Deposit Insurance

l) Register of Chargers

m) Inspection of Register

n) Independent Director

o) Director Identification Number

⊙ Essay Type Questions

1. Discuss the provisions about the 'nominated member' of One Person Company.
2. Which provisions of the Act in regard to Management and Administration are not applicable to One Person Company?
3. What are the documents to be submitted to Registrar of Companies for incorporation of a company?
4. In which manner the memorandum and Articles are to be signed on behalf of the company.
5. Discuss the procedure for alteration of memorandum.
6. What is the procedure for rectification of name of a company?
7. Which copies of documents may be furnished to the members at their request?
8. Discuss the procedure for service of documents on a company or its officers.
9. Discuss the procedure for obtaining a licence from the Government by Section 8 Companies.
10. What action may be taken by the Central Government on revocation of licence of Section 8 companies?
11. Describe the procedure for conversion of OPC into a public company or a private company.

12. Discuss the provisions relating to conversion of a private company into OPC.
13. Explain the provisions relating to pay commission in connection with the subscription to the securities, by a company.
14. What are the attachments to be made along with the Annual Return in Form PAS-3.
15. Describe the procedure of offer, allotment of securities under private placement scheme.
16. What are the conditions to issue equity shares with differential rights as to dividend, voting?
17. Sweat equity shares are issued to directors or employees at a discount or for consideration other than cash. – Discuss.
18. What is bonus share? How it is issued to the existing share holders?
19. Explain the provisions to voting rights of share holders.
20. What is the procedure for transfer and transmission of shares?
21. What are the conditions to issue preference shares?
22. What are the conditions for 'redemption of preference shares'?
23. What is the procedure for further issue of redeemable preference shares
24. What are the disclosures to be contained in the explanatory statement attached with the notice, in respect of buy back of shares by private companies and unlisted companies?
25. What are the obligations of a company in respect of buy back of shares?
26. What are the conditions for the issue of secured debentures?
27. Who may not be appointed as debenture trustee?
28. What is the procedure for conversion of debentures into shares?
29. What are the terms and conditions for acceptance of deposits?
30. What are the particulars to be entered in the Register of Deposits?
31. What are the conditions in issuing global depository receipt?
32. Briefly discuss the voting rights of the holder of global depository receipt.
33. Write the provision for rectification by Government in register of charges.
34. What is the procedure for registration of charges?
35. Discuss the provisions for certificate of registration.
36. When the holder of charge can file registration?
37. Discuss the provisions on foreign register.
38. What particulars are to be entered in the Register of Members?
39. By whom the Registers can be authenticated under Rule 8?
40. Indicate what are the particulars to be incorporated in the Annual Return?
41. Where the returns to be kept by the company and what are is its preservation period?

42. Describe the procedure of sending notice through electronic means.
43. What is the quorum of meeting? What is the consequence of the quorum is not present in the meeting?
44. Discuss briefly the methods of voting in a meeting.
45. What is the procedure for conducting a poll in a meeting?
46. What are the types of resolutions? Give a brief note of them.
47. Any member shall be entitled to inspect minutes of general meeting. – Discuss.
48. Describe the powers of Tribunal in calling for AGM?
49. In which form the report of AGM is to be prepared?
50. When is the first AGM is to be conducted? Describe the procedure of the same.
51. Discuss the procedure in detail for the conduct of Extra ordinary general meeting
52. Discuss the procedure for rotation of directors and re-appointment of directors.
53. What are the disqualifications for the appointment of director?
54. When the office of a Director shall become vacant?
55. Which will not form part of the remuneration of a Director?

⊙ Unsolved Cases

1. X was appointed as a Director by the Articles of Association of a public company incorporated on 1st June, 1970. The Managing Director empowered X to appoint a successor. X appointed Y as his successor after his death. Can Y succeed X as the director of the company?
2. A was a shareholder of a Company XYZ Ltd., which was a private company. The decision taken by the Board of Directors of this company was not followed by A and as a consequence A was removed as a shareholder from the company. Is this legally justified?
3. Mr. Abhishek filed a petition under Section 241 of Companies Act, 2013, as the initial director and shareholder of Punjab Petroleum Private Limited. The company Punjab Petroleum Private Limited is Respondent No. 1 in this case. Mr. Abhishek had subscribed to the Company's Memorandum of Association with Mr. Jogi, who is also the brother of Mr. Abhishek and the Respondent No. 2, having initial shareholding of 49% and 51% respectively. After the initial investment, Respondent No. 2 made further rounds of investment into the company by issuing the shares to the other shareholders (also respondents to the petition) during the period from 2010 to 2013, to meet its loan liability and other financial requirements. This caused the shareholding of the Petitioner to reduce from 49% to 8.45%. The meetings that had been conducted by the Board of Directors of the Company had not been notified to the Petitioner regarding increase in paid-up share capital of the Company and Respondent No. 2 had embezzled funds from the Company for personal benefits in addition to exploiting corporate opportunity for personal gains. Additionally the Board Meeting had been conducted in absence of a proper quorum and Respondent No. 2 had changed his own designation as Managing Director and appointed his wife as another director. Respondent No. 2 had also not given adequate notice before holding the shareholders' meeting to increase the authorized share capital and issuance of shares to other shareholders. Respondent No. 2 in his reply has stated that the issuance of shares was to the family members, therefore, formal intimation was not served to all the members.

a) According to the facts mentioned above, has the Petitioner been oppressed, and if so, is the present petition maintainable?

b) Discuss the case of Needle Industries (India) Ltd. vs. Needle Industries Newey Holding, AIR 1981 SC 1289.

Answer:

Multiple Choice Question:

1. a; 2. c; 3. b; 4. d; 5. d; 6. d; 7. c; 8. a; 9. b; 10. c; 11.d; 12. d; 13. a; 14. c; 15. b.16. c; 17. a; 18. b; 19. c; 20. a; 21. d; 22. b; 23. c; 24. b; 25. b.

State TRUE or FALSE

1. True; 2. False; 3. True; 4. False; 5. True; 6. True; 7. False; 8. True; 9. True; 10. False; 11. True; 12. True; 13. False; 14. False; 15. True; 16. False; 17. True; 18. True; 19. False; 20. False; 21. True; 22. True; 23. True; 24. False; 25. True; 26. True; 27. False; 28. True; 29. False; 30. True; 31. True; 32. False; 33. False; 34. True; 35. True.

Fill in the blanks

1. 7; 2. 200; 3. Table D; 4. Table G; 5. 7; 6. 15; 7. Void; 8. Corporate Identification Number – CIN; 9. Articles; 10. F, I; 11. 15 days; 12. 15 days; 13. Form No. INC – 23, Regional Director; 14. 30 days; 15. 30 days, INC-22; 16. 5; 17. Dematerialized form; 18. PAS 2, one month; 19. Prospectus; 20. Red herring prospectus; 21. 200; 22. ₹20,000; 23. 60; 24. 15, 60; 25. 12%; 26. Stock; 27. Equity share capital, preference share capital; 28. With voting rights, with differential rights as to dividend, voting; 29. SH-6; 30. 10%; 31. 30; 32. Void; 33. Two months; 34. SH-4; 35. 15%; 36. Dividend, any surplus in the winding up proceedings; 37. 20 years; 38. Increase, reduction; 39. Register of Members; 40. Cumulative, non cumulative; 41. One year; 42. SH-8; 43. One year; 44. 7 days; 45. Six months; 46. Voting rights; 47. Moveable; 48. Three fourth; 49. 30th day of April; 50. 25%; 51. ₹100 crores, ₹500 crores; 52. 30; charge; 53. BWRFBBB; 54. Trust deed, DPT-2; 55. 21 days; 56. 1%; 57. Special; 58. India; Indian; 59. Issue of public share or debentures; 60. India, outside India; 61. 30; 62. 300; 63. CHG -1; 64. CHG- 4, 30; 65. MGT-1; 66. 8 years; 67. 45; 68. Duplicate, 30; 69. 6 months; 70. MGT-7; 71. A director, Company Secretary; 72. 60 days; 73. 8 years; 74. MGT-10, 15; 75. 21; 76. 2; 77. 50, 10%; 78. A show of hands; 79. Scrutinizer; 80. MGT 12; 81. 7; 82. 30; 83. 30; 84. 7 working days. 85. OPC; 86. Nine months; 87. 30 days; 88. A National Holiday. 89. One tenth, paid up share capital;90. 21; 91. 45 days; 92. 3 months; 93. 45 days. 94. 2; 95. 15; 96. 20000; 97. 30; 98. Director Identification Number; 99. 30; 100. 70; 101. 11%; 102. ` 1 lakh; 103. 12 months.

SECTION - D

BUSINESS ETHICS

Business Ethics and Emotional Intelligence

13

This Module includes

Business Ethics and Emotional Intelligence

SLOB Mapped against the Module

To acquire the requisite knowledge of business ethics, emotional intelligence principles of public life, and how a strong code of ethics can help businesses to prosper.

Module Learning Objectives:

After studying this module, the students will be able -

- To acquire the requisite knowledge of business ethics, emotional intelligence, principles of public life, and how a strong code of ethics can help businesses to prosper.
- To develop an understanding about the internal code of ethics applicable to business, how ethics and law are related, how relevant are ethics to modern day business in a competitive world as ours, and how helpful is emotional quotient for business and self-development.

Ethics - Meaning, Importance and Nature

13.1

Business ethics is an essential skill. Almost every company now has a business ethics program, mostly because technology and digital communication have made it easier to identify and publicize ethical missteps. To avoid the negative implications, companies are devoting more resources to business ethics. In addition to establishing formal programs, companies are creating ethical workplaces by hiring employees with high integrity and honesty. Business successes is very intrinsically linked to ethics in the workplace.

Ethics

Business is an extension of the society and no business can sustain in the long run ignoring social values. Individual values percolate into society and turn into social values, which is turn are adopted by corporates and become corporate values. Corporate ethics, therefore, is choosing, adopting and practicing good thing and avoid bad things. Right and wrong varies from company to company but there some virtues and values which are universally accepted.

Ethics is a set of rules that define right and wrong conduct. The term 'ethics' derived from Latin word 'ethos' which means character. Ethics is a social science which deals with concepts such as right and wrong, moral and immoral, good and bad behavior of dealing with one another.

Ethics is the basic concepts and fundamental principles of decent human conduct. It includes the study of universal values of such as the essential quality of all men and women, human or natural rights, obedience to the law of land, concern for health and safety and increasingly, also for the natural environment.

Ethics are the set of moral principles that guide a person's behavior. These morals are shaped by social norms, cultural practices, and religious influences. Ethics reflect beliefs about what is right, what is wrong, what is just, what is unjust, what is good, and what is bad in terms of human behavior. They serve as a compass to direct how people should behave toward each other, understand and fulfill their obligations to society, and live their lives.

While ethical beliefs are held by individuals, they can also be reflected in the values, practices, and policies that shape the choices made by decision makers on behalf of their organizations. The phrases 'business ethics and corporate ethics' are often used to describe the application of ethical values to business activities. Ethics applies to all aspects of conduct and is relevant to the actions of individuals, groups, and organizations.

In addition to individual ethics and corporate ethics there are professional ethics. Professionals such as managers, lawyers, and accountants are individuals who exercise specialized knowledge and skills when providing services to customers or to the public. By virtue of their profession, they have obligations to those

they serve. For example, lawyers must hold client conversations confidential and accountants must display the highest levels of honest and integrity in their record keeping and financial analysis. Professional organizations, such as the American Medical Association, and licensing authorities, such as state governments, set and enforce ethical standards.

Type of ethics

Ethics may be divided into three types as follows:

- Meta ethics;
- Normative ethics;
- Applied ethics.

Meta ethics deal with the nature of moral judgment. It looks at the origins and meanings of ethical principles. Normative ethics is concerned with the content of moral judgments and the criteria for what is right or wrong. Applied ethics looks at controversial topics like war, animal rights and capital punishment.

Importance of ethics

Ethics is a requirement for human life. It is our means of deciding a course of action. Without it, our actions would be random and aimless. There would be no way to work towards a goal because there would be no way to pick between a limitless number of goals. Even with an ethical standard, we may be unable to pursue our goals with the possibility of success. To the degree which a rational ethical standard is taken, we are able to correctly organize our goals and actions to accomplish our most important values. Any flaw in our ethics will reduce our ability to be successful in our endeavors.

A proper foundation of ethics requires a standard of value to which all goals and actions can be compared to. This standard is our own lives, and the happiness which makes them livable. This is our ultimate standard of value, the goal in which an ethical man must always aim. It is arrived at by an examination of man's nature and recognizing his peculiar needs. A system of ethics must further consist of not only emergency situations, but the day-to-day choices we make constantly. It must include our relations to others and recognize their importance not only to our physical survival, but to our well- being and happiness. It must recognize that our lives are an end in themselves, and that sacrifice is not only not necessary, but destructive.

Ethics – Nature and relevance to the business

Several factors play a role in the success of a company that is beyond the scope of financial statements alone. Organizational culture, management philosophy and ethics in business each have an impact on how well a business performs in the long term. No matter the size, industry or level of profitability of an organization, business ethics are one of the most important aspects of long-term success.

The management team sets the tone for how the entire company runs on a day-to-day basis. When the prevailing management philosophy is based on ethical practices and behavior, leaders within an organization can direct employees by example and guide them in making decisions that are not only beneficial to them as individuals, but also to the organization as a whole. Building on a foundation of ethical behavior helps create long lasting positive effects for a company, including the ability to attract and retain highly talented individuals and building and maintaining a positive reputation within the community. Running a business in an ethical manner from the

top down builds a stronger bond between individuals on the management team, further creating stability within the company.

When management is leading an organization in an ethical manner, employees follow in those footsteps. Employees make better decisions in less time with business ethics as a guiding principle; this increases productivity and overall employee morale. When employees complete work in a way that is based on honesty and integrity, the whole organization benefits. Employees who work for a corporation that demands a high standard of business ethics in all facets of operations are more likely to perform their job duties at a higher level and are also more inclined to stay loyal to that organization.

The importance of business ethics reaches far beyond employee loyalty and morale or the strength of a management team bond. As with all business initiatives, the ethical operation of a company is directly related to profitability in both the short and long term. The reputation of a business from the surrounding community, other businesses and individual investors is paramount in determining whether a company is a worthwhile investment. If a company's reputation is less than perfect based on the perception that it does not operate ethically, investors are less inclined to buy stock or otherwise support its operations. With consistent ethical behavior comes increasingly positive public image, and there are few other considerations as important to potential investors and current shareholders. To retain a positive image, businesses must be committed to operating on an ethical foundation as it relates to treatment of employees, respect to the surrounding environment and fair market practices in terms of price and consumer treatment, business ethics is an applied ethics.

The Seven Principles of Public Life: Selflessness, Integrity, Objectivity, Accountability, Openness, Honesty, and Leadership

13.2

The Seven Principles of Public Life were set out by Lord Nolan for the first time in the year 1995. These principles of public life will apply to anyone who works as a public office holder, including elected and appointed to public office either locally or nationally. These principles apply to civil service, local government, the police, the Courts and probation of services, non-departmental public bodies, health, education, social are care services. These principles also apply to other sector that delivers public services.

The British Government appointed a committee called as Committee on Standards in Public Life to advise the Prime Minister on ethical standards of public life. The Committee was established in October 1994. The term of reference to the committee is –

- to examine current concerns about standards of conduct of all holders of public office, including arrangements relating to financial and commercial activities; and
- to make recommendations as to any changes in present arrangements which might be required to ensure the highest standards of propriety in public life.

The Committee submitted its first report in the year 1995 containing the seven principles of public life. The said principles have been amended over year. The seven principles of public life as amended up to and as on 2015 are as follows-

- **Selflessness** – Holders of public office should act solely in terms of the public interest.
- **Integrity** - Holders of public office must avoid placing themselves under any obligation to people or organizations that might try inappropriately to influence them in their work. They should not act or take decisions in order to gain financial or other material benefits for themselves, their family, or their friends. They must declare and resolve any interests and relationships.
- **Objectivity** - Holders of public office must act and take decisions impartially, fairly and on merit, using the best evidence and without discrimination or bias.
- **Accountability** - Holders of public office are accountable to the public for their decisions and actions and must submit themselves to the scrutiny necessary to ensure this.
- **Openness** - Holders of public office should act and take decisions in an open and transparent manner. Information should not be withheld from the public unless there are clear and lawful reasons for so doing.
- **Honesty** - Holders of public office should be truthful
- **Leadership** - Holders of public office should exhibit these principles in their own behavior. They should actively promote and robustly support the principles and be willing to challenge poor behavior wherever it occurs.

The Relationship between Ethics and Law 13.3

Laws and ethics both serve similar purposes of guiding human conduct to make it conducive to civilized social existence. They enforce a sense of right and wrong. Laws refer to the set of codified norms which are enforced by the state. They act as external obligations. On the other hand, ethics refer to the set of norms which guide our internal compass and judgements.

While laws apply uniformly to all, ethics can vary from person to person, and they change more frequently than laws. In case of a breach of law, the state is within its right to punish. Hence, they work as a medium of retributive justice. On the other hand, ethics are generally not enforceable.

The relationship between laws and ethics is a complex one. Many laws are representative of ethics of the time and have been shaped by what is considered ethical. The idea that everyone is equal before law is derived from the value that human is born equal. At the same time, laws have shaped ethics. They have been used to counter regressive doctrines.

From the above we can say that laws alone are not enough to promote ethical behaviour. Laws can never be so exhaustive to cover each and every scenario possible. Hence, there will always be scope for discretion. In such scenarios, ethical behaviour should come from within.

There are many scenarios where laws cannot exist, as we cannot have strict laws to scrutinize every small act of corruption. Even with laws, some unethical practices continue to exist such as violence against women. Laws and ethics are equally important and go hand in hand.

Business Ethics and its Relevance to Business

13.4

A business code of ethics is a body of policies based on laws and values that a company wants all employees to adhere to. Different types of industries have differing regulatory requirements that partially govern a company's code of ethics. All companies can set their own value-based policies as part of the company brand. Use examples of code of ethics to assist when creating your policies.

Promoting Green Business Practices

Another value-based code of ethics topic is promoting green and environmentally sounds business practices. This often includes limiting paper consumption but also has to do with recycling, waste disposal and the types of products a company uses to reduce its carbon footprint. That same cleaning company could require that all products follow specific environmental standards of safety for people, pets and the environment.

Obeying the Law

Obeying the law is a code of ethics subject that seems as if you shouldn't need to state it. However, finding out that employees have broken the law either during or after work can affect a company's brand. For example, a flower shop might require that all delivery drivers maintain a clean driving record. If an employee gets a DUI after work, this could affect his ability to do his job, even though the activity wasn't during his shift but this is a necessary part of the code of ethics.

Caring and Consideration Policies

Consumers often feel that businesses are just in it for the money and a quick sale. They are inundated with sales pitches all day long. As part of its code of ethics, your company could establish, that employees conduct business in a caring, considerate manner. Think about a home-care provider who is working with senior citizens and their loved ones; treating the patient and family in a way that demonstrates care can greatly increase the ability to get new clients.

This type of value-based code of ethics is a topic that employers should explain clearly in the document and to train employees as to what the expectations are for being a caring, considerate employee.

Confidentiality and Privacy Policies

In recent years, many companies and agencies have fallen prey to hackers stealing client information or proprietary data. One code of ethics section can require that employees maintain confidentiality when handling customers' personal or private information. Also include a similar policy that relates to the company secrets. Privacy policies are more than something you should do as a business owner, they are now regulated and required by law when any company collects personal and private information. Train employees on best practices to keep personal information out of the hands of the bad guys.

Professional Appearance Policies

Your company may have a dress code or dress policy. This could include a uniform shirt for service providers, a suit and tie for account representative or business casual for Fridays. What a person wears is part of the value-based code of ethics section. You could also state that you want employees' clothing to be clean and pressed; a cleaning service coming into someone's home appears more professional when the employees show up wearing company shirts that are clean and wrinkle-free.

Values and Attitudes of Professional Accountants

13.5

The roles, professional accountants take on a vast array of other roles in businesses of all sorts including in the public sector, not-for-profit sector, regulatory or professional bodies, and academia. Their wide ranging work and experience find commonality in one aspect – their knowledge of accounting. As such, professional accountants in businesses therefore have the task of defending the quality of financial reporting right at the source where the numbers and figures are produced besides the cost accounting. Like their counterparts in taxation or auditing, professional accountants in business play important roles that contribute to the overall stability and progress of society. Without public understanding of all these diverging roles and responsibilities of different accounting specialists working in business, public perceptions of their value may be misinformed.

A competent professional accountant in business is an invaluable asset to the company. These individuals employ an inquiring mind to their work founded on the basis of their knowledge of the company's financials. Using their skills and intimate understanding of the company and the environment in which it operates, professional accountants in business ask challenging questions. Their training in accounting enables them to adopt a pragmatic and objective approach to solving issues. This is a valuable asset to management, particularly in small and medium enterprises where the professional accountants are often the only professionally qualified members of staff.

Cost management is an activity of managers related to planning and control of costs. Managers have to take decisions regarding use of materials, processes, product designs and have to plan costs or expenses to support the operating plan for their department or section. All these activities come under cost management. Information from accounting systems help managers in cost management activities. But the cost accounting system and the reports it generates is not the cost management system. Accounting system can be interpreted as a part of cost management system of an organization.

Cost management is not cost reduction alone. It is much broader. Organization increase advertising expenditure to increase sales, increase research and development expenditures to promote new products. Here the concerned managers are deliberately incurring additional costs in a period (compared to the previous period) as they expect profits from such decisions or expenditures. Cost management system has to ensure that a cost is incurred with the expectation of profit.

The role of management accounting is also described as problem solving, score keeping and attention directing.

- **Problem solving:** The role of accounting in problem solving is to provide information useful in evaluating alternatives.
- **Scorekeeping:** Scorekeeping records the results of various actions of the managers and helps in assessing whether the results expected from the various actions are realized or not.

- **Attention directing:** The scorekeeping function in combination with expected results, and comparative analysis of scores of various companies, divisions and departments, comparative analysis of present period scores or results with previous periods show opportunities of focusing attention of managers to improve things.

Value Chain

Value chain is a visualization of complete business as a sequence of activities in which usefulness is added to the products or services produced and sold by an organization. Management accountants provide decision support for managers in each activity of value chain.

The design of management accounting system has to take into consideration the decision needs of the managers. Also it has to take into consideration the new themes and challenges that managers face currently.

- **Customer focus:** The challenge for managers it invest sufficient resources to enhance customer satisfaction. But every action of the organization has to result enhanced profitability or maintained profitability for the organization.
- **Key Success Factors:** These are nonfinancial factors which have an effect on the economic viability of the organization. Cost, quality, time and innovation are important key success factors. Management accounting systems need to have provisions for tracking the performance of the organization and its divisions as well as competitors on these success factors.
- **Continuous improvement:** Continuous improvement or kaizen is a popular theme. Innovation related to this area in costing is kaizen costing.
- **Value Chain and Supply Chain Analysis:** Value chain as a strategic framework for analysis of competitive advantage was promoted by Michael Porter. Management accountants have to become familiar with the framework and provide information to implement the framework by strategic planners.

Professional Ethics

Like other professionals, accountants also face ethical dilemmas. They need ethical guidelines. Competence, confidentiality, integrity and objectivity shall be the important themes of the guidance note.

Mission statement of The Institute of Cost Accountants of India

The Cost and Management Accountant professionals would ethically drive enterprises globally by creating value to stakeholders in the socio-economic context through competencies drawn from the integration of strategy, management and accounting.

The Institute has promulgated the following standards of ethical conduct for practitioners-

- maintain at all times independence of thought and action;
- not to express an opinion on cost / financial reports or statements without first assessing her or his relationship with her or his client to determine whether such Member might expect her or his opinion to be considered independent, objective and unbiased by one who has knowledge of all the facts; and
- when preparing cost / financial reports or statements or expressing an opinion on cost / financial reports or statements, disclose all material facts known to such Member in order not to make such cost / financial reports or statements misleading, acquire sufficient information to warrant an expression of opinion and report all material misstatements or departures from generally accepted accounting principles.

- not to disclose or use any confidential information concerning the affairs of such Member's employer or client unless acting in the course of his or her duties or except when such information is required to be disclosed in the course of any defense of himself or herself or any associate or employee in any lawsuit or other legal proceeding or against alleged professional misconduct by order of lawful authority or any committee of the Society in the proper exercise of their duties but only to the extent necessary for such purpose;
- inform his or her employer or client of any business connections or interests of which such Member's employer or client would reasonably expect to be informed;
- not, in the course of exercising his or her duties on behalf of such Member's employer or client, hold, receive, bargain for or acquire any fee, remuneration or benefit without such employer's or client's knowledge and consent; and
- take all reasonable steps, in arranging any engagement as a consultant, to establish a clear understanding of the scope and objectives of the work before it is commenced and will furnish the client with an estimate of cost, preferably before the engagement is commenced, but in any event as soon as possible thereafter.
- conduct himself or herself toward other Members with courtesy and good faith;
- not to accept any engagement to review the work of another Member for the same employer except with the knowledge of that Member, or except where the connection of that Member with the work has been terminated, unless the Member reviews the work of others as a normal part of his or her responsibilities;
- not to attempt to gain an advantage over other Members by paying or accepting a commission in securing management accounting work;
- not to act maliciously or in any other way which may adversely reflect on the public or professional reputation or business of another Member;
- at all times maintain the standards of competence expressed by the Institute from time to time;
- undertake only such work as he or she is competent to perform by virtue of his or her training and experience and will, where it would be in the best interests of an employer or client, engage, or advise the employer or client to engage, other specialists;

Primary Norms of Business Ethics: Honesty, Accountability etc., the Application in Decisions Regarding Employers, Finance and Trading

13.6

There are many kinds of business ethics. These may include personal responsibility, corporate responsibility, loyalty, respect, trustworthiness, fairness, community and environmental responsibility

- **Personal responsibility:** Each person who works for a business, whether on the executive level or the entry-level, will be expected to show personal responsibility. This could mean completing tasks your manager has assigned to you, or simply fulfilling the duties of your job description. If you make a mistake, you acknowledge your fault and do whatever you need to do to fix it.
- **Corporate responsibility:** Businesses have responsibilities to their employees, their clients or customers, and, in some cases, to their board of directors. Some of these may be contractual or legal obligations, others may be promises, for example, to conduct business fairly and to treat people with dignity and respect. Whatever those obligations are, the business has a responsibility to keep them.
- **Loyalty:** Both businesses and their employees are expected to show loyalty. Employees should be loyal to their co-workers, managers, and the company. This might involve speaking positively about the business in public and only addressing personnel or corporate issues in private. Customer or client loyalty is important to a company not only to maintain good business relations but also to attract business through a good reputation.
- **Respect:** Respect is an important business ethic, both in the way the business treats its clients, customers and employees, and also in the way its employees treat one another. When you show respect to someone, that person feels like a valued member of the team or an important customer. You care about their opinions, you keep your promises to them, and you work quickly to resolve any issues they may have.
- **Trustworthiness:** A business cultivates trustworthiness with its clients, customers and employees through honesty, transparency and reliability. Employees should feel they can trust the business to keep to the terms of their employment. Clients and customers should be able to trust the business with their money, data, contractual obligations and confidential information. Being trustworthy encourages people to do business with you and helps you maintain a positive reputation.
- **Fairness:** When a business exercises fairness, it applies the same standards for all employees regardless of rank. The same expectations with regard to honesty, integrity and responsibility placed upon the entry-level employee also apply to the CEO. The business will treat its customers with equal respect, offering the same goods and services to all based on the same terms.
- **Community and Environmental Responsibility:** Not only will businesses act ethically toward their clients, customers and employees, but also with regard to the community and the environment. Many companies look for ways to give back to their communities through volunteer work or financial investments. They will also adopt measures to reduce waste and promote a safe and healthy environment.

Internal Code of Ethics

13.7

A code of ethics in business is a set of guiding principles intended to ensure a business and its employees act with honesty and integrity in all facets of its day-to-day operations and to only engage in acts that promote a benefit to society. All companies will have a different code of ethics with different areas of interest, based on the industry they are involved in, but the five areas that companies typically focus on include integrity, objectivity, professional competence, confidentiality, and professional behavior. Many firms and organizations have adopted a Code of Ethics.

According to the CFAI's website, Members of CFA Institute, including CFA, and candidates for the CFA designation must adhere to the following Code of Ethics:

- Act with integrity, competence, diligence, respect, and in an ethical manner with the public, clients, prospective clients, employers, employees, colleagues in the investment profession, and other participants in the global capital markets.
- Place the integrity of the investment profession and the interests of clients above their own personal interests.
- Use reasonable care and exercise independent professional judgment when conducting investment analysis, making investment recommendations, taking investment actions, and engaging in other professional activities.
- Practice and encourage others to practice professionally and ethically that will reflect credit on themselves and the profession.
- Promote the integrity and viability of the global capital markets for the ultimate benefit of society.
- Maintain and improve their professional competence and strive to maintain and improve the competence of other investment professionals.

Ethics in Business Dealings

13.8

Meaning

Business ethics deals with morality in the business. It is a system of moral principles and values applied to business activities. This means the business activities should be conducted according to ethics or moral standard.

Definition

Business ethics is an art or science of maintaining harmonious relationship with society, its various groups and institution as well as reorganizing for right or wrong of business conduct.

Features of business ethics

- Code of conduct;
- Provide protection to social group;
- Provide basic frame work;
- Need willing acceptance;
- Education and guidance;
- Not against for profit making.

Principles

- Avoid exploitation of consumers;
- Avoid unfair trade practices;
- Fair treatment to employees.

Business ethics is defined as written unwritten codes of principles and values that govern decisions and actions within a company. Seven principles in business ethics are-

- Be trustful;
- Be keep open mind;
- Meet obligations;
- Have clear documents;
- Become community involved;
- Maintain accounting control;
- Be respectful.

Wrong doing by businesses has focused public attention and government involvement to encourage more acceptable business conduct. Any business decision may be judged as right or wrong, ethical or unethical, legal or illegal. Business ethics is the principles and standards that determine acceptable conduct in business organizations. The acceptability of behavior in business is determined by customers, competitors, government regulators, interest groups, and the public, as well as each individual's personal moral principles and values.

Many consumers and social advocates believe that businesses should not only make a profit but also consider the social implications of their activities. We define social responsibility as a business's obligation to maximize its positive impact and minimize its negative impact on society. Although many people use the terms social responsibility and ethics interchangeably, they do not mean the same thing. Business ethics relates to an individual's or a work group's decisions that society evaluates as right or wrong, whereas social responsibility is a broader concept that concerns the impact of the entire business's activities on society. From an ethical perspective, for example, we may be concerned about a health care organization or practitioner overcharging the provincial government for medical services. From a social responsibility perspective, we might be concerned about the impact that this overcharging will have on the ability of the health care system to provide adequate services for all citizens.

Areas in business ethics

- Corporate Social Responsibility;
- Fiduciary responsibility to stake holders;
- Industrial espionage.

Ethical behavior and corporate social responsibility can bring significant benefits to a business.

For example, they may

- attract customers to the firm's products, which means boosting sales and profits
- make employees want to stay with the business, reduce labour turnover and therefore increase productivity
- attract more employees wanting to work for the business, reduce recruitment costs and enable the company to get the most talented employees
- attract investors and keep the company's share price high, thereby protecting the business from takeover.

Knowing that the company, they deal with, has stated their morals and made a promise to work in an ethical and responsible manner allows investors' peace of mind that their money is being used in a way that arranges with their own moral standing. When working for a company with strong business ethics, employees are comfortable in the knowledge that they are not by their own action allowing unethical practices to continue. Customers are at ease buying products or services from a company they know to source their materials and labor in an ethical and responsible way.

A company which sets out to work within its own ethical guidelines is also less at risk of being fined for poor behavior, and less likely to find themselves in breach of one of a large number of laws concerning required behavior. Reputation is one of a company's most important assets, and one of the most difficult to rebuild should it be lost. Maintaining the promises it has made is crucial to maintaining that reputation. Businesses not following any kind of ethical code or carrying out their social responsibility leads to wider consequences. Unethical behavior may damage a firm's reputation and make it less appealing to stakeholders. This means that profits could fall as a result. The natural world can be affected by a lack of business ethics. For example, a business which does not show care for where it disposes its waste products, or fails to take a long-term view

when buying up land for development, is damaging the world in which every human being lives, and damaging the future prospects of all companies.

Emerging Issues in business ethics

The business is suffering and troubles by lack of proper directions and is struck on issues like logic, reasons etc. The issues like fairness, justice and honesty are the main issues that are posing complex dilemma to the businesses. A wrong or biased decision can have a profound impact on the goodwill of the company as well as its market position.

General business ethics

- Ethics of human resource management;
- Ethics of sales and marketing;
- Ethics of production;
- Ethics of Intellectual property, knowledge and skills;

Common unethical practices by executives of a corporate

i) Corruption - financial/non-financial

ii) Greed for profit/turnover

iii) Accommodating a group, may be employees, vendors, customers. (iv) Leak of knowledge

v) Leak of professionalism

vi) External pressure

vii) Ego and dominance of top management ignoring right things

Importance of business ethics

- Public expects business to exhibit high levels of ethical performance and social responsibility;
- Encouraging business firms and their employees to behave ethically is to prevent harm to society;
- Promoting ethical behavior is to protect business from abuse by unethical employees or unethical competitors;
- High ethical performance also protects the individuals who work in business.
- Improving consumer confidence
- Business become conscious of social responsibilities;
- Create good image of business;
- Goodwill;
- Profitability;
- Survival of heated competition
- Safety from legal perspectives

Need for business ethics

The following points discuss the need and importance of business ethics-

- to stop business malpractice;
- to improve customers' confidence;
- for the survival of business;
- to safeguard consumers' rights;
- to protect employees and shareholders;
- to develop good relations;
- to create good image;
- for smooth functioning;
- consumer movement;
- consumer satisfaction;
- importance of labor;
- healthy competition.

To stop business malpractice

Some unscrupulous businessmen do business malpractices by indulging in unfair trade practices like black-marketing, artificial high pricing, adulteration, cheating in weights and measures, selling of duplicate and harmful products, hoarding, false claims of representations about their products etc., These business malpractices are harmful to the consumers. Business ethics help to stop these business malpractices.

To improve customers' confidence

Business ethics are needed to improve the customers' confidence about the quality, quantity, price etc., of the products. The customs have more trust and confidence in the businessmen who follow ethical rules. They feel that such businessmen will not cheat them.

For the survival of the business

Business ethics are mandatory for the survival of business. The businessmen who do not follow it will have short term success, but they will fail in the long run. This is because they can cheat a consumer only once. After that, the consumer will not buy goods from that businessman. He will also tell others not to buy from that businessman. So this will defame his image and provoke a negative publicity. This will result in failure of the business. Therefore, if the businessmen do not follow ethical rules, he will fail in the market. So, it is always better to follow appropriate code of conduct to survive in the market.

To safeguard consumers' right

Consumer sovereignty cannot be either ruled out or denied. Business can survive so long it enjoys the patronage of consumer. The consumer has many rights such as right to health and safety, right to be informed, right to choose, right to be heard, right to redress, etc., But many businessmen do not respect and protect these rights. Business ethics must safeguard these rights of the consumers.

To protect employees and shareholders

Business ethics are required to protect the interest of employees, shareholders, competitors, dealers, suppliers etc., It protects them from exploitation through unfair trade practices.

To develop good relations

Business ethics are important to develop good and friendly relations between business and society. This will result in a regular supply of good quality goods and services at low prices to the society. It will also result in profits for the businesses thereby resulting in growth of economy.

For smooth functioning

If the business follows all the business ethics, then the employees, shareholders, consumers, dealers and suppliers will all be happy. So they will give full cooperation to the business. This will result in smooth functioning of the business. So, the business will grow, expand and diversify easily and quickly. It will have more sales and more profits.

Consumer movement

Business ethics are gaining importance because of the growth of the consumer movement. Gone are the days when the consumer can be taken for ride by the unscrupulous business by their false propaganda and false claims, unfair trade practices. Today, the consumers are aware of their rights and well informed as well as well organized. Now they are more organized and hence cannot be cheated easily. They take actions against those businessmen who indulge in bad business practices. They boycott poor quality, harmful, high priced and counterfeit goods. Therefore, the only way to survive in business is to be honest and fair. Consumer fora and consumer associations are more active and vocal now.

Consumer satisfaction

Today the consumer is the king of the market. Any business simply cannot survive without the consumers. Therefore, the main aim or objective of business is consumer satisfaction. If the consumer is not satisfied, then there will be no sales and thus no profits too. Consumers will be satisfied only if the business follows all the business ethics and hence are highly needed.

Importance of labor

Labor, i.e., employees or workers play a very crucial role in the success of a business. Therefore, business must use business ethics while dealing with the employees. The business must give them proper wages and salaries and provide them with better working conditions. There must be good relations between employer and employees. The employees must also be given proper welfare facilities.

Healthy competition

The business must use business ethics while dealing with the competitors. They must have healthy competition with the competitors. Healthy competition brings about efficiency, breaks complacency and leads to optical utilization of scarce resources, hence is always welcome. They must not do cut- throat competition. Similarly, they must give equal opportunities to small scale business. They must avoid monopoly. This is because a monopoly is harmful to the consumers.

Advantages of business ethics

The following are the advances for following the principles of business ethics-

- It offers a company a competitive advantage;

- Goodwill of the firm hikes depending on its responds towards its ethical issues;
- Productivity through rigid, firm and sincere workers as well as other business chain members;
- Through increasing morale and trust business can increase their market share;
- Publicity due to well and ethical performance;
- Acceptance of products of the company by the public;
- Overall growth of the society;
- Makes change management easy;
- Value integration with quality and strategy;

Recognition of ethical issues in business

Learning to recognize ethical issues is the most important step in understanding business ethics. An ethical issue is an identifiable problem, situation, or opportunity that requires person to choose from among several actions that may be evaluated as right or wrong, ethical or unethical. In business, such a choice often involves weighing monetary profit against what a person considers appropriate conduct. The best way to judge the ethics of a decision is to look at a situation from a customer's or competitor's viewpoint.

Many business issues may seem straightforward and easy to resolve, but in reality, a person often needs several years of experience in business to understand what is acceptable or ethical. Ethics are also related to the culture in which a business operates.

Business Relationship

The behavior of business persons toward customers, suppliers, and others in their workplace may also generate ethical concerns. Ethical behavior within a business involves keeping company secrets, meeting obligations and responsibilities, and avoiding undue pressure that may force others to act unethically.

Improving ethical behavior in business

Understanding how people make ethical choices and what prompts a person to act unethically may reverse the current trend toward unethical behavior in business. Ethical decisions in an organization are influenced by three key factors: individual moral standards, the influence of managers and coworkers, and the opportunity to engage in misconduct. It is difficult for employees to determine what conduct is acceptable within a company if the firm does not have ethics policies and standards. And without such policies and standards, employees may base decisions on how their peers and superiors behave. Professional codes of ethics are formalized rules and standards that describe what a company expects of its employees. Codes of ethics, policies on ethics, and ethics training programs advance ethical behavior because they prescribe which activities are acceptable and which are not, and they limit the opportunity for misconduct by providing punishments for violations of the rules and standards. The enforcement of such codes and policies through rewards and punishments increases the acceptance of ethical standards by employees.

Case Study on Business Ethics 13.9

Wells Fargo was a well-known name in the banking industry in the United States of America, with high returns on its equity and rising stock prices. Among their major goals, the company enlisted sale of its various products to its existing customers for more revenues. In September 2016, it came to light that the pressure on employees to hit sales quotas was immense such as hourly tracking, pressure from supervisors to engage in unethical behavior, and a compensation system based heavily on bonuses and commissions proportionate to the sales made. It came to be known that Wells Fargo had fired over 5,300 employees over the past few years related to questionable sales practices. However, the CEO John Stumpf tried to clarify by claiming that the scandal was the result of a few bad employees who did not honor the company's values and that there were no incentives to commit unethical behavior.

Further disclosures and reporting found more troubling information. Many employees had quit under the immense pressure to engage in unethical sales practices, and some were even fired for reporting misconduct through the company's ethics hotline. Senior leadership was aware of these aggressive sales practices as far back as 2004, with incidents as far back as 2002 identified.

The Board of Directors commissioned an independent investigation that identified cultural, structural, and leadership issues as root causes of the improper sales practices. The report cites: the wayward sales culture and performance management system; the decentralized corporate structure that gave too much autonomy to the division's leaders; and the unwillingness of leadership to evaluate the sales model, given its longtime success for the company.

What steps can leaders take to design systems that encourage ethical behavior rather than unethical behavior? What behaviors can leaders model in order to encourage ethical behavior in their organization?

Emotional Intelligence (Concept and Importance)

13.10

Emotional intelligence also known as emotional quotient or EQ, is the ability to understand, use, and manage your own emotions in positive ways to relieve stress, communicate effectively, empathize with others, overcome challenges and defuse conflict. Emotional intelligence helps you build stronger relationships, succeed at school and work, and achieve your career and personal goals. It can also help you to connect with your feelings, turn intention into action, and make informed decisions about what matters most to you.

Emotional intelligence is commonly defined by four attributes

- **Self-management –** You're able to control impulsive feelings and behaviors, manage your emotions in healthy ways, take initiative, follow through on commitments, and adapt to changing circumstances.
- **Self-awareness –** You recognize your own emotions and how they affect your thoughts and behavior. You know your strengths and weaknesses, and have self-confidence.
- **Social awareness –** You have empathy. You can understand the emotions, needs, and concerns of other people, pick up on emotional cues, feel comfortable socially, and recognize the power dynamics in a group or organization.
- **Relationship management –** You know how to develop and maintain good relationships, communicate clearly, inspire and influence others, work well in a team, and manage conflict.

Why is emotional intelligence so important?

As we know, it's not the smartest people who are the most successful or the most fulfilled in life. You probably know people who are academically brilliant and yet are socially inept and unsuccessful at work or in their personal relationships. Intellectual ability or your intelligence quotient (IQ) isn't enough on its own to achieve success in life. Yes, your IQ can help you get into college, but it's your EQ that will help you manage the stress and emotions when facing your final exams. IQ and EQ exist in tandem and are most effective when they build off one another.

Emotional intelligence affects

Your performance at school or work: High emotional intelligence can help you navigate the social complexities of the workplace, lead and motivate others, and excel in your career. In fact, when it comes to gauging important job candidates, many companies now rate emotional intelligence as important as technical ability and employ EQ testing before hiring.

Your physical health: If you're unable to manage your emotions, you are probably not managing your stress either. This can lead to serious health problems. Uncontrolled stress raises blood pressure, suppresses the immune

system, increases the risk of heart attacks and strokes, contributes to infertility, and speeds up the aging process. The first step to improving emotional intelligence is to learn how to manage stress.

Your mental health: Uncontrolled emotions and stress can also impact your mental health, making you vulnerable to anxiety and depression. If you are unable to understand, get comfortable with, or manage your emotions, you'll also struggle to form strong relationships. This in turn can leave you feeling lonely and isolated and further exacerbate any mental health problems.

Your relationships: By understanding your emotions and how to control them, you're better able to express how you feel and understand how others are feeling. This allows you to communicate more effectively and forge stronger relationships, both at work and in your personal life.

Conclusion

Business ethics is important to practice good ethical behavior. One of the most formidable challenges is avoiding immoral management, and transitioning from an amoral to a moral management mode of leadership, behavior, decision making, policies and practices. Moral management requires ethical leadership. It entails more than just 'not doing wrong'.

Moral management requires that managers search out of those vulnerable situations in which amorality may reign if carful, thoughtful reflection is not given by management. Moral management requires that managers understand, and be sensitive to, all the stakeholders of the organization and their stakes. If the moral management model is to be achieved, managers need to integrate ethical wisdom with their managerial wisdom and take steps to create and sustain an ethical climate in their organizations.

EXERCISE

⊙ Multiple Choice Question:

1. The relationship between laws and ethics is:

   a)Complex b) Simple

   c)Inexplicable d) None of the above

2. Many laws are ____ to ethics of time:

   a)Complimentary b) Supplementary

   c)Representative d) None of the above

3. Law gives us a certain right because all humans are born ___:

   a)Equal b) Unequal

   c)Subordinate d) None of the above

4. The role of accounting in problem solving is to provide information useful in _____ alternatives:

   a)finding b) Evaluating

   c)dismissing d) None of the above

5. Ethics are the set of moral principles that guide a person's

   a) Behaviour b) Philosophy

   c) Religion d) Profession

6. The following is the disadvantage of business ethics:

   a) Through increasing morale and trust business can increase their market share

   b) Publicity due to well and ethical performance

   c) Acceptance of products of the company by the public

   d) Diversity in achievements

⊙ State TRUE or FALSE

1. The term ethics is derived from latin word 'Ethos'.
2. Ethics is a requirement for human life.
3. The businessmen who do not follow business ethics will have short term success, but they will fail in the long run.
4. Ethics, in the practical sense, is also known as moral action and is an applied discipline.
5. Meta ethics deal with the nature of Moral Judgement.

Fill in the blanks

1. Selflessness means that the holders of public office should act solely in terms of the _____ .
2. Integrity means that the holders of _____ must avoid placing themselves under any obligation to people.
3. Accountability means that the holders of public office are accountable to the public for their decisions and actions and must submit themselves to the _____ necessary to ensure this.
4. Openness means that the holders of public office should act and take decisions in an open and ____ manner.
5. Objectivity means that the holders of public office must act and take decisions impartially, fairly and on merit, using the best evidence and without discrimination or _____.

Short Essay Type Questions

1. What is the role of management accounting in ethics?
2. What are the needs for business ethics?
3. Define 'Business ethics'.
4. What are the areas in business ethics and write note of the same.

Essay Type Questions

1. Discuss the concept of emotional intelligence
2. Discuss the nature of ethics and its importance in business
3. Explain what an internal code of ethics and its relevance in business is
4. Explain the seven principles of public life
5. How should the values and attitudes of professional accountants be like?
6. What are the standards of ethical conduct for practitioners fixed by the Institute of Cost Accountants of India?

Unsolved Cases

1. X was appointed as a Director by the Articles of Association of a public company. He knew certain information about the company which were financially unfavourable and could affect the interests of the shareholders largely. He appointed an auditor to unscrupulously audit the accounts to show it was running in profits, so that shareholders do not lose confidence in the company. Is X justified in doing so?

2. Z is the promoter of a company who wishes to sell his own property to the company at a high price which was unfair. However he appointed his nominees to the Board of Directors to ratify his sale price. Is he ethically justified in doing the same?

Answer:

Multiple Choice Question

1.a; 2.c; 3.a; 4.b; 5.a; 6.d

State TRUE or FALSE

1.True ; 2.False; 3.True; 4.True; 5.True

Fill in the blanks

1.public interest; 2 public office; 3. Scrutiny; 4. transparent; 5. Bias

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