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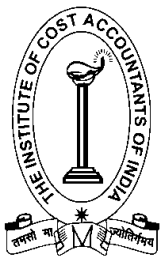
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SYLLABUS - 2016

# LAWS & ETHICS

INTERMEDIATE

STUDY NOTES



**The Institute of Cost Accountants of India**

CMA Bhawan, 12, Sudder Street, Kolkata - 700 016

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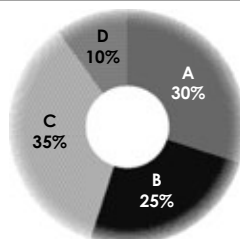
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# Syllabus – 2016

## PAPER 6: LAWS & ETHICS (LNE)

### Syllabus Structure

A	Commercial Laws	30%
B	Industrial Laws	25%
C	Corporate Laws	35%
D	Ethics	10%



### ASSESSMENT STRATEGY

There will be examination of three hours.

### OBJECTIVES

To give an exposure to some of the important laws essential and relevant for a business entity. To demonstrate an overview of laws related to Companies. To provide knowledge, comprehension and principles of Corporates. To construct the principles and ethical values of the business and professionals.

### Learning Aims

The syllabus aims to test the student's ability to:

- Explain fundamental aspects of laws relevant for a business entity
- Understand the principles of corporate governance and ability to implement and report compliance
- Create awareness and understanding of the ethical values

### Skill sets required

Level B: Requiring the skill levels of knowledge, comprehension, application and analysis.

**Note: Subjects related to applicable statutes shall be read with amendments made from time to time.**

<b>Section A : Commercial Laws</b>	<b>30%</b>
1. Laws of Contracts (Advanced level)	
2. Laws relating to Sale of Goods (Advanced level)	
3. Negotiable Instruments Act, 1881 (Advanced Level)	
4. Indian Partnership Act, 1932	
5. Limited Liability Partnership Act, 2008	
<b>Section B : Industrial Laws</b>	<b>25%</b>
6. Factories Act, 1948	
7. Payment of Gratuity Act, 1972	
8. Employees Provident Fund and Miscellaneous Provisions Act, 1952	
9. Employees State Insurance Act, 1948	
10. Payment of Bonus Act, 1965	
11. Minimum Wages Act, 1948	
12. Payment of Wages Act, 1936	
13. Pension Fund Regulatory and Development Authority Act, 2013	
<b>Section C : Corporate Laws</b>	<b>35%</b>
14. Companies Act, 2013	
<b>Section D : Ethics</b>	<b>10%</b>
15. Business Ethics	

**SECTION A: COMMERCIAL LAWS [30 MARKS]**

**1. Indian Contracts Act, 1872**

- (a) Essential elements of a contract, offer and acceptance
- (b) Void and voidable agreements
- (c) Consideration
- (d) Legality of object
- (e) E-contracts
- (f) Constraints to enforce contractual obligations
- (g) Quasi-contracts, contingent contracts, termination or discharge of contracts
- (h) Special contracts: Indemnity and Guarantee; Bailment and Pledge; Laws of Agency

**2. Sale of Goods Act, 1930**

- (a) Definition
- (b) Transfer of ownership
- (c) Conditions and Warranties
- (d) Performance of the Contract of Sale
- (e) Rights of Unpaid Vendor
- (f) Auction Sales

**3. Negotiable Instruments Act, 1881**

- (a) Definition and features of Negotiable Instrument
- (b) Crossing, Endorsement and Material Alteration
- (c) Acceptance, Assignment and Negotiation
- (d) Rights and liabilities of Parties
- (e) Dishonor of a Negotiable Instrument.

**4. Indian Partnership Act, 1932**

- (a) Nature of Partnership
- (b) Rights and liabilities of Partners
- (c) Formation, Reconstitution and Dissolution of Firms

**5. Limited Liability Partnership Act, 2008**

- (a) Concept, formation, membership, functioning
- (b) Dissolution

**SECTION B: INDUSTRIAL LAWS: Objects, Scope and Applicability of the following Acts [25 MARKS]**

- 6. Factories Act, 1948
- 7. Payment of Gratuity Act, 1972
- 8. Employees Provident Fund Act, 1952
- 9. Employees State Insurance Act, 1948
- 10. Payment of Bonus Act, 1965
- 11. Minimum Wages Act, 1948
- 12. Payment of Wages Act, 1936
- 13. Pension Fund Regulatory and Development Authority Act, 2013

**SECTION C : CORPORATE LAWS [35 MARKS]**

**14. Companies Act, 2013**

- (a) Company types, promotion, formation and related procedures i.e, Sec 1 to Sec 122 of Companies Act, 2013.
- (b) Director-Role, Responsibilities, Qualification, disqualification, appointment, retirement, resignation, removal, remuneration and powers, Director Identification Number.

**SECTION D : ETHICS [10 MARKS]**

**15. Business Ethics:**

- (a) Ethics-meaning, importance, nature and relevance to business
- (b) Values and attitudes of professional accountants.
- (c) Seven principles of public life-selflessness, integrity, objectivity, accountability, openness, honesty and leadership.
- (d) Ethics in Business



# Contents

## SECTION – A: COMMERCIAL LAWS

### Study Note 1 : Indian Contract Act, 1872

1.1	Essential Elements of a Contract, Offer and Acceptance	1
1.2	Void and voidable agreements	4
1.3	Consideration	7
1.4	Legality of object	9
1.5	E-contracts	10
1.6	Constraints to enforce contractual obligations	10
1.7	Quasi-contracts, contingent contracts, termination or discharge of contracts	19
1.8	Special contracts: Indemnity and Guarantee; Bailment and Pledge; Laws of Agency	25

### Study Note 2 : Sale of Goods Act, 1930

2.1	Definition	49
2.2	Transfer of ownership	52
2.3	Conditions and Warranties	56
2.4	Performance of the Contract of Sale	59
2.5	Rights of Unpaid Vendor	62
2.6	Auction Sales	65

### Study Note 3 : Negotiable Instruments Act, 1881

3.1	Definition and features of Negotiable Instrument	69
3.2	Crossing, Endorsement and Material Alteration	76
3.3	Acceptance, Assignment and Negotiation	81
3.4	Rights and liabilities of Parties	89
3.5	Dishonor of a Negotiable Instrument	93

### Study Note 4 : Indian Partnership Act, 1932

4.1	Nature of Partnership	103
4.2	Rights and liabilities of Partners	108
4.3	Formation, Reconstitution and Dissolution of Firms	113

### **Study Note 5 : Limited Liability Partnership Act, 2008**

5.1	Concept, formation, membership, functioning	127
5.2	Dissolution	153

## **SECTION – B : INDUSTRIAL LAWS**

### **Study Note 6 : Factories Act, 1948**

6.1	Factories Act, 1948 – Objects, Scope and Applicability	173
-----	--	-----

### **Study Note 7 : Payment of Gratuity Act, 1972**

7.1	Payment of Gratuity Act, 1972 – Objects, Scope and Applicability	191
-----	--	-----

### **Study Note 8 : Employees Provident Fund and Miscellaneous Provisions Act, 1952**

8.1	Employees Provident Fund and Miscellaneous Provisions Act, 1952 – Objects, Scope and Applicability	207
-----	---	-----

### **Study Note 9 : Employees State Insurance Act, 1948**

9.1	Employees State Insurance Act, 1948 – Objects, Scope and Applicability	219
-----	--	-----

### **Study Note 10 : Payment of Bonus Act, 1965**

10.1	Payment of Bonus Act, 1965 – Objects, Scope and Applicability	235
------	---	-----

### **Study Note 11 : Minimum Wages Act, 1948**

11.1	Minimum Wages Act, 1948 – Objects, Scope and Applicability	249
------	--	-----

### **Study Note 12 : Payment of Wages Act, 1936**

12.1	Payment of Wages Act, 1936 – Objects, Scope and Applicability	267
------	---	-----

### **Study Note 13 : Pension Fund Regulatory and Development Authority Act, 2013**

13.1	Introduction	283
13.2	National Pension System	284



## SECTION – C : CORPORATE LAW

### Study Note 14 : Companies Act, 2013

14.1	Company Types, Promotion, Formation and Related Procedures	287
14.2	Directors	397

## SECTION – D : ETHICS

### Study Note 15 : Business Ethics

15.1	Ethics - Meaning, Importance, Nature and Relevance to Business	415
15.2	Values and Attitudes of Professional Accountants	417
15.3	Seven Principles of Public Life	419
15.4	Ethics in Business	420





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# **Section A**

## **Commercial Laws**

**(Syllabus - 2016)**

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# Study Note - 1

## INDIAN CONTRACT ACT, 1872



### This Study Note includes

- 1.1 Essential Elements of a Contract, Offer and Acceptance
- 1.2 Void and Voidable Agreements
- 1.3 Consideration
- 1.4 Legality of Object
- 1.5 E-Contracts
- 1.6 Contraints to Enforce Contractual Obligations
- 1.7 Quasi-Contracts, Contingent Contracts, Termination or Discharge of Contracts
- 1.8 Special Contracts: Indemnity and Guarantee; Bailment and Pledge; Laws of Agency

### 1.1 ESSENTIAL ELEMENTS OF A CONTRACT, OFFER AND ACCEPTANCE

#### Introduction

The law relating to contracts in India is contained in **INDIAN CONTRACT ACT, 1872**. The Act was passed by British India and is based on the principles of English Common Law. It extends to the whole of India. It determines the circumstances in which promises made by the parties to a contract shall be legally binding on them. All of us enter into a number of contracts everyday knowingly or unknowingly. Each contract creates some rights and duties on the contracting parties. Hence this legislation, Indian Contract Act of 1872, being of skeletal nature, deals with the enforcement of these rights and duties on the parties in India.

#### Commencement of Act

The Act came into effect from 1<sup>st</sup> September, 1872 and applies to all contracts in India.

#### Proposal

According to Section 2(a) of Act, when one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal.

#### Acceptance

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".

#### Agreement

According to Section 2(e), every promise and every set of promises, forming the consideration for each other, is an agreement.

As per Section 2(f), promises which form the consideration or part of the consideration for each other are called reciprocal promises.

#### Void Agreement

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



## **Contract**

Section 2(h) defines the term 'contract ' 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.

## **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 i.e., it is not impossible of being performed.

## **OFFER AND ACCEPTANCE**

### **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'.

The offer must be a valid one. The following points are to be taken into account for a valid offer-

- The offer must be in clear, definite, complete and final in terms. It should not be vague in terms;
- The offer must be communicated to the offeree. The offer becomes effective only when it has been communicated to the offeree so as to give him an opportunity to accept or reject the offer;
- The communication may be in writing or oral;
- The communication may be in expressed terms or in implied terms;
- 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;



- Communication of offer is complete when it comes to the knowledge of the person to whom it is made. (Section 4)

An offer which has been communicated properly continues as such until it lapses or revoked by the offeror 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.

### Revocation of offer

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.

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;
- as against the person to whom it is made, when it comes to his knowledge.

**Example –** A revokes his proposal by telegram. The revocation is complete as against A when the telegram is dispatched. It is complete as against B when B receives it.

As per Section 6, a proposal is revoked—

- (1) by the communication of notice of revocation by the proposer to the other party;
- (2) by the lapse of the time prescribed in such proposal for its acceptance, or, if no time is so prescribed, by the lapse of a reasonable time, without communication of the acceptance;
- (3) by the failure of the acceptor to fulfil a condition precedent to acceptance; or
- (4) by the death or insanity of the proposer, if the fact of his death or insanity comes to the knowledge of the acceptor before acceptance.

A proposal also stands revoked if –

- It is not accepted in the prescribed mode and if no mode is prescribed, in some usual and reasonable manner or
- The offered makes a counter offer.

### 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 'Thawardar Pherumal V. 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.

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 offeror, since acceptance is completed the moment it is communication;
- 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 communication 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.

**1.2 VOID AND VOIDABLE AGREEMENTS****Void agreement**

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.

### 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 donee 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 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, for the natural 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.



### Agreement in restraint of marriage

minor, is void.

### 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 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 stipulate 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.

### 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;
- (c) A who is a dealer in coconut oil only, agrees to sell to B 'One hundred tons of oil'. The nature of A's trade affords an indication of the meanings of the words, and A has entered into a contract for the sale of one hundred tons of coconut oil.



- (d) A agrees to sell to B, 'all the grain in my granary at Ramnagar'. There is no uncertainty here to make the agreement void;
- (e) A agrees to sell to B 'One thousand maunds of rice at a price to be fixed by C'. As the price is capable of being made certain, there is no uncertainty here to make the agreement void;
- (f) A agrees to sell to B 'my white horse for ₹500/- or ₹1000/-. There is nothing to show which of the two prices was to be given. The agreement is void.

### 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 favor 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.

## 1.3 CONSIDERATION

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 promisee 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 donor's 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 donor's brother agreeing to pay the annuity. Afterwards the donee 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 types-

- 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.
- Executed or present – it is an act or forbearance made or suffered for a promise.
- 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: [Sec. 25]**

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:

1. Promise made on account of natural love and affection.
2. Promise to compensate for voluntary services.
3. 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.

**STRANGER TO CONTRACT / DOCTRINE OF PRIVACY OF CONTRACT:**

The doctrine of privacy of contract means that a contract is between the parties only and no third person can sue upon it. It means that a stranger to contract cannot sue upon it. The Supreme Court of India recognized this rule in *MC Chacko v State Bank of Travancore*. It is settled law that a person not a party to a contract cannot subject to certain well recognized exceptions, enforce the terms of the contract. Under the English Common law, only a person who is party to a contract can sue upon it. In India, the common law doctrine of privacy of contract is applicable. In the course of time, the courts have introduced a number of exceptions to rule of privacy of contract.

The Indian Contract Act, 1872 is silent about the right of a stranger to contract to sue or not to sue but the Privy Council extended the Principle of English Common law to India in its decision in *Jamna Das V Ram Avtar Pandey* which was affirmed by the Honourable Supreme Court of India in the case of *MC Chako v State Bank of Travancore*.

Accordingly, in the following circumstances a stranger to contract can sue:

1. Beneficiaries under trust or charge.
2. Marriage settlement, partition or other family arrangements.
3. Acknowledgement or estoppel.
4. Agency.
5. Assignee in case of insurance policy.



## 1.4 LEGALITY OF OBJECT

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 ₹1000/- to A. The agreement is void, because it is immoral;
- (k) A agrees to let her daughter to hire to B for concubinage. The agreement is void, because it is immoral, though the letting may not be punishable under the Indian Penal Code.



## 1.5 E-CONTRACTS

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 modeled, 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, accurate and reliable. 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.

## 1.6 CONSTRAINTS TO ENFORCE CONTRACTUAL OBLIGATIONS

### CAPACITY OF CONTRACT

#### Who are Competent to Contract? (Section 11)

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:

- (a) A person who has not attained the age of majority, i.e. minor.
- (b) A person of unsound mind
- (c) 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) SOUND MIND PERSON:**

#### **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.

#### **Illustrations:**

- (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.

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.

A 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.

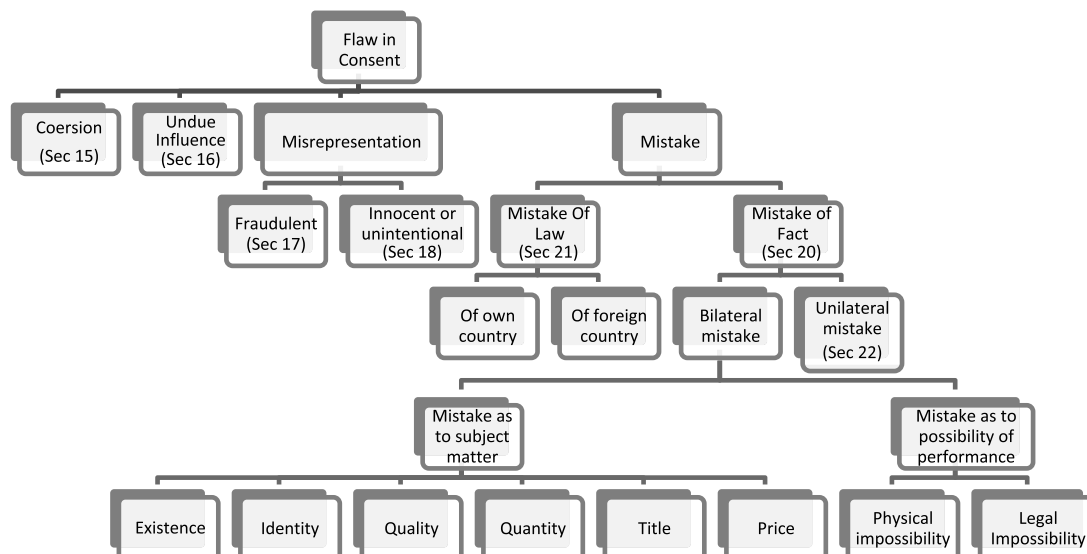
**FREE CONSENT**

**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—

- (1) Coercion (Sec 15), or
- (2) Undue influence (Sec 16), or
- (3) Fraud (Sec 17), or
- (4) Misrepresentation (Sec 18), or
- (5) Mistake, subject to the provisions of Sec 20, 21 and 22.







### **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;

- (i) Committing or threatening to commit any act forbidden by Indian Penal Code;
- (ii) 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, 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.

### **UNDUE INFLUENCE: [Sec. 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 forgoing 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:

- (i) The relationship subsisting between the parties is such that one party is in a position to dominate the will of other and
- (ii) 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 19 A 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:

- (i) the other party was in a position to dominate the will; and
- (ii) 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

### **FRAUD: [Sec. 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 keeping silence to speak, or unless his silence is, in itself, equivalent to speech.

### **Does silence amount to fraud?**

At times one of the parties to a contract makes silence 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 amount 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 contract, nevertheless, is not voidable, if the party whose consent was so caused had the means of discovering the truth with ordinary diligence.

**MISREPRESENTATION: [Sec. 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—

- (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, makes an absolute and explicit statement of facts, that fact is true, though he has no reliable source to form this opinion, but he believe 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 reaching A, and thus induces A to sell him his interest in the estate. The sale is voidable at the option of A.

### **MISTAKE: [Sec. 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 (Sec 21)
- (B) Mistake of fact (Sec 20)

**(A) Mistake of law may be:**

- (i) **mistake of law of the country**
- (ii) **mistake of law of a foreign country**

**(i) 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.

- (ii) **Mistake of law of foreign country:** Such a mistake is treated as mistake of fact and agreement in such case is void.

**(B) Mistake of fact may be:**

- (I) **Bilateral mistake, or**
- (II) **Unilateral mistake**

**(I) 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 identity 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.

(II) **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.

## 1.7 QUASI CONTRACTS, CONTINGENT CONTRACTS, TERMINATION OR DISCHARGE OF CONTRACTS

### 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.

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) A supplies B, a lunatic, with necessaries suitable to his condition in life. A is entitled to be reimbursed from B's property.



(b) 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.

**Examples:**

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 rupees to C, A alone pays the amount to C, and B, not knowing this fact, pays 100 rupees 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.

## 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-

**Example:**

A contracts to pay B ₹ 10,000 if B's house is burnt. This is a contingent contract.

The following are the essentials of a 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 'Harbakhsh 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 contracts 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 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.

#### **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.

### **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.

1. Discharge by performance
2. Discharge by agreement
3. Discharge by lapse of time
4. Discharge by operation of law
5. Discharge by impossibility of performance
6. Discharge by breach of contract

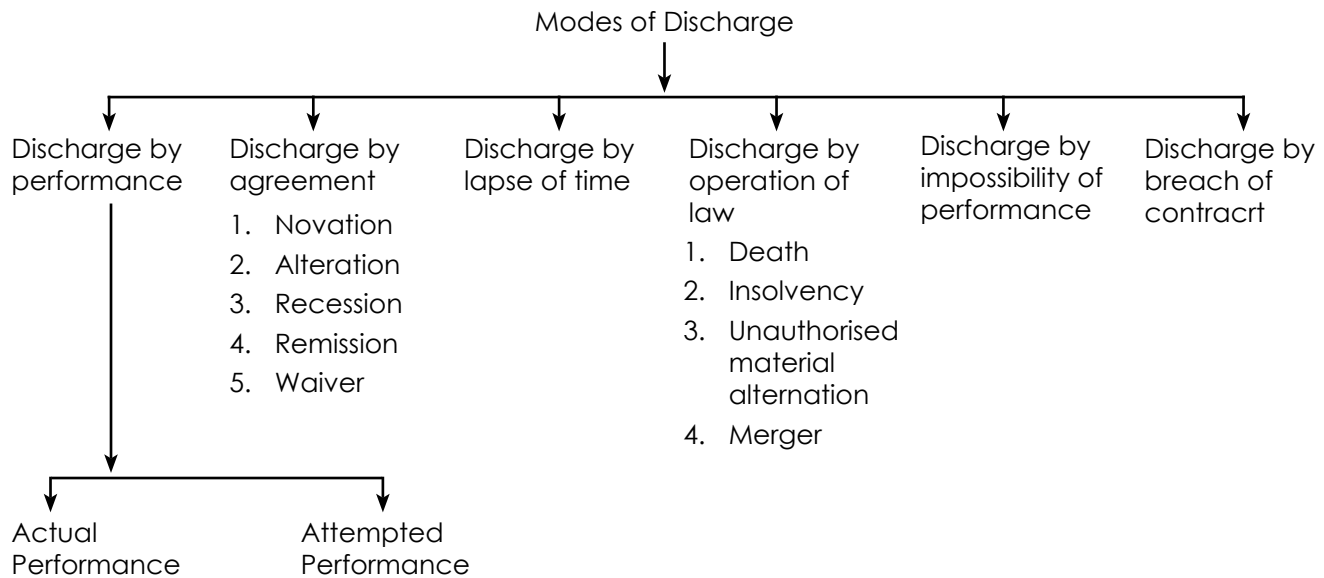
#### **1. Discharge by performance:**

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.
- (b) Alteration
- (c) Rescission
- (d) Remission
- (e) Waiver

**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 than what is actually due under the contract. There is no need of any consideration for remission.

**Example:** A has borrowed Rs. 500 from B. A agrees to accept Rs. 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
- (b) Insolvency
- (c) Unauthorized material alteration.
- (d) Merger

**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 lecturership.

**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.

## 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 V. 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.

## 1.8 SPECIAL CONTRACTS: INDEMNITY AND GUARANTEE; BAILMENT AND PLEDGE; LAWS OF AGENCY

### 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 mean 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 V. 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 shown, 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.

### **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 V. 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.

### 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 indemnifier 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.

### 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 V. 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 .

### **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 notwithstanding 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 ₹5000. B discounts bill for C to the extent of ₹2000/-. 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 ₹2000/- 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.





### 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;

### Which will not discharge the surety?

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.

### 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 ₹20000/- 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.

### 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 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.

### 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 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 30,000 rupees. A, B and C are each liable to pay 10,000 rupees.
- (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 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 40,000 rupees. A is liable to pay 10,000 rupees, and B and C 15,000 rupees 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 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 70,000 rupees. A, B and C have to pay each the full penalty of his bond.

### 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 ₹2000/- payment for rice to be supplied by C to B. C supplies to B rice to a less amount, than ₹2000/-, but obtains from A payment of the sum of ₹2000/- in respect of the rice supplied. A cannot recover from B more than the price of the rice actually supplied.

## BAILMENT AND PLEDGE

Chapter IX of the Act 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 interfere 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**

Section 151 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 Section 151 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 V. 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 purpose 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.

Section 157 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 V. 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 V. 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.

### 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 'Maharashtra State Co-operative Bank Limited V. Assistant Provident Fund Commissioner' – (2009) 10 SCC 123 it was held that in a pledge the pledgee 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 favor of the pledgee. Delivery of goods is necessary to complete a pledge.

### Difference between pledge and bailment

Section 172 of the Act defines 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. Section 173 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.

Section 175 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 pawnor upon the debt or promise and retain the goods pledged as a collateral security, or he may sell the things pledged, on giving the pawnor 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 pawnor 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 pawnor.

### **Retaining of the goods by pawnee**

Section 174 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 pawnor 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**

Section 178A provides that when the pawnor has obtained possession of the goods pledged by him under a contract voidable under Section 19 or Section 19A, but the contract has not been rescinded at the time of pledge, the pawnee acquires a good title to the goods, provided he acts in good faith and without notice of the pawnor's defect of title.

### **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 bailor 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.





## 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;

Section 187 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;
- (b) A, without B's authority, lends B's money to C. Afterwards B accepts interest on the money from C. 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.

**Example –**

- (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 far as regards the agent, take effect before it becomes known to him, or, so far as regards third persons, before it becomes known to them.



### Example –

- (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;



### Right 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 fact, 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 directs 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 prescribed 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 ₹2000/- 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 Singapur, 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 unskillfully 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 ₹6000/-. 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 fulfill the contract, if he can show that, if he had known who was the principal in the contract, or if he had known that the agent was not a principal, he would not have entered into the contract.

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 ₹1000/- 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 agent induces the agent to act upon the belief that the principal only will be held liable, or induces the principal to act upon the belief that the agent only will be held liable, he cannot 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 or obligations, if he has by his words or conduct induced such third persons to believe that such acts and obligations were within the scope of the agent's authority.

### Example –

- (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 principals.

**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.

**CHECK YOUR PROGRESS****Fill in the blanks**

1. Proposal is other called as\_\_\_\_\_.
2. Uncommunicated communication cannot result in a \_\_\_ or \_\_\_\_\_.
3. Agreements of wagers are\_\_\_\_\_.
4. Consideration is of three types, \_\_\_\_, \_\_\_\_\_ and \_\_\_\_\_.
5. The person in respect of whose default the guarantee is given is called the \_\_\_\_\_.
6. The person delivering the goods is called the \_\_\_\_\_.
7. No consideration is necessary to create\_\_\_\_\_.
8. The ratification may be\_\_\_\_\_ or \_\_\_\_\_ in the conduct of the person on whose behalf the acts are done.
9. \_\_\_\_\_ is a person employed to do any act for another or to represent another in dealing with the third person.
10. A contract of bailment is\_\_\_\_\_, if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of bailment.

**Choose the correct answer**

1. Which one of the following is not a quasi contract?
  - (a) Claim for necessaries supplied to person incapable of contracting, or on his account;
  - (b) Reimbursement of persons paying money by another, in payment of which he is interested;
  - (c) Uncertainty and futurity of the event to which it is related;
  - (d) Responsibility of finder of goods.
2. The breach of contract may be-
  - (a) Actual;
  - (b) Anticipatory;
  - (c) None of the above;
  - (d) Either of the above.
3. Which one of the following is not the feature of the contract of guarantee?
  - (a) There are two parties in this contract;
  - (b) The liability of surety is secondary;
  - (c) There is an existing debt for which the surety gives guarantee to the creditor on behalf of the principal debtor;
  - (d) The surety gives contract at the request of the principal debtor.
4. A person may not become an agent-
  - (a) If he is of the age of maturity;
  - (b) If he is of unsound mind;
  - (c) Either of the above;
  - (d) None of the above.



5. Which one of the following is not a contract?
  - (a) A finds B's purse and gives it to him. B promises to give him ₹1,000/-;
  - (b) A promises, for no consideration, to give ₹10,000/-;
  - (c) A agrees to sell a horse worth of ₹1,000/- for ₹10/-;
  - (d) A supports B's infant son. B promises to pay A's expenses in so doing.
6. Which one of the following is not a lawful object?
  - (a) A promises to obtain for B an employment in the public service and B promises to pay ₹ 2 lakhs to A;
  - (b) A agrees to sell his house to B for ₹25 lakhs for which B agrees;
  - (c) A promises to maintain B's child and B promises to pay ₹5,000/- per month;
  - (d) A promises to pay ₹1 lakh at the end of six months if C who owes that sum to B fails to pay. B promises to grant time to C accordingly.
7. Which one of the following is not the discharge by operation of law?
  - (a) By merger;
  - (b) By insolvency;
  - (c) By breach of contract;
  - (d) By the unauthorized alteration of items of a written document.

**State whether TRUE or FALSE**

1. Silent on the part of the offeree amounts to acceptance.
2. An agreement to which the consent of the promisee is freely given is not void.
3. Electronic contracts are paperless contracts.
4. Claim for necessities supplied to person incapable of contracting, or on his account is called contingent contract.
5. The surety gives contract at the request of the principal debtor.
6. In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety.
7. Gratuitous bailment continues even after the death of either of the bailor or bailee.
8. The pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods released.
9. The sub agent is responsible for his act to the principal.
10. The termination of the authority of an agent causes the termination of the authority of all sub agents appointed by him.

**Model Questions**

1. What are the points to be taken into account for a valid offer?
2. What are the requirements for a valid contract?
3. When an offer may be lapsed?
4. What are two points to be taken into account in case of acceptance?
5. Describe the procedure to revoke offer and acceptance?
6. Under what circumstances the agreement becomes void?
7. Write short notes on –
  - (a) e-contracts;
  - (b) Quasi Contracts;
  - (c) Contingent contracts.



8. In which ways the contract may be discharged?
9. Differentiate between contract of indemnity and contract of guarantee.
10. Who is surety in a contract? What are his rights?
11. What are the rights of the finder of goods?
12. Differentiate pledge from bailment.
13. Discuss the duties of agents.
14. What are the obligations of the Principal to agent?
15. How the agency can be terminated?

**Answer:**

**Fill in the blanks**

1. Offer;
2. Promise, acceptance;
3. Void;
4. Executor, executed, past;
5. Principle debtor;
6. Bailee;
7. Agency;
8. Expressed, implied;
9. Agent;
10. Voidable at the option of the bailor.

**Choose the correct answer**

1. C;
2. D;
3. A;
4. D;
5. B;
6. A
7. C.

**State whether TRUE or FALSE**

1. FALSE;
2. TRUE;
3. TRUE;
4. FALSE;
5. TRUE;
6. TRUE;
7. FALSE;
8. TRUE;
9. FALSE;
10. TRUE.

# Study Note - 2

## SALE OF GOODS ACT, 1930



### This Study Note includes

- 2.1 Definition
- 2.2 Transfer of Ownership
- 2.3 Conditions and Warranties
- 2.4 Performance of Contract of Sale
- 2.5 Rights of an Unpaid Vendor
- 2.6 Auction Sales

### 2.1 DEFINITION

#### Introduction

The law relating to sale or purchases goods was dealt with by the Indian Contract Act, 1872, prior to 1930. During the year 1930, Sections 76 to 123 of the Indian Contract Act were repealed. A separate Act viz., Sale of Goods Act, 1930 was passed. The Sale of Goods Act, 1930 lays down the special provisions governing the contract of sales of goods. The provisions of the Indian Contract Act are also applicable to the contracts for the sale of goods unless they are inconsistent with the express provisions of the Sale of Goods Act.

#### Applicability

This Act extends to whole of India.

#### Effective date

This Act came into force from 01.07.1930.

### IMPORTANT DEFINITIONS

#### Goods

Section 2(7) defines the term 'goods' as 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.

#### Future Good

Section 2(6) defines the phrase 'future good' as goods to be manufactured or produced or acquired by the seller after making of the contract of sale.

#### Document of title to goods

Section 2(4) defines the phrase 'document of title to goods' as including bill of lading dock-warrant, warehouse keeper's certificate, wharfingers' certificate, railway receipt, multimodal transport document, warrant or order for the delivery of goods and any other document used in the ordinary course of business as proof of the possession or control of goods or authorizing or purporting to authorize, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented.



## Insolvent

Section 2 (8) provides that a person is said to be "insolvent" who has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due, whether he has committed an act of insolvency or not;

## Mercantile agent

Section 2(9) defines the phrase 'mercantile agent' as a mercantile agent having in the customary course of business as such agent 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 goods.

## Specific goods

Section 2(14) defines the phrase 'specific goods' as goods identified and agreed upon at the time a contract of sale is made;

## CONTRACT OF SALE

As per section 4(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." According to Section 4(2), a contract of sale may be absolute or conditional.

## Essentials of a Contract of Sale

The following are thus the essentials of a contract of sale of goods:

- (1) **Bilateral contract:** It is a bilateral contract because the property in goods has to pass from one party to another. A person cannot buy the goods himself.
- (2) **Transfer of property:** The object of a contract of sale must be the transfer of property (meaning ownership) in goods from one person to another.
- (3) **Goods:** The subject matter must be some goods.
- (4) **Price** or money consideration: The goods must be sold for some price, where the goods are exchanged for goods it is barter, not sale.
- (5) All essential elements of a valid contract must be present in a contract of sale.

## Agreement to sell

As per Section 4(3), 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. Section 4(4) provides that 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.

## Contract of sale how made

Section 5(1) provides that 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 of both, or for the delivery or payment by instalments, or that the delivery or payment or both shall be postponed.

Section 5(2) provides that 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.



### **Subject matter of contract**

The subject matter of the contract –

- existing or future goods;
- goods perishing before making contract;
- goods perishing before sale but after agreement to sell.

### **Existing or future goods**

Section 6 provides that-

- 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.
- 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.
- 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.

### **Goods perishing before making contract**

Section 7 provides 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.

### **Goods perishing before sale but after agreement to sell**

Section 8 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.

### **Ascertainment of price**

Section 9(1) provides that the price 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.

Section 9(2) provides that where the price is not determined in accordance with the foregoing provisions, the buyer shall pay the seller a reasonable price. What is a reasonable price is a question of fact dependent on the circumstances of each particular case.

### **Agreement to sell at valuation**

Section 10(1) provides that 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. If the goods or any part thereof have been delivered to, and appropriated by, the buyer, he shall pay a reasonable price therefor.

Section 10(2) provides that 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.

### **Stipulations to time**

Section 11 provides that 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.

**Difference between contract of sale and agreement to sell.**

<b>Basis</b>	<b>Contract of sale</b>	<b>Agreement to sell</b>
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.
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.

**2.2 TRANSFER OF OWNERSHIP****Transfer of Ownership**

The Sections 18 to 25 of the Sale of Goods Act, determine when the property passes from the seller to the buyer.

**Rules for Ascertaining Passing of Property:**

The provisions are discussed hereunder:

**(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 section 20-24 are required to be applied for ascertaining the time of transfer of property and the same are discussed hereunder:

**(i) Specific goods (Secs 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. (Sec 20). 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 (Sec. 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 (Sec 21).

**(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. (Sec 22).

**(ii) Unascertained goods (Sec 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' (Sec 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.

**Reservation of Right of Disposal (Sec 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.

**Sec 25(2)**– Where goods are shipped or delivered to a railway administration for carriage by railway and by the bill of lading 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.

**Sec 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.

### **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.

### **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.

### **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 qui 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, if 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 goods pawned subject to satisfying some conditions.
  - (iii) 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.
  - (iv) 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.

### 2.3 CONDITIONS AND WARRANTIES

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.

#### 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.

#### 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.

#### Differences between Condition and Warranty

S.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.

#### 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.

### **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).

### **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.

### **Implied conditions are of the following types:**

#### **(i) Condition as to title [Sec 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 (Sec 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 such as MP Atta, Dehradun Rice, Kashmiri Rajama, Amul butter and the buyer contracted relying on such description of goods by the seller.

#### **(iii) Condition as to quality or fitness (Sec 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'. However, there are some exceptions to this 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.

It may be noted 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.

#### **(iv) Sale by sample (Sec 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.

- (v) 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.**

#### **Implied warranties are of following types:**

The implied warranties are as under:

##### **(i) Warranty of quiet possession [Sec.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.



**(ii) Warranty of freedom from encumbrances [Sec.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.

**(iii) 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.

**(iv) Warranty to disclose dangerous nature of goods:**

Where a person sell 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.

**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”. In simple words, 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) 4 A.C. 13, 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.

Exceptions: Section 16 lays down the following exceptions to the doctrine of Caveat Emptor:

- (1) Where the seller makes a false representation and the buyer relies on it.
- (2) When the seller actively conceals a defect in the goods which is not visible on a reasonable examination of the same.
- (3) When the buyer, relying upon the skill and judgement of the seller, has expressly or impliedly communicated to him the purpose for which the goods are required.
- (4) Where goods are bought by description from a seller who deals in goods of that description.

**2.4 PERFORMANCE OF CONTRACT OF SALE**

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



### **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 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 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 installments 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 installments which are to be separately paid for and-

- the seller makes no delivery or defective delivery in respect of one or more installments; or
- the buyer neglects or refuses to take delivery of or pay for one or more installments

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 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.

### **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.

## **2.5 RIGHTS OF AN UNPAID VENDOR**

### **Unpaid seller**

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.

### **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



**(a) 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:

- (i) the goods have been sold without any stipulation as to credit; or
- (ii) the goods have been sold on credit, but the term of credit has expired; or
- (iii) 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.

A lien is lost – (i) 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;

- (ii) When the buyer or his agent lawfully obtains possession of the goods;
- (iii) By waiver of his lien by the unpaid seller

**(b) 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

- (i) when the buyer becomes insolvent; and
- (ii) 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:

- (i) If the buyer obtains delivery before the arrival of the goods at their destination;
- (ii) 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;
- (iii) 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.

**(c) Right of re-sale** (Section 54):

The unpaid seller may re-sell:

- (i) where the goods are perishable;
- (ii) where the right is expressly reserved in the contract;
- (iii) 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.

**(d) 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.

**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: [Sec. 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: [Sec. 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: [Sec. 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 painting, 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,

- (a) set up the breach of warranty in extinction or diminution of the price payable by him, or
- (b) 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.

## 2.6 AUCTION SALE

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, bid 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.

### CHECK YOUR PROGRESS

#### Fill in the blanks

1. 'Goods' under Sale of Goods Act is \_\_\_\_\_ property.
2. The contract of sale is an \_\_\_\_\_ contract.
3. A warranty is a stipulation \_\_\_\_\_ to the main purpose.
4. In an agreement to sale, the transfer of property in the goods is to take place at a \_\_\_\_\_ time.
5. When the property is transferred to the buyer the goods are at the \_\_\_\_\_ risk whether the delivery has been made or not.
6. The seller of the goods is deemed to be \_\_\_\_\_ when the whole of the price has not been paid.
7. The unpaid seller has the right of \_\_\_\_\_ on the goods for the price while he is in possession of them.
8. The contract of sale is not \_\_\_\_\_ by the mere exercise by unpaid seller of his right of lien or stoppage in transit.
9. Where no time is fixed for the acceptance of goods, the measure of damage is the difference between the \_\_\_\_\_ price and the market price on the date of refusal by the buyer to accept the goods.
10. If the buyer or his agents obtains delivery of the goods before their arrival at the appointed destination, the transit is at an \_\_\_\_\_.

#### Choose the correct answer

1. Which one of the following is not the feature of 'agreement to sale'?
  - (a) It is an executor contract;
  - (b) Sales takes place for existing and specific goods;
  - (c) The seller can sue for damages only in case of breach by the buyer;
  - (d) It gives a right to the buyer against the seller to sue for damages.
2. Which one of the following is the subject matter of the contract?
  - (a) Existing or future goods;
  - (b) Goods perishing before making contract;
  - (c) Goods perishing before sale but after agreement to sell;
  - (d) Any of the above.



3. Which is not the circumstance in which the transit of the goods is at end?
  - (a) If the buyer or his agents obtains delivery of the goods before their arrival at the appointed destination;
  - (b) Where the earlier or other bailee wrongfully refuses to deliver the goods to the buyer or his agents in that behalf;
  - (c) If the goods are rejected by the buyer and the carrier or other bailee continues in possession of them;
  - (d) Where the carrier or other bailee wrongfully refuses to deliver the goods to the buyer or his agents in that behalf.
4. Find out the right of the unpaid seller from the following-
  - (a) A lien on the goods for the price while he is in possession of them;
  - (b) A right of resale as limited by the Act;
  - (c) In case of the insolvency of the buyer a right of stopping the goods in transit after he has parted with the possession of them.
  - (d) All the above.
5. Which one of the following is correct in regard to risk with property?
  - (a) Risk is involved on both the seller and the buyer;
  - (b) Where the delivery has been delayed through the fault of either buyer or seller, the goods are at the risk of the party in fault;
  - (c) Both (a) and (b);
  - (d) None of the above.

**State whether TRUE or FALSE**

1. In a contract of sale the property in the goods is transferred from the seller to the buyer.
2. In an 'agreement to sale' the buyer is entitled to recover the same from the Official Liquidator in case of insolvency of the seller.
3. A condition is a stipulation essential to the main purpose of the contract.
4. In a sale by sample an implied condition is that the bulk shall correspond with the sample in quality.
5. Unless otherwise agreed, the goods remain at the buyer's risk until the property is transferred to the buyer.
6. The seller of the goods is not bound to deliver them until the buyer applies for the delivery.
7. The buyer of the goods is not bound to accept the delivery of goods by installments unless otherwise agreed.
8. If the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer cannot sue to seller damages for non delivery.
9. In an auction sale the sale may be noticed to be subject to a reserved or set up price.
10. The buyer is not to reject to goods where there is a breach of warranty by the seller.

**Model Questions**

1. What are the differences between 'contract of sale' and 'agreement to sale'.
2. When conditions are to be treated as warranty?
3. Under which circumstances the buyer can obtain the good title?



4. Explain the provisions relating to delivery of goods.
5. What are the rights of unpaid seller against the goods?
6. Give the picture of effects of stoppage of goods in transit.
7. Write a note on auction sale.
8. What are the remedies available for breach of warranty?
9. For what purposes suits may be filed by either of the parties for breach of contract?
10. Discuss the provisions on the re-selling of goods.

**Answers:**

**Fill in the blank**

1. Moveable;
2. Executed;
3. Collateral;
4. Future;
5. Buyer's
6. Unpaid seller;
7. Lien;
8. Rescinded;
9. Contract;
10. End.

**Choose the correct answer**

1. B;
2. D;
3. C;
4. D;
5. C.

**State whether TRUE or FALSE**

1. TRUE;
2. FALSE;
3. TRUE;
4. TRUE;
5. FALSE;
6. TRUE;
7. TRUE;
8. FALSE;
9. TRUE;
10. FALSE.



# Study Note - 3

## NEGOTIABLE INSTRUMENTS ACT, 1881



### This Study Note includes

- 3.1 Definition and Features of Negotiable Instrument
- 3.2 Crossing, Endorsement and Material Alteration
- 3.3 Acceptance, Assignment and Negotiation
- 3.4 Rights and Liabilities of Parties
- 3.5 Dishonour of Negotiable Instrument

### 3.1 DEFINITION AND FEATURES OF NEGOTIABLE INSTRUMENT

#### Introduction

The law relating to negotiable instruments is contained in the negotiable Instruments Act, 1881. It is an act to define and amend the law relating to promissory note, bills of exchange and cheques. The purpose of the Act is to present an orderly and authoritative statement of the leading rules of law relating to the negotiable instruments. The word negotiation has come from latin word "negos" which means "business".

#### Applicability of the Act

This Act is applicable to the whole of India.

#### Negotiable Instrument

Generally, an instrument, under legal parlance, denotes a piece of paper by which rights or liabilities of a person is created, satisfied, diminished, enhanced in relation to any other person.

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. A promissory note, bill of exchange or cheque-

- is payable to order which is expressed to be so payable or which is expressed to be payable to a particular person and does not contain words prohibiting transfer or indicating an intention that it shall not be transferable;
- is payable to the bearer which is expressed to be so payable or on which the only or last endorsement is an endorsement in blank;
- either originally or by endorsement, is expressed to be payable to two or more payees jointly, or it may be made payable in the alternative to one of two, or one or some of several payees.

Section 13 shows that the Act is confined to three specific types of instruments most in common use, namely, promissory notes, bills of exchange and cheques. The Contract Act is a general statute dealing with contracts. The Negotiable instruments Act is a statute dealing with a particular form of the contract. The law laid down for special cases must always overrule the provisions of general character as held in 'Kwong Hip Lone Saw Mill Co. V. C.A.M.A.L. Firms' – AIR 1933 Rang.131. The following are not the negotiable instruments-

- share certificate passing from hand to hand with blank transfers – Hazarimaul V. Statis Chandra' – ILR 46 Cal.331;



- Deposit receipts – Anantharam V. O.L., of T.N.Q. Bank' – 1939 Mad W.N. 1096;
- Mate's receipt – Nacheppa Chetty V. Irravaddy Flotila & Co., - ILR 41 Cal. 670;
- Bill of lading – United Bank of India V. N.S. Bank – AIR 1959 Cal. 328;
- Promissory note - Khirodnath Gountia V. Arjun Panda' – (1971) 2 Cut. W.R. 223
- A benefit under a letter of credit – Joseph Pyke & Son V. Kedarnath- AIR 1962 Cal.326.

#### **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

#### **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.

**Example - 1.** I promise to B or order ₹ 50,000/-;

2. I acknowledge myself to be indebted to B in ₹1 lakh to be paid on demand, for value received.

The instruments in the above two examples are promissory notes.

3. I promise to pay B ₹20,000/- seven days after my marriage with Helen.

4. 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 v. 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 'Bahadurrisa V. 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.

Though currency note has all the features of promissory, it is not to be considered as such. Further bearer promissory note cannot be issued as it would have the same feature of a currency note.



## 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.

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 'Hundi V. Sinha V. Bidhy Bhasan' 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 V. 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 V. Punjab National Bank Limited' – AIR 1960 All. 238;
- An order issued by a District Board Engineer on Government Treasury for payent to or order of a certain person – Rangaswami V. Sankaralingam – ILR 43 Mad 816.

## 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.

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**

<b>Promissory Note</b>		<b>Bill of Exchange</b>	
1.	It is defined in Sec. 4 of NI Act, 1881.	1.	It is defined in Sec. 5 of the NI Act, 1881.
2.	There are two parties: <ul style="list-style-type: none"><li>• Maker.</li><li>• Payee</li></ul> If it is given a guarantee, then there will be a third person, who is called as "Guarantor" or "Surety".	2.	There are three parties: <ul style="list-style-type: none"><li>• Drawer.</li><li>• Drawee.</li><li>• Payee.</li></ul>
3.	It contains a <b>Promise</b> to pay.	3.	It contains an <b>order</b> to pay.
4.	<b>No conditions</b> shall be made in a promissory note.	4.	A bill may be <b>accepted conditionally</b> .
5.	The liability of a maker of the promissory note is primary and absolute.	5.	The liability of the drawee of a bill of exchange is secondary and conditional.

**Distinction between Promissory Note and Cheque**

<b>Promissory Note</b>		<b>Cheque</b>	
1.	It is defined in Sec. 4 of NI Act, 1881.	1.	It is defined in Sec. 6 of the NI Act, 1881.
2.	There are two parties: <ul style="list-style-type: none"><li>• Maker.</li><li>• Payee</li></ul> If it is given a guarantee, then there will be a third person, who is called as "Guarantor" or "Surety".	2.	There are three parties: <ul style="list-style-type: none"><li>• Drawer.</li><li>• Drawee.</li><li>• Payee.</li></ul>
3.	Promissory note contains a promise to pay the sum with interest or without interest at a later date.	3.	A cheque is payable immediately on demand without any days of grace.
4.	Promissory note is not crossed.	4.	Cheque can be crossed.
5.	No protection is available to the payee of note.	5.	Statutory protection is given to the drawee banker. (Sec. 128)
6.	A promissory note cannot be self drawn.	6.	A cheque can be self drawn or bearer cheque.
7.	No criminal liability shall be imposed on the maker.	7.	Criminal Liability may be imposed on drawee for the dishonour of cheques in certain circumstances.
8.	Stamp is necessary.	8.	Stamp is not necessary.
9.	Limitation: 3 years	9.	Limitation: 6 months



### Distinction between Bill of Exchange and Cheque

Bill of Exchange		Cheque	
1.	It is defined in Sec. 5 of NI Act, 1881.	1.	It is defined in Sec. 6 of the NI Act, 1881.
2.	There are three parties: <ul style="list-style-type: none"> <li>• Drawer.</li> <li>• Drawee.</li> <li>• Payee.</li> </ul>	2.	There are three parties: <ul style="list-style-type: none"> <li>• Drawer.</li> <li>• Drawee.</li> <li>• Payee.</li> </ul>
3.	Bills of exchange are not crossed.	3.	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.	4.	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.	5.	The drawee is always a banker.
6.	It must be accepted before the acceptor can be made liable upon it.	6.	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.	7.	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.	8.	Sec. 85 of the N.I Act, 1881 affords protection to bankers.
9.	Civil Liability in case of dishonour of bill of exchange.	9.	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.

### 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 V. Bsihambar'- 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 'Anjanaiih V. 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 V. 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**

<b>Holder</b>	<b>Holder in due course</b>
1. Holder is entitled in his own name to possess the instrument and the amount thereon from parties involved.	1. 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.	2. Holder in due course gets a better title than transferor.
3. Holder may receive the instrument without consideration.	3. Holder in due course always receives the instrument for consideration.
4. Holder does not get certain privileges available to the holder in due course.	4. 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.

#### **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 amount intended by him to be paid there under.

### Maturity (Sec 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.

In 'Hemadri V. 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.



**Example – 1.** A negotiable instrument, dated 29<sup>th</sup> January, 2015, is made payable at one month after date. The instrument is at maturity on the third day after the 28<sup>th</sup> February, 2015, i.e., 3<sup>rd</sup> March, 2015;

**2.** A negotiable instrument, dated 30<sup>th</sup> August, 2015 is made payable three months after date. The instrument is at maturity on 3<sup>rd</sup> December, 2015;

**3.** A promissory note or bill of exchange dated 31<sup>st</sup> August, 2015, is made payable three months after date. The instrument is at maturity on the 3<sup>rd</sup> December, 2015.

Section 24 provides for exclusion of days in calculating the maturity date. In calculating the date at which a promissory note or bill of exchange made payable a certain number of days after date or after sight or after a certain event is at maturity, the day of the date, or of presentment for acceptance or sight, or of protest for non acceptance, or on which the event happens shall be excluded.

If the maturity day is a public holiday then which will be the maturity date. Section 25 provides that when the day on which a promissory note or bill of exchange is maturity is a public holiday, the instrument shall be deemed to be due on the next preceding business day. The public holiday includes Sundays and any other day declared by the Central Government, by notification in the Official Gazette to be a public holiday.

**Example –** The maturity date is 14<sup>th</sup> April, 2016. That day was declared by the Central Government, as a public holiday on the eve of Dr. Ambedhkar's birthday. In this case the maturity date is 13<sup>th</sup> April, 2016.

## 3.2 CROSSING, ENDORSEMENT AND MATERIAL ALTERATION

### CROSSING OF CHEQUES

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.

### 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.

### **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.

## **ENDORSEMENT**

**Meaning of Endorsement:** The term 'Endorsement' can also be pronounced as 'Indorsement'. This term is said to have been derived from the Latin word 'indorsum', which means 'upon the back' (in = upon; dorsum = back).

The 'Indorsement' 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 negotiation on the back or face thereof or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as 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 can not 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 be noted 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:

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 an endorser but this operates 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:

If A is a payee and holder of a negotiable instrument. He endorses it in blank and delivers it to B who in turn endorses 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 endorsement 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 by 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 first 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 1:**

The Endorser of a negotiable instrument signs his name adding the words "without recourse" upon this endorsement he incurs no liability.

#### **Example 2:**

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 endorses 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 dishonored, 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 can not 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 endorse it for ₹4000 in favor of any party such endorsement will not be valid.

However, where ₹ 1000 has been received against that instrument and the fact is recorded in the instrument then the endorsement of balance ₹4000 is perfectly valid.

- (f) Facultative endorsement;-In case of such an endorsement the endorser abandone some rights or increases his liability as endorser e.g "Pay A or order, notice of dishonor waived".

**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 *Lookaram Sethiya V 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 effects 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;

- (i) Alteration of an order cheque to a bearer cheque except by or with the consent of the drawer.
- (ii) Alteration by tearing material part of the instrument.
- (iii) Alteration by erasing account paying crossing (*J Ladies Beauty V State Bank of India, AIR 1984 Guj 33*)
- (iv) Alteration by affixing stamps without the promisor's knowledte to a note. (*Thommer v Union Khan 1967 Ker LJ 80 N Gowda v B Gowda 1968 1 Myrs LJ 591*)
- (v) Alteration of the date of payment [(*A Subha Reddy v Neelapa Reddy Rammana Reddy AIR 1966 AP 267*)]
- (vi) Alteration of the time of payment. (*Long v Moore, 1790 3 Esp 155*)
- (vii) Alteration of the place of payment (*Tidamarsh v Grover 1813 23 LJ QB 261*)
- (viii) Alteration of the sum payable (*scholfield v Earl of Londesborough 1896 AC 514*)
- (ix) Alteration by adding new party to the instrument (*Garner v Walsh 1855 5 ESB 83*)
- (x) Alteration by tearing a material part of the instrument.
- (xi) 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;--

- (i) Alteration before the completion of the instrument.
- (ii) Crossing of an open cheque or conversion of general crossing into a special crossing.
- (iii) Making qualified acceptance.
- (iv) Completion of inchoate instrument.
- (v) Making a blank endorsement into full endorsement.
- (vi) Conversion of a bearer cheque into an order cheque.
- (vii) Alteration with the consent of the party liable on the instrument.
- (viii) Alteration made for the purpose of correcting mistake.
- (ix) Making a blank instrument into a full endorsement.

#### **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)

### **3.3 ACCEPTANCE, ASSIGNMENT AND NEGOTIATION**

#### **ACCEPTANCE**

Only certain types of bills require acceptance. Essentials of a valid acceptance are—

- (i) Must be written on the face of the bill,
- (ii) The bill must be signed by drawee or his authorized agent.
- (iii) 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 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.

### **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.

## NEGOTIATION

Chapter IV of the Act deals with 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.

In 'L. Parsotam V. L. Bankey Lal' – AIR 1935 All. 1041 it was held that handing over a negotiable instrument to an agent for safe custody is not negotiation. There must be a transfer by the holder to the transferee to make the latter a holder within the meaning of Section 8.

### 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 V. 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 V. Mh. 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.

#### **Example:**

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 possesses the instrument as B's agent. The instrument has been negotiated, and B has become the holder of it.

### **Negotiation by endorsement**

Section 48 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 V. 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 direction to pay to any other person as endorsee, convert the endorsement in blank into an endorsement in full and the holder does not thereby incur the responsibility of an endorser.

### **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 V. 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 dishonor**

Section 59 provides that the holder of a negotiable instrument, who has acquired it after dishonor, 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 V. 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 dishonored 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 be fixed with liability on it. It is acceptance that establishes privity on the instrument between the payee and the drawee.

In 'Banaras Bank Limited V. 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 V. 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 V. 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 V. 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

**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.

**ASSIGNMENT OF NEGOTIABLE 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 chose 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.

**Difference between Negotiation and Assignment**

<b>Negotiation</b>	<b>Assignment</b>
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 than he would have been if such cheque had been paid.

In 'Abdul Majid V. 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.

## **3.4 RIGHTS AND LIABILITIES OF PARTIES**

### **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 V. 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.

### **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.

### **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.

### **Liability of drawer**

Section 30 provides that the drawer of a bill of exchange or cheque is bound, in case of dishonor by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonor has been given to, or received by the drawer as herein provided.

In 'Union Bank of India V. Swastika Motors' – AIR 1983 Del. 420 it was held that a drawee having dishonored the hundis, their drawer would be liable to the payee provided he had due notice of dishonor, even if the documents of title, accompanying the hundis, had been delivered to the drawee without valid acceptance.

In 'Silchar Bank V. Pioneer Bank' - AIR 1951 Assam 127 it was held that if the drawee bank dishonors the cheque after the drawer had stopped payment, the question of notice of dishonor does not arise; the drawer is liable to compensate the holder.

### **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.

### **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 V. 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 V. 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.

### **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.

### **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.

### **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 dishonor by the drawee, acceptor or maker, to compensate such holder for any loss or damage caused to him by such dishonor, provided due notice of dishonor has been given to, or received by, such indorser as herein after provided.

### **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.

### **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 or 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 dishonors 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 'Mutyala Yarakadu V. State of Andhra Pradesh' – 1955 An.WR 870 it was held that where a promissory note has been endorsed to a third person, Section 44 cannot be applied so as to prejudice his rights. Where the maker of the promissory note stands in immediate relation to the payee, Section 44 would entitle the debtor to relief.

In 'Tirupagari Tayaramma V. 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.

### 3.5 DISHONOUR OF NEGOTIABLE INSTRUMENT

**Notice of dishonor**

Chapter VIII deals with the notice of dishonor.

**When dishonored?**

The dishonor may be due to the following reasons-

- non acceptance; and
- by nonpayment.

Section 91 provides that a bill of exchange is said to be dishonored 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 dishonored.

Section 92 provides that an instrument is said to be dishonored by nonpayment 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.

**Notice**

Section 93 provides that when an instrument is dishonored the holder must give notice that the instrument has been dishonored. In 'Union bank V. 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 dishonored and he will be held liable thereon. It must be given within a reasonable time after dishonor 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 dishonor must, in order to render any prior party liable to himself, give notice of dishonor 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 dishonor.

Section 97 provides that when the party, to whom a notice of dishonor 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.

### **Noting and Protest**

Chapter IX deals with the procedure of noting and protest.

#### **Noting**

Section 99 provides that when an instrument is dishonored for any reason, the holder may cause the dishonor 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 dishonor. The noting must specify the date of dishonor, the reason assigned for such dishonor or if the instrument has not been expressly dishonored, the reason the holder treats it as dishonored and the notary's charges.

#### **Protest**

Section 100 provides that when an instrument is dishonored the holder may cause such dishonor 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 holder 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 dishonored, the place and time of dishonor 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 dishonor 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 dishonored, the Court shall, on proof of the protest, presume the fact of dishonor, 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.

### **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 dishonored. 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 dishonor and what notice of dishonor is sufficient.

**Example** – A bill of exchange is drawn and indorsed in India but accepted payable in France, is dishonored. The indorsee causes it to be protested for such dishonor 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.

### **Penalties**

Section 138 provides penalty for dishonor 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.

### 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.

### 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 dishonored on presentment for the reasons stated in the section.

### **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 ₹5000/-.

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 purporting 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 dishonored, presume the fact of dishonor 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 negating 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.

**CHECK YOUR PROGRESS****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 \_\_\_\_\_.

**Choose the correct answer**

1. One of the following is not a negotiable instrument. Identify the same.
  - (a) Share certificate;
  - (b) Bill of exchange;
  - (c) Cheque;
  - (d) Promissory note.
2. Which one of the following is a Bill of Exchange?
  - (a) A banker's draft;
  - (b) A demand draft;
  - (c) An order issued by a District Board Engineer on Government Treasury for payment to or order of a certain person;
  - (d) All the above.
3. Which one of the following is not the element of draft?
  - (a) It cannot be drawn on private individual;
  - (b) It cannot be countermanded easily;
  - (c) It is open to the person to stop payment;
  - (d) The bank undertakes the liability which it is bound to discharge in whose favor the draft is issued;
4. Holder in due course means any person-
  - (a) Drawing the instrument;
  - (b) Who for consideration became the possession of a promissory note;
  - (c) Named in the instrument to whom or to whom order the money is directed to be paid;
  - (d) None of the above.
5. Who may negotiate?
  - (a) Drawer;





- (b) Payee;
  - (c) All of the joint makers;
  - (d) None of the above
  - (e) Any of (a) to (c).
6. The liability on the instrument may be discharged-
- (a) By cancellation;
  - (b) By release;
  - (c) By payment;
  - (d) By any one of the above methods.
7. A cheque shall be deemed to be crossed specially-
- (a) On addition of the name of the banker;
  - (b) Drawing two lines parallel;
  - (c) Any of (a) or (b);
  - (d) None of (a) and (b).

**State whether true or false**

- 1. Currency note is a negotiable instrument.
- 2. Cheque is a bill of exchange.
- 3. The maker of the promissory note can also be called a drawer.
- 4. Handing over a negotiable instrument to an agent for safe custody is negotiation.
- 5. If the maturity date is a public holiday the instrument shall be deemed to be due on the next preceding business day.
- 6. Bill of exchange is an instrument in writing an unconditional order directing to pay a certain sum of money to the bearer of the instrument.
- 7. If the indorser signs his name only, the indorsement is called to be 'in full'.
- 8. Only drawee can be acceptor except in need for hour.
- 9. A holder is not having right to duplicate of lost bill, before it is overdue.
- 10. When an instrument is dishonored the holder must give notice that the instrument has been dishonored.

**Model Questions**

- 1. What are the elements to be present to hold an instrument on a promissory note?
- 2. Write not on 'bill of exchange'.
- 3. What are the differences between a cheque and a draft?
- 4. Discuss about the various types of instruments.
- 5. Who are the parties to an instrument?
- 6. How the maturity date of an instrument is calculated?
- 7. Discuss about the liability of drawer, agent, representative and drawee.
- 8. Where are the procedures involved in the presentment of negotiable instrument?
- 9. Under which circumstances the presentment of negotiable instrument is not necessary.
- 10. When an acceptance is said to be qualified?



11. Under which circumstances the notice for dishonor is not required?
12. Write notes on 'noting' and 'protest'.
13. Discuss about the contents to be incorporated in a protest.
14. Briefly discuss the various types of estoppels.
15. Discuss the provisions relating the negotiable instrument in International Law.

**Answers:**

**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.

**Choose the correct answer**

1. A;
2. D;
3. C;
4. B;
5. E;
6. D;
7. A.

**State whether true or false**

1. FALSE;
2. TRUE;
3. TRUE;
4. FALSE;
5. TRUE;
6. TRUE;
7. FALSE;
8. TRUE;
9. FALSE;
10. TRUE.

# Study Note - 4

## INDIAN PARTNERSHIP ACT, 1932



### This Study Note includes

- 4.1 Nature of Partnership
- 4.2 Rights and Liabilities of Partners
- 4.3 Formation, Reconstitution and Dissolution of Firms

### 4.1 NATURE OF PARTNERSHIP

#### Introduction

The Indian Partnership Act was enacted during the year 1932. Before the enactment of this Act, the provisions relating to partnership were contained in Chapter XI, consisting of Section 239 to 266 of the Indian Contract Act, 1872. A necessity of a new legislation on partnership was deeply felt. The Act is principally based on the English Partnership Act, 1890, with such minor modifications as were necessary for the Indian conditions.

#### Applicability

This Act extends to the whole of India.

#### Effective

The provisions of this Act came into effect from 01.10.1932 except Section 69 which deals with the effect of non registration. Section 69 of this Act came into effect with effect 01.10.1933.

#### WHAT IS PARTNERSHIP?

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 or implied.

#### Different types of partnership

There are four types of partnership which are as detailed below-

- General Partnership;
- Limited Partnership;
- Partnership at will;
- Particular Partnership.



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.

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.

**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.

**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

#### **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 liable to pay ₹ 20,000 to Ramu. Here, Jalal is a partner by holding out.

### 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.

### Difference between a partnership and a company

The following are the differences between the 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 is having responsibility to run the management
Relationship	The relationship with partners is of that of agency.	No such relationship in the 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.

**Difference between partnership and limited liability partnership**

Base	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 100 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.

The following are the differences between the partnership and Hindu Undivided Family.

Base	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.



### **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 firm

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.

### **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 or 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.

### **Particular partnership**

Section 8 provides that a person may become a partner with another person in particular adventures or undertakings.



## 4.2 RIGHTS AND LIABILITIES OF PARTNERS

### 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 amongst





the 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 in view of the Section 29 of the Act.

In 'Sasthi Kenker V. Man 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 @ Moolchand' – 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 or 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.

### **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 Section 14, 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 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.

### **Personal profits**

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 dissolution



and 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 fails to give such notice, he shall become a partner in the firm on the expiry of the said six months.

If a minor elects 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 sue 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.

## **4.3 FORMATION, RECONSTITUTION AND DISSOLUTION OF FIRMS**

### **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 licences 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.

### **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, 2001, they decided to share profits equally. Here, change in the existing profit sharing ratio results into reconstitution of the firm.



In this case one partner 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 Haqqe are partners sharing profit in the ratio of 3:2. On April 1, 2013 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, 2003. 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, 2003. 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.

### **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 or 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.

### **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 . For 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.

## **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 change 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.

### **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 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 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 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 'Chaikaram Sidhakaran Oswal V. 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 wilfully 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 V. 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 thereof 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 bought 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.



## Goodwill

Section 55 provides that after the dissolution of a firm the goodwill shall be included in the assets and it be sold either separately or along with other property of the firm. Where the goodwill of the firm is sold a partner may carry on a business competing with that of the buyer and he may advertise such business, subject to agreement between him and the buyer, 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 its dissolution.

Goodwill of a business is the property of the firm and is often a very valuable asset. In a suit for dissolution, while taking accounts goodwill of the firm should be included in the assets and should be brought into common account. The goodwill of a business is inclusive of positive advantage such as carrying on the commercial undertaking at a particular place and in a particular name and also its business connections, its business prestige and several other intangible advantages with a business may acquire.

## CHECK YOUR PROGRESS

### Fill in the blanks

1. Partnership is the creation of \_\_\_\_\_.
2. The liability of a partner in a firm is \_\_\_\_\_.
3. Nominal partner is of two types, \_\_\_\_\_ and \_\_\_\_\_.
4. Maximum no. of partners in banking is \_\_\_\_\_.
5. In particular partnership a person may become a partner with another person in particular \_\_\_\_\_.
6. Partner is the \_\_\_\_\_ of the firm for the purpose of the business of the firm;
7. Where a partner in a firm is adjudicated as insolvent, he ceases to be a partner on the date on which \_\_\_\_\_.
8. A partnership firm is to be registered with \_\_\_\_\_.
9. Partnership at will is a partnership formed for \_\_\_\_\_ period.
10. A firm is a collective of \_\_\_\_\_ partners.

### Choose the correct answer

1. Who can take active part in the management of the firm?
  - (a) Sleeping partner;
  - (b) Secret partner;
  - (c) Working partner;
  - (d) Nominal partner.
2. A new partner can be introduced as a partner into a firm-
  - (a) At the discretion of active partner;
  - (b) At the decision of partners authorized in this behalf;
  - (c) With the consent of all existing partners;
  - (d) None of the above.
3. A partner may retire-
  - (a) With the consent of all partners;
  - (b) In accordance with an express agreement by the partners;
  - (c) By giving notice in writing to all partners;





- (d) Any one of the above.
- 4. Intimation of the reconstitution of change in a registered partnership is to be given to the Registrar of firms-
  - (a) No time limit;
  - (b) Within 30 days;
  - (c) Within 60 days;
  - (d) Within 90 days.
- 5. A firm shall not contain any name-
  - (a) King;
  - (b) Queen;
  - (c) Empire;
  - (d) All the above.

**State whether true or false**

- 1. A sleeping partner is not entitled to share profits of the firm.
- 2. Partners in profits only share in the profits of the firm but not losses.
- 3. Audit is compulsory for the partnership firm.
- 4. Creditors of a firm can proceed against the partners jointly and severally.
- 5. Partnership firm is a separate legal entity.
- 6. The death of karta will not lead to the dissolution of the HUF business.
- 7. Every partner has a right to take part in the conduct of the business.
- 8. A partner is not required to indemnify the firm or any loss caused to it by his willful neglect in the conduct of the business of the firm.
- 9. An advance by a partner to a firm is not treated as increase of his capital.
- 10. If a partner derives any profit for himself from any transaction of the firm, he shall account for the profit and pay it to the firm.
- 11. An outgoing partner may, carrying on a business, use the firm name.
- 12. After the dissolution of a firm the goodwill shall be included in the assets and it be sold either separately or along with the property.
- 13. If a firm closes a branch or open a branch the same should be intimated to the Registrar of Firms.
- 14. A unregistered firm can file a suit to enforce a right, arising from a contract, in any court against any third party.
- 15. A minor has to elect, on his attaining or majority as to become a partner or not.

**Model Questions**

- 1. What are the essential ingredients for the constitution of a partnership?
- 2. Write a note on different types of partners.
- 3. Differentiate the partnership from a company.
- 4. What are the differences between partnership and limited liability partnership?
- 5. In which way the partnership is different from Hindu Undivided Family?
- 6. Describe the duties and rights of partners.
- 7. Write a note on implied authority of a partner of a firm.
- 8. Whether a partner's interest may be transferred to another person? If so what are the entitlements of the recipient?
- 9. Minor as a partner – discuss his rights and liabilities.



10. What are the rights of outgoing partners?
11. What are the various types of dissolution of a firm? Write a note on them.
12. What are the rights and liabilities of partners after dissolution?
13. Describe the procedure for registration of a firm.
14. What are the effects of non registration of a firm?
15. Write note on alteration in firm name or place of business.

**Answers:**

**Fill in the blanks**

1. Contract;
2. Unlimited;
3. Partner by estoppel, partner by holding out;
4. 50;
5. Adventure or undertaking;
6. Agent;
7. The order of adjudication is made;
8. Registrar of firms;
9. An indefinite;
10. Partners.

**Choose the correct answer**

1. E;
2. C;
3. D;
4. A;
5. D.

**State whether true or false**

1. FALSE;
2. TRUE;
3. FALSE;
4. TRUE;
5. FALSE;
6. TRUE;
7. TRUE;
8. FALSE;
9. TRUE;
10. TRUE;
11. FALSE;
12. TRUE;
13. TRUE;
14. FALSE;
15. TRUE.

# Study Note - 5

## LIMITED LIABILITY PARTNERSHIP ACT, 2008



### This Study Note includes

- 5.1 Concept, Formation, Membership, Functioning
- 5.2 Dissolution

### 5.1 CONCEPT, FORMATION, MEMBERSHIP, FUNCTIONING

#### Introduction

The Partnership Act was enacted during the year 1932. The business scenario has been changed drastically. The entire world is brought as one economic village. The Partnership Act has not been made in consonance with the development of world economy. The Partnership Act, 1932 suffers from certain disadvantages, as detailed below:

- The liability of each partner is unlimited;
- The partners are jointly and severally liable for the debts and liabilities of the firm to the risk of the personal assets of the partners;
- The partner is not having right to transfer his holding in the partnership unless he retires from partnership and other partners agree to admit the same;
- The number of members is limited by which more investments will not be there which results inhibiting the growth of the business.

A need has been felt for a long time to provide for a business format that would combine the flexibility of a partnership and the advantages of the limited liability of the company at a low compliance cost.

During the financial crisis of the late 1980s and early 1990s hundreds of US saving and loan firms were declared insolvent. As a result of the collapse many accountancy and legal firms faced legal claims instigated by the US government. Successful claims could have resulted in all partners, including those who were not responsible for the failure of the savings and loan firms, being liable to repay millions of dollars in compensation. In 1991 Texas introduced the concept of a limited liability partnership (LLP). The concept was popular and the majority of US states eventually passed LLP legislation.

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.

#### CONCEPT OF LLP

The concept of LLP is explained as below:

- It is an alternative corporate business form 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.

It is a hybrid between a company and partnership.

### **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 Limited Liability Partnership, the Central Government made 'The Limited Liability Partnership (Winding up and Dissolution) Rules, 2012.

### **Date of effect of the provisions**

Section 1(3) of the Act provides that the Act shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint. Different dates may be appointed for different provisions of the Act. The following are the date of effect of the provisions-

- Sections 55 to 58, Second Schedule, Third Schedule and Fourth Schedule – Effect from 31.05.2009;
- Sections 51, 55 to 58, 72 to 73, 81 (b) and (c) dealing with the National Company Law Tribunal have not yet been notified;
- Other Sections and Schedule came into effect from 31.03.2009.

### **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.

### **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 ₹10000/- but which may extend to ₹1 lakh.

### **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 – ₹2000/-;
- LLP whose contribution exceeds ₹ 5 lakhs but does not exceed ₹10 lakhs – ₹4000/-
- LLP whose contribution exceeds ₹10 lakhs – ₹5000/-

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 ₹10000/- 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 trade mark or a trade mark 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 ₹2000/- 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 or 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 ₹10000/- 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 ₹2000/- 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 ₹2000 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 ₹50000/- 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 eight 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 six 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 ₹10000/- but which may extend to Re.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 two 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 ₹25000.

### **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:

- incorporation document;
- notice of situation of registered office;
- information with regard to LLP agreement or any change made therein;
- 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 enter brief particulars of the records destroyed and shall certify therein the date and mode of destructions.

#### **Conversion to LLP**

Chapter X of the Act deals with the conversion to LLP from other 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.

#### **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.

#### **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.

#### **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 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.

### **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 licence 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 licence 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 ₹10000/- but which may extend to ₹1 lakh and with a further fine which shall not be less than ₹50 rupees but which may extend to ₹500/- for every day after the first day after which the default continues.

### **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 Apostile 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.

#### **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.

**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;

### **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.





### **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 Tribunal but not exceeding 180 days of the order. The LLP Administrator shall, within 30 days of the making of 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 up 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 ₹50000.

### **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; orthe 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 off 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.

## **5.2 DISSOLUTION**

### **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 6f 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 in Form 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 is 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.

### **Appointment 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 firms 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 appointment, 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 other 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 of 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 settle 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 Rs. 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





determining whether a LLP is unable to pay its debts, the Tribunal shall take into account the contingent and prospective liabilities of the LLP.

### **Powers of Tribunal**

On hearing a winding up petition, under Rule 27, the Tribunal may-

- 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 arisen 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 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 as 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 to 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.

## CHECK YOUR PROGRESS

### Fill in the blanks

1. Every LLP has at least \_\_\_\_partners.
2. Designated partners shall always be \_\_\_\_\_.
3. The particulars of designated partner shall be filed within \_\_\_\_ days of his appointment with the Registrar.
4. Every partner shall inform the LLP of any change in his name or address within a period of \_\_\_\_ days of such change in Form No.\_\_\_\_\_.
5. Every partner of LLP is the \_\_\_\_\_ of LLP.
6. The books of accounts of a LLP are required to preserve for \_\_\_\_\_ from the date on which they are made.
7. The LLP shall inform the concerned Registrar within \_\_\_\_\_ of the date of registration about the conversion and the particulars of LLP.
8. The foreign LLP shall file any alteration with the Registrar within \_\_\_\_\_ days of the close of the financial year.
9. The Central Government may appoint Inspector to investigate the affairs of the LLP if not less than \_\_\_\_\_ the total number of partners of LLP make an application.
10. Where an LLP is not carrying on any business for a period of \_\_\_\_ or more, the name of the LLP may be struck off by the Registrar.

### Choose the correct answer

1. An LLP is a-
  - (a) Partnership;
  - (b) Company;
  - (c) Hybrid between a company and a partnership;
  - (d) None of the above.
2. The procedure for conversion from the firm into LLP is dealt with in the-
  - (a) First Schedule;
  - (b) Second Schedule;
  - (c) Third Schedule;
  - (d) Fourth Schedule.



3. Which one of the following is not an LLP?
  - (a) Corporate Sole;
  - (b) LLP registered under LLP Act;
  - (c) LLP incorporated outside India;
  - (d) Company registered outside India.
4. The minimum number of designated partners in an LLP shall-
  - (a) 1;
  - (b) 2;
  - (c) 7;
  - (d) 15.
5. The fee payable for registration of LLP whose contribution exceeds ₹10 lakhs is-
  - (a) ₹500/-;
  - (b) ₹2000/-;
  - (c) ₹4000/-;
  - (d) ₹5000/-.
6. A partner may contribute to the LLP-
  - (a) Tangible or intangible property;
  - (b) Moveable or immovable property;
  - (c) Money, promissory note etc.,
  - (d) Any of the above.
7. The accounts of LLP shall be audited if the turnover of LLP exceeds-
  - (a) ₹ 10 lakhs;
  - (b) ₹20 lakhs;
  - (c) ₹40 lakhs;
  - (d) ₹ 1 crore.
8. Which one of the following documents is required to keep for more than 5 years?
  - (a) Copies of Government order relating to LLP;
  - (b) All papers, registers, refund orders and correspondence relating to the LLP liquidation accounts;
  - (c) Copies of statistical returns furnished to Government;
  - (d) Annual return of a LLP.
9. The Act does not allow the conversion from \_\_\_\_\_ into LLP-
  - (a) Conversion from firm into LLP;
  - (b) Conversion from private company to LLP;
  - (c) Conversion from listed company into LLP;
  - (d) Conversion from unlisted company into LLP.
10. A compromise or arrangement may be proposed-
  - (a) Between a LLP and its partners;
  - (b) Between a LLP and its creditors;
  - (c) Either (a) or (b);
  - (d) None of the above.



**State whether TRUE or FALSE**

1. The liability of a partner in an LLP is limited.
2. LLP is a separate legal entity.
3. An LLP is incorporated outside India is also included in the definition of LLP.
4. If the minimum number of partners is reduced below LLP may not carry its business.
5. The liabilities of LLP shall be met out of the properties of designated partners.
6. No partner shall be entitled to remuneration for acting in the business of LLP.
7. The Central Government may compound any offence under this Act which is punishable with fine only.
8. A company may apply to convert itself into a LLP if and only if the partners of the LLP to which it converts comprise all the shareholders of the company and no one else.
9. LLP Administrator shall be appointed from a panel maintained by the State Government for winding up and dissolution of LLP.
10. The liability of every designated partner of the dissolved LLP shall continue and may be enforced as if the LLP had not been dissolved.

**Model Questions**

1. Discuss the salient features of LLP.
2. Who may be a partner in LLP?
3. Define 'designated partner'. Discuss the procedure of the appointment of a 'designated partner'.
4. Write notes on Designated Partners Identification Number.
5. What are to be included in 'incorporation document'.
6. Discuss the procedure in changing registered office of the LLP.
7. Describe the circumstances under which an LLP would be wound up.
8. Discuss the matters contained in the first schedule in regard to the terms of the agreement for an LLP.
9. Write a note on cessation of partnership interest. Discuss about the liability and entitlement of a ceased partner.
10. Write short notes on-
  - (a) Statement of Accounts & Solvency;
  - (b) Annual Return;
  - (c) Compounding of offences.
11. Discuss about the procedure relating to preservation of LLP records.
12. Discuss the procedure for conversion from a firm into an LLP.
13. Discuss the procedure for conversion from a private company into an LLP.
14. Discuss the procedure for conversion from an unlisted company into an LLP.
15. Elaborate the procedure for convening a meeting of creditors/partners in regard to compromise or arrangement.



**Answers:**

**Fill in the blanks**

1. 2;
2. Individual;
3. 30;
4. 15, Form 6;
5. Agent;
6. 8 years;
7. 15 days;
8. 60 days;
9. One fifth;
10. 2 years.

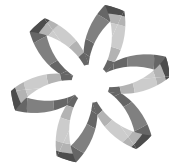
**Choose the correct answer**

1. C;
2. B;
3. A;
4. B;
5. D;
6. D;
7. C;
8. B;
9. C;
10. C.

**State whether TRUE or FALSE**

1. FALSE;
2. TRUE;
3. TRUE;
4. FALSE;
5. TRUE;
6. FALSE;
7. TRUE;
8. TRUE;
9. FALSE;
10. TRUE.





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**Section B**  
**Industrial Laws**  
(Syllabus - 2016)

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# Study Note - 6

## FACTORIES ACT, 1948



**This Study Note includes**

**6.1 Factories Act, 1948 – Object, Scope and Applicability**

### 6.1 FACTORIES ACT, 1948 – OBJECT, SCOPE AND APPLICABILITY

#### Introduction

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, licencing and registration of factories and no factory can run without such licence or approval. Power to delicense 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 spot 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 every 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**

Section 15 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**

Section 16 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 least 14.2 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 as a 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 PM 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 14<sup>th</sup> year shall be required or allowed to work in any factory.

### **Adolescent worker**

Section 68 provides that a child who has completed his 14<sup>th</sup> 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 14<sup>th</sup> 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 15<sup>th</sup> 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 ₹1000/- 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 ₹5000/- 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 ₹5000/- 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 one year after the date of conviction, the offender shall be punishable with imprisonment for a term which may extend to ten 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.

## **CHECK YOUR PROGRESS**

### **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 14<sup>th</sup> 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.

**Choose the correct answer**

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) 1000 (e) 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 of a 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 whether 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.

**Questions**

1. What are the responsibilities of an occupier in a factory?
2. Discuss the obligations and the right of the worker under the Factories Act.
3. Write a note on 'hazardous processes'.
4. What are the powers that can be exercised by an Inspector under this Act?
5. List the welfare measures to be taken by an Occupier in a factory.
6. What are the measures to be taken to keep the factory clean?
7. Define – Manufacturing Process and Factory.
8. Critically examine the duties of certified surgeon.



9. Briefly discuss the provisions in respect of first aid appliances.
10. Write notes on prohibition of employment of young persons under this Act.

**Answers:**

**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

**Choose the correct answer**

1. B
2. C
3. A
4. B
5. E
6. A
7. B
8. C
9. D
10. C

**State whether TRUE or FALSE**

1. TRUE
2. FALSE
3. FALSE
4. TRUE
5. FALSE
6. FALSE
7. TRUE
8. FALSE
9. TRUE
10. TRUE

# Study Note - 7

## PAYMENT OF GRATUITY ACT, 1972



### This Study Note includes

#### 7.1 Payment of Gratuity Act, 1972 – Object, Scope and Applicability

#### 7.1 PAYMENT OF GRATUITY ACT, 1972 – Object, Scope and Applicability

##### Introduction

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 16<sup>th</sup> 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 retiral 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).

##### Effect

The Act came into effect from 16<sup>th</sup> September, 1972.

##### 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.

### **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 one year or six month, 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 twenty months' wages. The maximum gratuity payable is ₹ 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 x 15/26 x 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.

### **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.

### **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.

### **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.

### **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.

### **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.

### **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.

### **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.

### **Appeal**

Any person aggrieved by an order may, within sixty 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.

### **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.

### **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.

### **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.

**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.

**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.

**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.





## CHECK YOUR PROGRESS

### 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 \_\_\_\_\_.

### Choose the correct answer

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.



**State whether 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.

**Model 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. Discuss the grounds on which the gratuity may be forfeited.
3. Explain the provisions relating to 'nomination'.
4. What are the powers of the Controlling Authority in deciding an application for payment of gratuity?
5. What is the remedy available if the employer rejects the application of an employee for payment of gratuity?
6. Explain the procedure for an employer to determine the gratuity payable to the employee.
7. Describe the procedure for mode of payment of gratuity.
8. Explain the provisions relating to exemption given to the employer from the liability in certain cases from payment of gratuity.
9. Discuss the penal provisions under this Act.
10. Write a short on approved gratuity fund.

**Answers:**

**Fill in the blanks**

1. 5
2. ₹ 20 lakhs;
3. 30 days;



4. 60 days;
5. 10%;
6. F;
7. 15 days;
8. 500;
9. 90 days;
10. Controlling Authority.

**Choose the correct answer**

1. D
2. D
3. C
4. A
5. B
6. B
7. A
8. C
9. B
10. C

**State whether TRUE or FALSE**

1. FALSE
2. TRUE
3. TRUE
4. FALSE
5. FALSE
6. TRUE
7. FALSE
8. TRUE
9. FALSE
10. TRUE

# Study Note - 8

## EMPLOYEES PROVIDENT FUND AND MISCELLANEOUS PROVISIONS ACT, 1952



### This Study Note includes

#### 8.1 Employees Provident Fund and Miscellaneous Provisions Act, 1952 – Object, Scope and Applicability

#### 8.1 EMPLOYEES PROVIDENT FUND AND MISCELLANEOUS PROVISIONS ACT, 1952 – OBJECT, SCOPE AND APPLICABILITY

##### Introduction

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.

##### 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.

### **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 2<sup>nd</sup> 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.

### **Applicability of the scheme**

This scheme shall apply to all factories and other establishments to which the Act applies. This scheme shall not be applicable to the tea factories in the State of Assam.

### **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.

### **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)

### **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.



### **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

### **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.

### **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.

### 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.

### 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 on 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.

### **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.

### **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% of 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.

### **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.

### **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.

### **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.

### **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 ₹ 5000 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 ₹10000/- in case of default of payment of the employees' contribution ;



- Which shall not be less than six months and a fine of ₹ 5000/- 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 ₹5000.

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 ₹ 4000 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 non compliance, 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 ₹ 5000.

### 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.

## CHECK YOUR PROGRESS

### 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 assist the Central Board in the performance of its functions.



**Choose the correct answer**

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) ₹1000      (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 whether 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.

**Model Questions**

1. What are the schemes available in the EPF Act?
2. What are the consequences if an employer makes default in the payment of any contribution to the Fund?
3. Under what circumstances advances can be received by employer from the PF Fund?
4. Discuss the matters provided for the insurance fund under the Schedule.
5. How the money due from employers is determined in respect of PF, pension scheme or the insurance scheme?
6. Explain the provisions relating to EPF Appellate Tribunal.
7. Discuss the procedure involved in review of order of the officer passed under Section 7A of the Act.
8. Describe the procedure for the payment of assured benefits in case of no nomination is filed by the employee.
9. Narrate the features of Employees' Pension Scheme.
10. Define the term 'appropriate government' and 'employee'.



**Answers:**

**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.

**Choose the correct answer**

1. D;
2. A
3. D
4. B
5. D
6. C
7. C;
8. A
9. B
10. C

**State whether TRUE or FALSE**

1. TRUE;
2. FLASE;
3. TRUE;
4. FALSE;
5. TRUE;
6. TRUE;
7. FALSE;
8. TRUE;
9. FALSE;
10. FALSE.



# Study Note - 9

## EMPLOYEES STATE INSURANCE ACT, 1948



### This Study Note includes

#### 9.1 Employees State Insurance Act, 1948 – Object, Scope and Applicability

### 9.1 EMPLOYEES STATE INSURANCE ACT, 1948 – OBJECT, SCOPE AND APPLICABILITY

#### Introduction

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.

#### 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.



### **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 occupational 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 dependants' 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.

### **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 One year and fine of Ten thousand rupees 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 Five thousand rupees 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 One year or with fine up to Four thousand rupees 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 Two years and with fine of Five thousand rupees.

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 Five years but which shall not be less than Two years and shall be liable to pay fine of Twenty Five Thousand rupees.

**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.

## CHECK YOUR PROGRESS

**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 \_\_\_\_\_.

**Choose the correct answer**

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 whether 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.

**Model Questions**

1. Define the terms 'immediate employer' and 'employee' under ESI Act.
2. Distinguish between the 'permanent partial disablement' and 'permanent total disablement'.
3. What are the various bodies constituted by the ESI Corporation and describe the functions of such bodies.
4. What is 'Employees' State Insurance Fund' and for what purposes the fund may be expended?
5. List the benefits that are entitled to the insured persons under this Act.
6. Discuss the method of recovery of contribution from the employer.



7. Whether an employee can be dismissed or punished during sickness? Substantiate your answer.
8. What are the disputes that can be settled by ESI Court?
9. What are the punishments described under Section 85 of the Act for failure to pay contribution etc.,
10. State the obligations of Principal Employer.

**Answers:**

**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

**Choose the correct answer**

1. C;
2. B;
3. A;
4. D;
5. B;
6. C;
7. D;
8. A;
9. B;
10. C.

**State whether TRUE or FALSE**

1. FALSE;
2. TRUE;
3. TRUE;
4. FALSE;
5. FALSE;
6. TRUE;
7. TRUE;
8. FALSE;
9. TRUE;
10. TRUE.



# Study Note - 10

## PAYMENT OF BONUS ACT, 1965



### This Study Note includes

#### 10.1 Payment of Bonus Act, 1965 – Object, Scope and Applicability

#### 10.1 PAYMENT OF BONUS ACT, 1965 – Object, Scope and Applicability

##### Introduction

In the early periods the payment of bonus to the employees was made voluntarily by the business organizations. The Payment of Bonus Act, 1965 has been enacted to provide for payment of bonus to persons employed in any industry to do any skilled or unskilled, manual, supervisory, managerial, administrative, technical or clerical work for hire or reward and drawing salary not exceeding the prescribed amount. Now it has been made as statutory obligation of an employer. It is one of the ways of sharing the profits of the industry or an establishment. It is an incentive to increase the production. The purpose of payment of bonus is to bridge the gap between the wages paid and the idea of living wage.

##### Object of the Act

The object of Payment of Bonus Act is to provide for the payment of bonus to persons employed in certain establishments on the basis of profits or on the basis of production or productivity and for matters connected therewith.

##### What is Bonus?

The term 'Bonus' has not been defined in this Act. The Bonus Commission has observed that it is difficult to define in rigid terms the concept of bonus, but it is possible to urge that once profits exceed a certain base, labor should legitimately have a share in them. In other words, it is proper to construe the concept of bonus as sharing by the workers in the prosperity of the concern in which they are employed.

In 'Muir Mills Company V. Muir Mills Mazdoor Union, Kanpur' – AIR 1955 SC 170 the Supreme Court held that the bonus was neither gratuitous nor deferred payment of wages and that where wages fell short of the living standard and the industry made profits, part of which was due to the contribution of the labor, a claim for bonus might be made legitimately by the workmen.

In 'State of Tamil Nadu V. K. Sabanayagam' – (1998) 1 SCC 318 the Supreme Court held that the Bonus Act is a piece of welfare legislation enacted for the benefit of a large category of workmen seeking a living wage to make their lives more meaningful and for fructifying the benevolent guarantee of Article 21 of the Constitution.

The bonus may be also customary bonus. Such bonus is not covered under the Bonus Act and therefore it is payable over and above the bonus payable under the Act. In 'Baidyanath Ayurveda Bhawan Mazdoor Union V. Management' – (1984) 1 SCC 279 the following tests have been laid by the Supreme Court to determine whether a particular payment is customary or festival bonus:

- that the payment has been made over an unbroken series of years;
- that it has been paid for a sufficiently long period – the period has to be longer in the case of an implied term of employment;



- that it did not depend on the earning of profits; and
- that the payment has been made at a uniform rate throughout.

### **Applicability of the Act**

Territorial wise this act is applicable to the whole of India. This Act shall apply to the following:

- every factory; and
- every other establishment in which twenty or more persons are employed on any day during an accounting year;
- any establishment or class of establishments as notified by the appropriate Government, employing such number of persons less than twenty as may be specified in the notification, that the number of persons so specified shall in no case be less than ten.
- an establishment to which this act applies shall continue to be governed by the Act notwithstanding that the number of persons employed falls below twenty or the number specified in the notification.

In deciding the number of persons employed in an establishment all employees, even those drawing more than the threshold limit must be taken into consideration. The strength of the employees of an establishment would be taken into consideration, irrespective of their place of work.

### **What is establishment?**

The term 'establishment' is of two types – establishment in private sector and establishment in public sector.

The term 'establishment in private sector' is defined under Section 2(15) of the Act as any establishment other than an establishment in public sector.

The term 'establishment in public sector' is defined as an establishment owned controlled or managed by-

- A Government company;
- A corporation in which not less than 40% of its capital is held, either singly or taken together by the Government or Reserve Bank of India or a Corporation owned by the Government or the Reserve Bank of India.

Section 3 provides that 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.

### **What is Appropriate Government?**

Section 2(5) defines the term 'appropriate Government' as-

- in relation to an establishment in respect of which the appropriate Government under the Industrial Disputes Act, 1947, is the Central Government, the Central Government;
- in relation to any other establishment, the Government of the State in which that other establishment is situate.

### **Exempted establishments**

The Act will not apply to the following classes of employees-

- Employees employed by the Life Insurance Corporation of India;
- Seaman as defined in Section 3(42) of the Merchant Shipping Act, 1958;
- Employees registered or listed under any scheme made under the Dock Workers (Regulation of Employment) Act, 1948 and employed by registered or listed employers;



- Employees employed by an establishment engaged in any industry carried on by or under the authority of any department of the Central Government or a State Government or a local authority;
- Employees employed by-
  - The Indian Red Cross Society or any other institution of like nature;
  - Universities and other educational institutions;
  - Institutions (including hospitals, Chambers of Commerce and Social Institutions) established not for the purpose of profit;
- Employees employed through contractors on building operations;
- Employees of the Reserve Bank of India;
- Employees of-
  - The Industrial Finance Corporation of India;
  - Any financial corporation established under Section 3 or Section 3A of the State Financial Corporation Act, 1951;
  - The Deposit Insurance Corporation;
  - The Agriculture Refinance Corporation;
  - The Unit Trust of India;
  - The Industrial Development Bank of India;
  - Any other financial institution, being an establishment in public sector which the Central Government notifies in the Official Gazette with regard to the capital structure, its objects, its extent of financial assistance and any other relevant factor.
- Employees of inland water transport establishments operating on routes passing through any other country.

Besides the appropriate Government is empowered to exempt any establishment or class of establishments from the applicability of this Act, if it is of the opinion that in regard to the financial position and other relevant circumstances, it would not be in the public interest to apply all or any of the provisions of the Act.

### **Award**

Section 2(7) defines the term 'award' as an interim or a final determination by an industrial dispute or of any question relating thereto by any Labour Court, Industrial Tribunal or National Tribunal constituted under the Industrial Disputes Act, 1947 or by any other authority constituted under any corresponding law relating to investigation and settlement of industrial disputes in force in a State and includes an arbitration award made under Section 10A of Arbitration and Conciliation Act, 1996.

### **Banking Company**

Section 2(8) defines the term 'banking company' as a banking company as defined in Section 5 of the Banking Companies Act, 1949 and includes-

- State bank of India and any subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959;
- Any corresponding new bank as specified in the I Schedule to the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970;
- Any corresponding new bank constituted under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980;
- Any co-operative bank as defined in Section 2(bii) of the Reserve Bank of India Act; and
- Any other banking institution which may be notified in this behalf by the Central Government.



## Employee

Section 2(13) defines the term 'employee' as any person employed on a salary or wage not exceeding ₹21,000/- per mensem (with effect from 01.04.2014) in any industry to do any skilled or unskilled manual, supervisory, managerial, administrative, technical or clerical work for hire or reward, whether the terms of employment be express or implied. Where the salary/wage of an employee exceeds ₹ 7,000/- per month, the bonus calculation shall be made assuming his salary as ₹ 7,000/- per month. Apprentice will not be treated as an employee.

The following case laws illustrate the eligibility of type of employees eligible for bonus-

- A temporary workman is entitled to bonus on the basis of the total number of days worked by him – 'Cooper Allen & Co. Limited V. Their Workmen' – 1951 (2) LLJ 576;
- A part time employee as a sweeper engaged on regular basis is entitled to bonus – 'Automobile Karmachari Sangh V. Industrial Tribunal' – 1970 (38) FJR 268;
- A dismissed employee, reinstated with back wages, is entitled to bonus – 'Gannon India Limited V. Niranjan Das'- 1984 (40 LLJ 223;
- A retrenched employee is eligible to get bonus provided he has worked for minimum qualifying period – 'Bank of Madura Limited V. Bank of Madura Employees' Union' – 1961 (1) LLJ 720;
- A piece rated worked is entitled to bonus – 'Malabar Tile Works V. Industrial Tribunal' – 1970 (I) LLJ 79.

## Employer

Section 2(14) defines the term 'employer' including-

- in respect of 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
  - the manager of the factory;
- 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.

## Salary or wage

Section 2(21) of the Act defines 'salary or wage'. According to this definition 'salary or wage' includes all remuneration except over time allowance payable to an employee in respect of his employment. Salary includes dearness allowance. Salary does not include-

- any other allowance which the employee is for the time being entitled;
- the value of any house accommodation or of supply of light, water, medical attendance or other amenity or of any service or of any concessional supply of food grains or other articles;
- any travelling concession;
- any bonus, including incentive, production and attendance bonus;
- any contribution to provident fund or pension fund under any law for the time being in force;
- any retrenchment compensation or gratuity or other retirement benefits payable to the employee or any *ex-gratia* payment made to him;
- any commission payable to the employee.

Where an employee is given in lieu of the whole or part of the salary or wage payable to him, free food allowance or free food by his employer, such food allowance or the value of such food shall be deemed to form part of the salary or wage of such employee.



### **Allocable Surplus [Section 2(4)]**

It means –

- (a) in relation to an employer, being a company (other than a banking company) which has not made the arrangements prescribed under the Income-tax Act for the declaration and payment within India of the dividends payable out of its profits in accordance with the provisions of Section 194 of that Act, sixty-seven per cent of the available surplus in an accounting year;
- (b) in any other case sixty per cent of such available surplus.

### **Available Surplus [Section 2(6)]**

It means the available surplus under Section 5. [Section 2(6)]

### **Eligibility for bonus**

Section 8 provides that every employee shall be entitled to receive bonus from his employer in an accounting year. For this he has to work in the establishment for not less thirty working days in that accounting year.

An employee suspended but subsequently reinstated with full back wages cannot be treated to be ineligible for bonus for the period of suspension as held in 'Project Manager, Ahmadabad Project, ONGC V. Sham Kumar Senegal' – (1995) 1 LLJ 863.

### **Computation of working days**

Section 14 provides that an employee shall be deemed to have worked in an establishment in any accounting year on the days on which-

- he has been laid off under an agreement or as permitted by the 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;
- he has been on leave with salary or wage;
- he has been absent due to temporary disablement caused by accident arising out of an in the course of his employment; and
- the employee has been on maternity leave with salary or wage during the accounting year.

### **Disqualification for bonus**

Section 9 provides that an employee shall be disqualified from receiving bonus, if he is dismissed from service for fraud or riotous or violent behavior while on the premises of the establishment or theft, misappropriation or sabotage of any property of the establishment.

In 'Pandian Roadways Corporation Limited Madurai V. Presiding Officer, Labor Court'- 1977 LLR 83 (Mad HC) the High Court held that the right of the management to forfeit bonus on the ground that the workman was dismissed from service for misconduct, would be only with reference to the accounting year in which the said Act of misconduct was committed and not with reference to any year or years preceding or succeeding the accounting in question.

### **Minimum and Maximum Bonus**

Section 10 provides that the employer shall be bound to pay every employee in respect of the accounting year a minimum bonus which shall be 8.33 % of the salary or wage earned by the employee during the accounting year or ₹100/- whichever is higher, whether or not the employer has any available surplus in the accounting year.

Section 11 provides that if the allocable surplus exceeds the amount of minimum bonus payable to the employee, the employer shall be bound to pay to every employee in that year in proportion to the salary or wage earned by the employee during the accounting year subject to the maximum of 20% of such salary or wage.



In absence of any allocable surplus in the concerned accounting year, only the minimum bonus is payable. However, in view of the settlement entered into by the employer before the Conciliation Officer for paying bonus at a higher rate the bonus was held accordingly payable for that year as held in 'Dishergarh Power Supply Co., Limited V. Workmen' – (1986) 3 SCC 450.

### **Calculation of Bonus with Respect to certain employees**

Section 12 states that, where the salary or wage of an employee exceeds seven thousand rupees per mensem, the bonus payable to such employee under section 10 or, as the case may be under section 11, shall be calculated as if his salary or wage were seven thousand rupees per mensem.

### **Computation of bonus**

The following are the steps required to be done for the computation of bonus:

- Computation of gross profits;
- Sums deductible from gross profits;
- Computation of available surplus ;
- Computation of allocable surplus

### **Computation of gross profit**

Section 16 of the Act provides that the gross profit derived by an employer from an establishment in respect of the accounting year shall-

- in the case of banking company, be calculated in the manner as specified in the First Schedule;
- in any other case, be calculated in the manner as specified in the Second Schedule.

### **Sums deductible from gross profit**

Section 6 of the Act provides the following to be deductible from the gross profit-

- depreciation admissible under Section 32 of the Income Tax Act, 1961;
- development rebate or investment allowance or development allowance which the employer is entitled to deduct from his income under the Income Tax Act, 1961;
- any direct tax payable for the accounting year by the employer;
- such other sums as specified in Third Schedule-
  - Company other than banking company – the following are deductible-
    - ◆ Dividends payable on preference share capital;
    - ◆ 8.5% of its paid up equity share capital as the commencement of the accounting year;
    - ◆ 6% of its reserves shown in the balance sheet at the commencement of the accounting year;
  - Foreign company – 8.5% on the aggregate of the value of net fixed assets and the current assets of the company in India after deducting the amount of its current liabilities in India;
  - Banking companies – the following are deductible-
    - ◆ Dividends payable on preference share capital;
    - ◆ 7.5% of its paid up equity share capital as at the commencement of the accounting year;
    - ◆ 5% of its reserves shown in the balance sheet as at the commencement of the accounting year;
    - ◆ Any sum transferred to a reserve fund under Section 17(1) of the Banking Regulation Act, 1949 or to any reserves in India in pursuance of any direction or advice given by RBI;



- Foreign banking company – the following are deductible-
  - ◆ Dividends payable to its preference shareholders;
  - ◆ 7.5% of its total paid up equity share capital as its total working funds in India bears to its total working funds;
  - ◆ 5% of such amount as bears the same proportion to its total disclosed reserves as its total working funds in India bear to its total working funds;
  - ◆ Any sum deposited with RBI under Section 11(2)(b)(ii) of the Banking Regulation Act, 1949 not exceeding the amount required to be deposited;
- Corporation – the following are deductible-
  - ◆ 8.5% of its paid up capital as at the commencement of the accounting year;
  - ◆ 6% of its reserves, if any, shown in its balance sheet as at the commencement of the accounting year;
- Co-operative society – the following are deductible-
  - ◆ 8.5% of the capital invested by such society in its establishment;
  - ◆ Such sum as has been carried forwarded to a reserve fund under any relating to co-operative societies;
- Any other employer not falling under any of the aforesaid categories – the following are deductible-
  - ◆ 8.5% of the capital invested at the commencement of the accounting year;

### Computation of available surplus

Section 5 provides that the available surplus in respect of any accounting year shall be the gross profit for that year after deducting there from the eligible sums. The available surplus shall be the aggregate of-

- The gross profits for that accounting year after deducting the sums;
- An amount equal to the difference between-
  - The direct tax, calculated under Section 7, in respect of an amount equal to gross profits of the employer for the immediately preceding accounting year; and
  - The direct tax, calculated under Section 7, in respect of an amount equal to the gross profits of the employer for such preceding accounting year after deducting the bonus which the employer has paid or is liable to pay to his employee in accordance with the provisions of the Act for that year.

### Set on and set off of allocable surplus

Section 15(1) provides that if the allocable surplus, in any accounting year, exceeds the amount of maximum bonus payable then the excess shall subject to a limit of 20% of the total salary or wage of the employees 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 utilized for the purpose of bonus.

Section 15(2) provides that where for any accounting year, there is no available surplus or allocable surplus in respect of that year falls short of the amount of minimum bonus payable to the employees and there is no amount or sufficient amount carried forward and set on which could be utilized 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 the manner illustrated in Fourth Schedule.

Section 15(4) provides that where in any accounting year any amount has been carried forward and set on or set off, then, in calculating bonus for the succeeding accounting year, the amount of set on or set off carried forward from the earliest account year, shall first be taken into account.

**Illustration:**

In ₹

Year	Amount equal to 60% or 65% as the case may be, or available surplus allocable as bonus (₹)	Amount payable as bonus (₹)	Set on or set off of the year carried forward (₹)	Total set on or set off carried forward (₹) of year
(1)	(2)	(3)	(4)	(5)
1	104167	104167**	NIL	NIL
2	635000	250000*	Set on ₹250000	Set on 250000 (2)
3	220000	250000 * (inclusive of 30000 from year 2)	NIL	Set on 225000 (2)
4	375000	250000*	Set on 125000	Set on 220000(2) 125000 (4)
5	140000	250000 *(inclusive of 110000 from year 2)	NIL	Set on 110000(2) 125000 (4)
6	310000	250000*	Set on 60000	Set on NIL + (2) 125000 (4) 60000 (6)
7	100000	250000* (inclusive of 125000 from year 4 and 25000 from year 6)	NIL	Set on 35,000 (6)
8	NIL (due to loss)	1046167** (inclusive of 35,000 from year 6)	Set off 69167	Set off 69167 (8)
9	10000	104167**	Set Off 94167	Set off 69176(8) 94167 (9)
10	215000	104167**	NIL	Set off 52501 (9)

\* Maximum bonus payable

+ The balance of ₹1,10,000 set on from year (2) lapses;

\*\* Minimum bonus

**Bonus limit**

Section 12 provides that where the salary or wage of an employee exceeds ₹10,000/- per month, the bonus payable to such employee shall be calculated as if his salary or wage were ₹10,000/- per month.

**Proportionate reduction**

Section 13 provides that where an employee has not worked for all the working days in an accounting year, the minimum bonus of ₹100/- or as the case may be, of ₹60/- if such bonus is higher than 8.33% of his salary or wage for the days he has worked in that accounting year, shall be proportionately reduced.

**Adjustment of customary bonus or interim bonus**

Section 17 provides that where in any accounting year an employer has paid any puja bonus or other customary bonus to an employee or an employer has paid a part of the bonus 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 in respect of that accounting year and the employee shall be entitled to receive only the balance.





### **Deduction from bonus**

Section 18 provides 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 in respect of that accounting year only and the employee shall be entitled to receive the balance, if any.

In 'Wheel & Rim Company of India Limited V. Government of Tamil Nadu' – 19971 II LLJ 299 (Mad HC) the High Court held that Section 18 provides for what should be done in case of a misconduct of an employee causing financial loss to employer. The employer can deduct any of the loss from the bonus payable under the Act for that Accounting year only. The section deals with minor misconduct causing financial loss to the employer.

### **Time limit**

Section 19 provides that all amount payable to an employee by way of bonus shall be paid in cash by his employer. The time limit for making payment of bonus is-

- If there is a dispute regarding the payment of bonus is pending before any authority, then the payment shall be made within a month on which the award becomes enforceable or the settlement comes into operation, in respect of such dispute;
- In any other case, within a period of 8 months from the close of the accounting year.

The appropriate Government or such authority as the appropriate Government may specify, upon an application made to it by the employer and for sufficient reasons, by order, extend the said period of 8 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 2 years.

### **Recovery of bonus due from an employer**

Section 21 of the Act provides the procedure for the recovery of bonus in case the employer has not paid under a settlement or an award or agreement. In such cases-

- the employee himself; or
- any other person authorized by him in writing in this behalf; or
- in the case of death of the employee, his assignee or heirs

may make an application to the appropriate Government for the recovery of the money due to him. If the appropriate Government or such authority authorized is satisfied that any money is due, it shall issue a certificate to the Collector for that amount to the Collector who shall proceed to recover the said amount in the same manner as an arrear of land revenue.

It may be noted that every such application shall be made within one year from the date on which the money become due to the employee from the employer. As such application may be entertained after the expiry of the said period of one year; if the Appropriate Government is satisfied that the applicant had sufficient cause for not making the application within the said period.

### **Reference of dispute**

Section 22 provides that where any dispute arises between an employer and his employee-

- in regard to the bonus payable; or
- with respect to the application of this Act 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 or of any corresponding law relating to investigation and settlement of industrial disputes in force in a State and the provisions of that Act apply accordingly.

### **Presumption about accuracy of balance sheet**

Section 23 deals with the presumption about accuracy of balance sheet and profit and loss account of corporations and companies. Section 23(1) provides that where, during the course of proceedings



before any arbitrator or Tribunal, 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, the authority may presume the statements and particulars contained in such balance sheet and profit and loss account to be accurate. It shall not be necessary to prove the accuracy of such statements and particulars by the filing of an affidavit or by any other mode. If the said authority is satisfied that the 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.

Section 23(2) provides that when an application is made to the said authority by the trade union or a party to the dispute requires any clarification regarding to any item in the balance sheet or the profit and loss account, the authority may, after satisfying itself that it is necessary to provide, order the company to furnish to them such clarification within such time as may be specified. The corporation or the company shall comply with the said direction.

### **Audit of accounts**

Section 24 provides that in the course of dispute the banking company is to submit the duly audited accounts of the banking company to the authority. The authority shall not permit any trade union or employees to question the correctness of such accounts. The trade union or the employees may be permitted to obtain from such company such information as is necessary for verifying the amount of bonus due under the Act. The trade union or the employees cannot obtain any information which the banking company is not compelled to furnish under the provisions of Section 34A of the Banking Regulation Act, 1949.

The employer other than a corporation or a company is to submit the duly audited accounts before the authority. The authority shall not permit any trade unions or employees to question the correct of such accounts. When the authority 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 it may direct the employer to get his accounts audited within such time specified or within such further time as it may allow by such auditor as it thinks fit. The employer shall comply with such direction. If an employer fails to get the accounts audited, the said authority may get the accounts audited by such auditor as it thinks fit. The expenses incurred in this regard shall be met by the employer. If default of such payment the same shall be recoverable from the employer through Collector as arrears of land revenue.

### **Obligations of the employer**

Section 26 requires that every employer shall prepare and maintain such registers, records and other documents in such form and in such manner as may be prescribed. Rule 4 of the Payment of Bonus Rules, 1975 provides that every employer shall prepare and maintain the following registers-

- a register showing the computation of the allocable surplus in Form A;
- a register showing the set on and set off of the allocable surplus in Form B;
- a register showing the details of the amount of bonus due to each of the employee, the deduction and the amount actually disbursed in Form C.

### **Annual Return**

Rule 5 provides that every employer shall on or before the 1<sup>st</sup> day of February in each year upload annual report in Form D on the web portal of the Ministry of Labor and Employment giving information as to the particulars specified in respect of the preceding year. Annual return may also be filed to Inspector on or before 1<sup>st</sup> day of February in each year.

### **Inspectors**

Section 27 provides that the appropriate Government may appoint such persons as Inspectors for the purposes of this Act. The Government may define the limits within which they shall exercise jurisdiction.



This section gives the Inspectors the following powers:

- to require an employer to furnish such information as he may consider necessary;
- to enter any establishment or any premises at any reasonable time and with such assistance require any one found in charge to produce before him for examination any accounts, books, registers and other documents relating to the employment of persons or the payment of salary or wage or bonus in the establishment;
- to examine the employer, his agent or servant or any other person found in charge of the establishment or any person whom the Inspector has reasonable cause to be or have been an employee in the establishment;
- to make copies of, or take extracts from any book, register or other document maintained in relation to the establishment.

Any person required producing any accounts, books, register or other documents or to give information by an Inspector shall be legally bound to do so.

### **Penalty**

If any person contravenes any of the provisions of this Act or any rule made thereunder; he 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. Likewise if any person, to whom a direction is given or a requisition is made under this Act, fails to comply with the direction or requisition, he 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 28).

### **Offences by companies**

Section 29 provides that if any offence is committed by a company, every person, who, at the time the offence was committed, was in charge of and was responsible to the company for the conduct of the business of the company, and the company shall be deemed to be guilty of the offence and 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 exercised all due diligence to prevent the commission of offence he will not be punished.

Where an offence 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, then such person shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

### **Cognizance of Offences**

Section 30 provides that no court shall take cognizance of any offence punishable unless a complaint is made by the authority of the appropriate Government or an offence not below the rank of a Regional Labor Commissioner in the case of Central Government and not below the rank of a Labor Commissioner in the case of State Government. No court inferior to that of a Presidency Magistrate or a magistrate of the I class shall try any offence punishable under this Act.

### **Productivity Linked Bonus**

Section 31A provides that-

- where an agreement or a settlement has been entered into by the employee with their employer before the commencement of the Payment of Bonus (Amendment) Act, 1976 or
- where the employees enter into any agreement or settlement with their employer after such commencement,

for payment of annual bonus linked with production or productivity in lieu of bonus based on profits payable then such employees shall be entitled to receive bonus due to them under such agreement or settlement. Any such agreement or settlement whereby the employees relinquish their right to receive the minimum bonus shall be null and void in so far as it purports to deprive them of such right. Such employees shall not be entitled to be paid in excess of 20% of the salary or wage earned by them during the relevant accounting year.

**CHECK YOUR PROGRESS****Fill in the blanks**

1. The two types of establishments under the Payment of Bonus Act are \_\_\_\_\_, \_\_\_\_\_.
2. To get eligible for bonus an employee is to work \_\_\_\_\_ in that accounting year.
3. Wage limit for getting bonus is ₹ \_\_\_\_\_.
4. The minimum bonus payable is at \_\_\_\_\_ of the salary or wage earned by the employee during the accounting year or ₹ \_\_\_\_\_ whichever is higher.
5. The time limit for bonus payment by issue of an award passed on the dispute regarding the payment of bonus is \_\_\_\_\_.
6. Annual return is to be filed in Form No. \_\_\_\_\_.
7. Any dispute arises between an employer and his employee in regard to the payment of bonus shall be deemed to be an \_\_\_\_\_.
8. Bonus is an \_\_\_\_\_ to increase the production.
9. Bonus is neither \_\_\_\_\_ nor \_\_\_\_\_ deferred payment of wages.
10. The establishment in public sector is an establishment owned, controlled or managed by \_\_\_\_\_.

**Choose the correct answer**

1. Which one of the following is not applicable to the Bonus Act?
  - (a) Every factory;
  - (b) Every establishment in which 20 or more persons are employed on any day during an accounting year;
  - (c) Life Insurance Corporation of India.
2. Who is not eligible to get bonus?
  - (a) A temporary workman;
  - (b) A dismissed employee;
  - (c) A piece rated employee;
  - (d) A retrenched employee.
3. The maximum bonus payable during an accounting year is \_\_\_\_\_ of the salary.
  - (a) 8.33%
  - (b) 12%
  - (c) 15%
  - (d) 20%
4. If an employee draws pay of ₹15,000/- what is the maximum bonus payable to him?
  - (a) ₹10,000/-
  - (b) ₹15,000/-
  - (c) ₹21,000/-
  - (d) None of the above
5. The time limit for making bonus payment is-
  - (a) Within a period of one month from the close of the accounting year;
  - (b) Within a period of three months from the close of the accounting year;
  - (c) Within a period of six months from the close of the accounting year;
  - (d) Within a period of eight months from the close of the accounting year.
6. Annual return shall be filed by every employer on or before-
  - (a) 31<sup>st</sup> March;
  - (b) 30<sup>th</sup> September;
  - (c) 1<sup>st</sup> February;
  - (d) 30<sup>th</sup> June.



7. Which of the following is included in the definition of 'salary' or 'wage'?
  - (a) Commission;
  - (b) Dearness allowance;
  - (c) Retrenchment compensation;
  - (d) Value of any house accommodation.
8. Which one of the following is deductible from the gross profit?
  - (a) Depreciation;
  - (b) Development rebate;
  - (c) Any direct tax payable;
  - (d) All of the above.
9. \_\_\_\_\_% of the paid up equity share capital as at the commencement of the accounting year is allowed deduction from the gross profit in respect of banking companies.
  - (a) 7.5% (b) 6%(c) 8.5% (d) 5%
10. 6% of the reserves shown in the balance sheet as at the commencement of the accounting year is allowed for\_\_\_\_\_ company.
  - (a) Foreign company;
  - (b) Banking company;
  - (c) Company other than banking company;
  - (d) Corporation.

**State whether TRUE or FALSE**

1. Customary bonus is covered under the Payment of Bonus Act, 1965.
2. Bonus Act is not applicable to Government Departments.
3. A dismissed employee, reinstated with back wages is entitled to bonus.
4. Where an employee has not worked for all the working days he is entitled to full bonus.
5. Where in any accounting year, an employee is found guilty of misconduct causing financial loss to the employer, then the employer may deduct the amount of loss from the bonus payable to the employee.
6. During the proceeding before any arbitrator or Tribunal it is required to prove the accuracy of accounts of the establishment.
7. No court shall take cognizance or any offence punishable unless a complaint is made by the authority by appropriate Government.
8. Where an establishment is newly set up the bonus shall be payable only in respect of the accounting year in which the employee derives profit from such establishment.
9. An establishment shall be deemed to be newly set up by reason of a change in its location, management, ownership.
10. Customary bonus can be adjusted against the amount of bonus paid to the employee.

**Model Questions**

1. Narrate the circumstances which disqualify an employee to receive bonus.
2. What is available surplus and allocable surplus?
3. Write notes on 'set on' and 'set off' of allocable surplus with example.



4. What are the various methods in computation of bonus?
5. What are the obligations of the employer under the Act?
6. Write short notes on Productivity Linked Bonus.
7. What are the powers of the Inspector under this Act?
8. Discuss Section 21 of the Act which deals with the recovery of bonus due to an employee.
9. Define the term 'banking company'. Whether a co-operative bank is a banking company.
10. List the establishments that are exempted from this Act.

**Answers:**

**Fill in the blanks**

1. Establishment in private sector, establishment in public sector;
2. Not less than 30 days;
3. ₹21,000/-;
4. 8.33%, ₹100;
5. One month within the award becomes enforceable;
6. D;
7. Industrial dispute;
8. Incentive;
9. Gratuitous, deferred;
10. A Government company.

**Choose the correct answer**

1. C;
2. B;
3. D;
4. A;
5. D;
6. C;
7. B;
8. D;
9. A
10. C.

**State whether TRUE or FALSE**

1. FALSE;
2. TRUE;
3. TRUE;
4. FALSE;
5. TRUE;
6. FALSE;
7. TRUE;
8. TRUE;
9. FALSE;
10. TRUE.

# Study Note - 11

## MINIMUM WAGES ACT, 1948



### This Study Note includes

#### 11.1 Minimum Wages Act, 1948 – Object, Scope and Applicability

#### 11.1 MINIMUM WAGES ACT, 1948 – Object, Scope and Applicability

##### Introduction

The concept of minimum wages first evolved with reference to remuneration of workers in those industries where the level of wages was substantially low as compared to the wages for similar types of labor in other industries. The International Labor Conference of International Labor Organization (ILO) adopted a draft convention on minimum wages. It was required the member countries to create and maintain a machinery whereby minimum wages can be fixed for workers employed in industries in which no arrangements exist for the effective regulation of wages and where wages are exceptionally low.

The Indian Government appointed a committee called as Labor Investigation Committee to look into the conditions of labor, in terms of their wages, housing, social conditions, employment etc., This committee was appointed on the basis of the recommendations of the ILO. The Committee recommended for a separate legislation for the fixation of minimum wages, working hours etc., especially on unorganized sectors. The bill on minimum wage was introduced in the Lok Sabha. A Standing Committee was appointed which set definitions and guidelines for formulating a wage structure in India. The Committee defined minimum wages as – “The minimum wages must be provided not merely for the bare subsistence of life but also for the preservation of efficiency of the workers by providing for some measures of education, medical requirement and amenities”.

The Central Government also made 'The Minimum Wages (Central) Rules, 1950 for the purposes of the Act. The rules came into effect from 14.10.1950.

##### Object of the Act

The object of this Act is to provide for fixing minimum rates of wages in certain employments.

In 'Bakshish Singh V. Darshan Engineering Works' – 1994 LLR 61 SC the Supreme Court held that there is one principle which admits of no exception. No industry has right to exist unless it is able to pay its workmen at least a bare minimum wage. If an employer cannot maintain his enterprise without cutting down the wages of his employees below even a bare subsistence or minimum wage, he would have no right to conduct his enterprise on such terms.

##### Applicability

This Act extends to whole of India. The Act provides the list of employments for which this Act applicable in the schedule to this Act.

##### Effect

This Act came into effect from 15.03.1948.

##### Important definitions

###### Adolescent

Section 2(a) defines the term 'adolescent' as a person who has completed his fourteenth year of age but has not completed his eighteenth year.



### **Adult**

Section 2(aa) defines the term 'adult' as a person who has completed his eighteenth year of age.

### **Appropriate Government**

Section 2(b) defines the term 'appropriate Government' as-

- in relation to any scheduled employment carried on by or under the authority of the Central Government or a railway administration or in relation to a mine oilfield or major port or any corporation established by a Central Act - the Central Government; and
- in relation to any other scheduled employment the State Government;

### **Child**

Section 2(bb) defines the term 'child' as in relation to any other scheduled employment of the State Government .

### **Cost of living index**

Section 2(d) defines the expression 'cost of living index number' in relation to employees in any scheduled employment in respect of which minimum rates of wages have been fixed as the index number ascertained and declared by the competent authority by notification in the Official Gazette to be the cost of living index number applicable to employee in such employment.

### **Employer**

Section 2(e) defines the term 'employer' as any person who employs, whether directly or through another person, or whether on behalf of himself or any other person, one or more employees in any scheduled employment in respect of which minimum rates of wages have been fixed under this Act and includes except in sub-section (3) of section 26 –

- (i) in a factory where there is carried on any scheduled employment in respect of which minimum rates of wages have been fixed under this Act, any person named under clause (f) of sub-section (1) of section 7 of the Factories Act 1948 (63 of 1948) as manager of the factory;
- (ii) in any scheduled employment under the control of any Government in India in respect of which minimum rates of wages have been fixed under this Act, the person or authority appointed by such government for the supervision and control of employees or where no person or authority is so appointed the head of the department;
- (iii) in any scheduled employment under any local authority in respect of which minimum rates of wages have been fixed under this Act, the persons appointed by such authority for the supervision and control of employees or where no person is so appointed, the chief executive officer of the local authority;
- (iv) in any other case where there is carried on any scheduled employment in respect of which minimum rates of wages have been fixed under this Act any person responsible to the owner for the supervision and control of the employees or for the payment of wages;

In 'Shiv Prasad Ghosh V. District Judge' – 1963 (6) FJR 447 it was held that under the definition of the word 'employer' in Section 2(e) (iv) of the Act any person responsible to the owner for the supervision and control of the employees or for the payment of wages them is also an employer.

In 'A.V. Prakash V. Senior Labour Inspector' – 1994 LLR 304 (Karn) it was held by the High Court that the definition of 'employer' is a restrictive definition and only a person who employs one or more employees in any scheduled employment would be employer within the meaning of the Act and no doubt it includes the employees as detailed in the various sub clauses of Section 2(e).





## Wages

Section 2(h) defines the term 'wages' as all remuneration, capable of being expressed in terms of money, which would, if the terms of the contract 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 house rent allowance, but does not include –

- the value of –
  - any house accommodation, supply of light, water, medical attendance; or
  - any other amenity or any service excluded by general or special order of the appropriate government;
- any contribution paid by the employer to any Pension Fund or Provident Fund or under any scheme of social insurance;
- any traveling allowance or the value of any traveling 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;

Section 2(h) defines the term 'wages' and not 'minimum wages'. It is up to the appropriate Government to fix the minimum wages considering into the various aspects of the employment, sectoral organization etc., In many a case the Courts declare who are eligible to receive minimum wages apart from the decisions of the appropriate Governments.

In 'Bandhua Mukti Morcha V. Union of India' – (1984) SCC (L&S) 389 the Supreme Court held that a piece rated worker is also entitled to receive the minimum wages irrespective of his output.

In 'Patel Ishwerbhai Pramod Bhai V. Taluka Development Officer' – 1983 Lab IC 321 it was held that where certain tube well operators were working in the District and Taluka Panchayats they would be in the scheduled employment as contemplated by Section 2(g), employment under any local authority being item 6 in the schedule to the Act, and as such would be entitled to minimum wages under the Act.

## Employee

Section 2(i) defines the term 'employee' as any person who is employed for hire or reward to do any work, skilled or unskilled, manual or clerical, in a scheduled employment in respect of which minimum rates of wages have been fixed; and includes an out-worker to whom any articles or materials are given out by another person to be made up, cleaned, washed, altered, ornamented, finished, repaired, adapted or otherwise processed for sale for the purposes of the trade or business of that other person where the process is to be carried out either in the home of the out-worker or in some other premises not being premises under the control and management of that other person; and also includes an employee declared to be an employee by the appropriate government; but does not include any member of the Armed Forces of the Union.

In 'Athni Municipality V. Shettappa Laxman Pattan' – (1965) II LLJ 307 it was held that having regard to the context and object of the Act, a discharged employee must also be held to be an employee within the meaning of the Act.

## Scheduled employment

Section 2(g) of the Act defines the terms 'scheduled employment' as an employment specified in the Schedule, or any process or branch of working forming part of such employment.

The Schedule is divided into two parts – Part I and Part II. Part I of the schedule has 18 entries. It was realized that it would be necessary to fix minimum wages in many more employments to be identified



in course of time. Accordingly, powers were given to appropriate Government to add employments to the Schedule by following the procedure laid down in Section 21 of the Act. As a result the State Government and Central Government have made several additions to the Schedule and it differs from State to State.

Part II relates to employment in agriculture. Employment in agriculture, that is to say, in any form of farming, including the cultivation and tillage of the soil, dairy farming, the production, cultivation, growing and harvesting of any agricultural or horticultural commodity, the raising of live-stock, bees or poultry and any practice performed by a farmer on a farm as incidental to or in conjunction with farm operations (including any forestry or timbering operations and the preparation for market and delivery to storage or to market or to carriage for transportation to market from produce).

### **Act – not violative of fundamental rights**

In 'T.G. Lakshmaiah Setty Sons, Adoni V. State of Andhra Pradesh,' – 1981 Lab IC 690 it was held that the Minimum Wages Act does not violate any of the fundamental rights. On the other hand, it fulfills, in part, at least, the obligations of the State under the Directive Principles of State Policy.

### **Fixing of minimum rates of wages**

Section 3 provides that the appropriate Government shall fix the minimum rates of wages payable to employees employed in an employment specified in Part I or Part II of the Schedule and in an employment added to either Part by notification under section 27. The appropriate government may in respect of employees employed in an employment specified in Part II of the Schedule instead of fixing minimum rates of wages under this clause for the whole State fix such rates for a part of the State or for any specified class or classes of such employment in the whole State or part thereof.

The appropriate government may refrain from fixing minimum rates of wages in respect of any scheduled employment in which there are in the whole State less than one thousand employees engaged in such employment but if at any time the appropriate government comes to a finding after such inquiry as it may make or cause to be made in this behalf that the number of employees in any scheduled employment in respect of which it has refrained from fixing minimum rates of wages has risen to one thousand or more it shall fix minimum rates of wages payable to employees in such employment as soon as may be after such finding.

The appropriate Government may fix minimum rate of wages for-

- time work, known as a Minimum Time Rate;
- piece work, known as a Minimum Piece Rate;
- a guaranteed time rate;
- overtime rate.

### **Different minimum wages**

Section 3(3) (a) provides that different minimum rates of wages may be fixed for-

- different scheduled employments;
- different classes of work in the same scheduled employment;
- adults, adolescents, children and apprentices;
- different localities;

### **Minimum wages on wage period**

Section 3(3) (b) provides that minimum of wages may be fixed by any one or more of the following wage periods-

- by the hour;



- by the day;
- by the month or
- by such other larger wage-period as may be prescribed

and where such rates are fixed by the day or by the month, the manner of calculating wages for a month or for a day as the case may be may be indicated. Where any wage-periods have been fixed under section 4 of the Payment of Wages Act 1936, minimum wages shall be fixed in accordance therewith.

### **Review of Minimum wages**

Section 3(1)(b) provides that the appropriate Government may review at such intervals, as it may think fit, such intervals not exceeding five years and revise the minimum rate of wages, if necessary. Where for any reason the appropriate Government has not reviewed the minimum rates of wages fixed by it in respect of any scheduled employment within any interval of five years, nothing contained in this clause shall be deemed to prevent it from reviewing the minimum rates after the expiry of the said period of five years and revising them, if necessary, and until they are so revised the minimum rates in force immediately before the expiry of the said period of five years shall continue in force.

### **Minimum wages when a dispute is pending**

Section 3(2A) provides that where in respect of an industrial dispute relating to the rate of wages payable to any employees employed in a schedule employed is pending before-

- A Tribunal or National Tribunal under the Industrial Disputes Act, 1947; or
- Before any like authority under any other law for the time being force; or
- An award made by any Tribunal, National Tribunal or such authority is in operation

and a notification is issued by the appropriate Government for fixing the minimum wages or revision of minimum wages, during the pendency of the above proceedings, no minimum wage cannot be fixed by the appropriate Government during the said period.

### **Minimum Rate of wages**

Section 4(1) provides that any minimum rate of wages fixed or revised by the appropriate government in respect of scheduled employments may consist of –

- a basic rate of wages and a special 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; or
- a basic rate of wages with or without the cost of living allowance and the cash value of the concessions in respect of suppliers of essential commodities at concession rates, where so authorized; or
- an all-inclusive rate allowing for the basic rate, the cost of living allowance and the cash value of the concessions, if any.

Section 4(2) provides that the cost of living allowance and the cash value of the concessions in respect of supplied of essential commodities at concession rate shall be computed by the competent authority at such intervals and in accordance with such directions as may be specified or given by the appropriate government.

In 'Karnataka Film Chamber of Commerce, Bangalore V. State of Karnataka' – 1986 Lab IC 1890 it was held that Section 4 is a definite indication that basic wage is an integral part of the minimum wage. It is not correct to say that a minimum wage under Section 4(1) necessarily should consist of basic wage and dearness allowance. The language of Section 4 does not lend itself to such an interpretation. On the plain terms of Section 4(1) it is clear that that the payment of dearness allowance would arise only



if the basic wage fixed for a category of workmen fell short of the minimum wage which the State Government has to fix taking into consideration the needs of the workers' family consisting of three consumption units.

### Example

Revised minimum rates of wages in Delhi with effect from 01.04.2016 are as follows:

Unskilled employees – ₹ 9568 per month;

Semi skilled employees – ₹ 10,582/- per month;

Skilled categories – ₹ 11,622/- per month; and

Graduate & Above – ₹ 12,662/- per month

### Procedure for fixing and revising minimum wages

Section 5 (1) provides that In fixing minimum rates of wages in respect of any scheduled employment for the first time under this Act or in revising minimum rates of wages so fixed, the appropriate government shall, either –

appoint as many committees and sub-committees as it considers necessary to hold enquiries and advise it in respect of such fixation or revision as the case may be; or

by notification in the Official Gazette, 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 will be taken into consideration.

Section 5(2) provides that after considering the advice of the committee or committees all representations received by it before the date specified in the notification, the appropriate government shall by notification in the Official Gazette, fix, or, as the case may be revise the minimum rates of wages in respect of each scheduled employment and unless such notification otherwise provides it shall come into force on the expiry of three months from the date of its issue. Where the appropriate government proposes to revise the minimum rates of wages by the mode specified in clause (b) of sub-section (1) the appropriate government shall consult the Advisory Board also.

In 'Bijay Unchana Paul V. State of Assam' – 1969 (19) FLR 11 it was held that it is necessary that the appropriate Government in issuing notifications for prescribing the rates of minimum wages under the Minimum Wages Act, 1948, punctiliously follows the letter of law and strictly complies with all the procedures laid down in the Act.

In 'T.G. Lakshmaiah Setty & Sons, Adoni V. State of Andhra Pradesh' – 1981 Lab IC 690 it was held that what is contemplated by the Act to be notified under Section 5(1)(b) is no doubt draft proposals. The objection to draft proposals can be made both by employers and employees as well. Thus, if the employees had exercised their privilege to represent and ask for higher wages and if eventually the State authorities had adopted higher rates of minimum wages.

### Correction of errors

Section 10 of the Act provides that if there is any clerical or arithmetical mistake in any order fixing or revising minimum rates of wages or errors arising therein from any accidental slip or omission, the appropriate Government may, at any time, by notification correct the same. Every such Notification shall, as soon as may be after it is issued, be placed before the Advisory Board for information.

### Advisory Board

Section 7 of the Act provides that the purpose of co-coordinating work of committees and sub-committees appointed under section 5 and advising the appropriate government generally in the matter of fixing and revising minimum rates of wages the appropriate government shall appoint an Advisory Board.



The Advisory body has no functioning of quasi judicial nature. Their recommendation/decision is not binding on the State Government but the same remains only a recommendation and nothing more than that. Merely because one member of the Board was extra, the recommendation of the Advisory Board would not be vitiated as held in 'Charadharpur Bidi and Tobacco Merchants Association V. State of Bihar' – 1997 (77) FLR 339.

### **Central Advisory Board**

Section 8 of the Act provides that for the purpose of advising the Central and State Governments in the matters of the fixation and revision of minimum rates of wages and other matters under this Act and for co-coordinating the work of the Advisory Board, the Central Government shall appoint a Central Advisory Board. The Central Advisory Board shall consist of persons to be nominated by the Central Government representing employers and employees in the scheduled employments who shall be equal in number and independent persons not exceeding one-third of its total number of members; one of such independent persons shall be appointed the Chairman of the Board by the Central Government.

### **Composition of Committee**

Section 9 of the Act provides that each of the committees sub-committees and the Advisory Board shall consist of persons to be nominated by the appropriate government representing employers and employees in the scheduled employments who shall be equal in number and independent persons not exceeding one-third of its total number of members; one of such independent persons shall be appointed the Chairman by the appropriate government.

### **Wages in kind**

Section 11(1) of the Act provides that Minimum wages payable under this Act shall be paid in cash. Section 11(2) provides that where it has been the custom to pay wages wholly or partly in kind, the appropriate government being of the opinion that it is necessary in the circumstances of the case may, by notification in the Official Gazette, authorize the payment of minimum wages either wholly or partly in kind.

Section 11(3) of the Act provides that if appropriate government is of the opinion that provision should be made for the supply of essential commodities at concession rates, the appropriate government may, by notification in the Official Gazette, authorize the provision of such supplies at concessional rates. Section 11(4) of the Act provides that the cash value of wages in kind and of concessions in respect of supplies of essential commodities at concession rates shall be estimated in the prescribed manner.

### **Payment of minimum rate of wages**

Section 12 of the Act provides that where in respect of any scheduled employment a notification under section 5 is in force, the employer shall pay to every employee engaged in a scheduled employment under him wages at a rate not less than the minimum rate of wages fixed by such notification for that class of employees in that employment without any deductions except as may be authorized within such time and subject to such conditions as may be prescribed. This provision will not affect the provisions of the Payment of Wages Act, 1936.

In 'Militant Security Bureau Private Limited V. B.R. Hehar' – (1991) 2 CLR 245 (Bom) it was held that once a contractor's establishment is covered under the Minimum Wages Act the employees engaged through the contractor shall be entitled to the wages as fixed under the Act.

### **Forced Labor**

In 'Union for Democratic Rights V. Union of India' – 1982 Lab IC 1646 it was held that where a person provides labor or service to another for remuneration which is less than the minimum wages, such labor is 'forced labor' within the meaning of Article 23 of the Constitution.



### **Fixing hours for a normal working day**

Section 13(1) of the Act provides that in regard to any scheduled employment minimum rates of wages in respect of which have been fixed under this Act the appropriate government may –

fix the number of hours of work which shall constitute a normal working day, inclusive of one or more specified intervals. Rule 24 provides that the number of hours which shall constitute a normal working day shall be-

in the case of an adult – 9 hours; the working day of an adult worker shall be so arranged that inclusive of the intervals of rest, if any, shall not spread over more than 12 hours on any day;

in case of a child – 4.5 hours. No child shall be permitted to work for more than 4.5 hours on any day.

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;

provide for payment for work on a day of rest at a rate not less than the overtime rate.

Section 13(2) provides that 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 :-

employees engaged on urgent work, or in any emergency which could not have been foreseen or prevented;

employees engaged in work in 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;

employees whose employment is essentially intermittent;

employees engaged in any work which for technical reasons has to be completed before the duty is over;

employees engaged in a work which could not be carried on except at times dependent on the irregular action of natural forces.

Section 13(3) provides that for the purposes 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.

### **Overtime**

Section 14(1) provides that where an employee whose minimum rate of wages is fixed under this Act 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 fixed under this Act or under any law of the appropriate government for the time being in force whichever is higher.

Rule 25 provides that when a worker works more than 9 hours on any day or more than 48 hours in a week, he shall be entitled to Overtime wages-

in case of employment in agriculture - one and a half times the ordinary rate of wages;

in case of any other scheduled employment – double the ordinary rate of wages.

A register in this regard shall be maintained. If no over time wage is paid for a particular month a NIL entry should be made.

Section 14(2) provides that this Act shall not prejudice the operation of the provisions of Section 59 of the Factories Act in any case where those provisions are applicable.



In 'Municipal Council, Hatta V. Bhagat Singh' – 1998 LLR 298 it was held that Section 14 provides for payment of overtime only to those employees who are getting minimum rate of wages under the Act. It does not apply to those getting better wages under other statutory rules.

#### **Wages of worker who works less than normal working day**

Section 15 of the Act provides that if an employee whose minimum rate of wages has been fixed under this Act 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 by him on that day as if he had worked for a full normal working day. However that he shall not be entitled to receive wages for a full normal working day –

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

in such other cases and circumstances as may be prescribed.

#### **Wages for two or more classes of work**

Section 16 of the Act provides that 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.

#### **Minimum time rate wages for piece work**

Section 17 of the Act provides that where an employee is employed on piece work for which minimum time rate and not a minimum piece rate has been fixed under this Act the employer shall pay to such employee wages at not less than the minimum time rate.

#### **Cash value of wages**

Rule 20 provides that the retail prices at the nearest market shall be taken into account in computing cash value of wages paid in kind and of essential commodities supplied at concessional rates. The computation shall be made in accordance with such directions as may be issued by the Central Government from time to time.

#### **Time of payment of wages**

Rule 21(1) provides that the wages of a worker in any scheduled employment shall be paid on a working day-

in the establishment for which less than 1000 persons are employed – before the expiry of 7<sup>th</sup> day;

in other establishments – before the expiry of 10<sup>th</sup> day

after the last wage period in respect of which the wages are payable.

Where the employment of any person is terminated by or on behalf of the employer, the wages earned by him shall be paid before the expiry of the second working day after the day on which his employment is terminated.

#### **Condition for payment of wages**

The wages of an employed person shall be paid to him without deduction of any kind except those authorized by or under the rules.

#### **Deductions**

Every payment made by the employed person to the employer or his agent shall be deemed to be a deduction of wages. Deductions from the wages shall be one of or more of the following-

finer;

absence from duty;



damage or loss of goods entrusted to the employed person for custody where the damage is directly attributable to his neglect or default;

loss of money for which he is required to account where such loss is directly attributable to his neglect or default;

house accommodation supplied by the employer;

such amenities and services supplied by the employer;

advances or for adjustment of over payment of wages;

income tax payable by the employed person;

by order of a Court or other competent authority;

repayment of advances from any provident fund;

payment to co-operative societies;

loans advanced by the employer;

payment of insurance premium;

adjustment of amounts, other than wages paid in error in excess of what is due to him;

with the written authorization of the employed person;

with the written authorization for contributions to National Defence Fund or the Prime Minister's National Relief Fund or to any Defence Savings Scheme approved by the Central Government;

loans granted for house building.

The prior approval of the Inspector or any other officer authorized is obtained in writing before making such deductions, unless the employee given his consent in writing to such deductions.

The total amount of deductions from the wages shall not exceed-

75% of such wages where such deductions are wholly or partly made for payments to Consumer Co-operative Stores run by any Co-operative Society; and

50% of such wages in any other case.

If the total amount of deductions that have to be made in wage period from the wages exceeds the limit, the excess shall be carried forward and recovered from the wages of succeeding wage period or wayer periods in such number of installments as may be necessary.

### **Fines**

Fine may be imposed on an employed person for damage or loss caused by him. The act or omission or the damage or loss in respect of which the find is proposed, the employed persons shall be explained personally and also in writing about the same. The employed person shall be given an opportunity to offer any explanation in the presence of another person. The amount of fine that is imposed on him shall also be intimated to him. The fine imposed shall be subject to such limits imposed by the Central Government. All fines imposed and deductions made shall be recorded in the register.

### **Weekly day of rest**

Rule 23 provides that an employee to whom this Act is applicable shall be allowed a day of rest every week which shall ordinarily be Sunday, but the employer may fix any other day of the week as the rest day for any employee in his employment. The employee should be informed about his weekly day of rest. To get the weekly day of rest the employee has to work for a continuous period of not less than six days in a week.





### Night shift

Rule 24A provides that where a worker in a scheduled employment works on shift which extends beyond midnight-

a holiday for the whole day for the purposes of week day rest shall, in his case mean a period of 24 consecutive hours beginning from the time when his shift ends; and

the following day in such a case shall be deemed to be the period of 24 hours beginning from the time when such shift ends and the hours after midnight during which such worker was engaged in work shall be counted towards the previous day.

### Claims

If there is any short payment of wages or wages at the over time etc., may be claimed by the employee himself or through any legal practitioner or any official of a registered trade union authorized by him or any Inspection or any person acting with the permission of the Authority by applying to the concerned authority. For this purpose the appropriate Government may appoint-

any Commissioner for Workmen's Compensation; or

any Officer of the Central Government exercising functions as a Labor Commissioner for any region; or

any Officer of the State Government not below the rank of Labor Commissioner; or

any other Officer with experience as a Judge of a Civil Court or as a stipendiary Magistrate

to be the authority to hear and decide for any specified area all claims.

The claim shall be presented to the authority by the employee within six months from the date on which the minimum wages or other amount became payable. The Authority may a claim beyond the six months if he is satisfied that the applicant had sufficient cause for not making the application within the prescribed period. Rule 27 provides that a single application in respect of a number of employees may be filed before the authority. The application shall be made in duplicate in Forms VI, VIA or VII, one copy of which shall bear the prescribed court fee. The authorization shall be given in Form VIII.

The Authority shall serve the copy of the application to the employer by registered post a notice in Form IX to appear before him on a specified date. He shall hear the applicant and the employer and after such further inquiry, if any, as it may consider necessary may, without prejudice of any other penalty to the employer, direct-

the payment to the employee of the amount by which the minimum wages payable to him exceed the amount actually paid, together with compensation as the authority may think fit, not exceeding 10 times the amount of such excess;

in any other case, the payment of the amount together with the payment of such compensation as the Authority may think fit, not exceeding ₹10.

If the employer fails to appear on the specified date the Authority may hear and determine the application ex-parte. If the applicant fails to appear on the specified date the application will be dismissed. Any such order may be set aside on sufficient cause being shown by the defaulting party within one month of the date of the said order and the application shall be re-heard.

If the Authority finds the application is a vexatious one he may impose penalty on the employees not exceeding ₹50/- to the employer.

The amount due may be recovered as if it were a fine imposed by the Authority as a Magistrate. Every direction of the Authority shall be final.

In 'Awadh Lal Sah V. State of Bihar' – 1984 Lab IC 169 (Pat HC) it was held that the minimum wages becoming payable can be claimed by an application presented within six months from the date on



which it became payable and if presented after the expiry of the period of limitation, the applicant has to satisfy the authority that he had sufficient cause for not making the application within such period.

In 'B. Ramdas V. The Authority under the Minimum Wages Act, Guntur Region, Guntur' – 1987 Lab IC 1493 it was held that while making the enquiry into the claim petition under Section 20 of the Act, the authority acts in quasi judicial capacity and *ipso facto* should ensure that no prejudice is caused to the employer by failure to follow the rules of natural justice.

In 'Premier Tobacco Packers (P) Limited V. Assistant Labor Officer' – 1988 Lab IC 283 it was held that an order imposing a monetary liability caused by violation of provisions of a statute cannot be upheld except in the presence of strict proof.

In 'Executive Engineer, Rural Works Division, Mayurbhanj V. Additional District Magistrate' – 2005 LLR 121 it was held that the claim of arrears of differential wages made by employee. There was delay in filing application beyond limitation period. Claimant submitted that they were pursuing their grievance before Labor Officer. Only when they failed, they approached the authority. It was held that delay has been rightly condoned.

### **Exemption to employer**

Section 23 provides that where an employer is charged with an offence against this Act, 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-

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 the 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. For this purpose 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.

### **Obligation of employer**

Section 18 imposes some obligations on the employer in keeping and maintenance of registers and records. Section 18(1) provides that every employer shall maintain such registers and records giving such particulars of employees employed by him, the work performed by them, the wages paid to them, the receipts given by them and such other particulars and in such Form as may be prescribed.

Section 18(2) provides that every employer shall keep exhibited, in such manner as may be prescribed, in the factory, workshop or place where the employees in the scheduled employment may be employed, or in the case of outworkers, in such factory, workshop or place as may be used for giving out-work to them, notices in the prescribed form containing the prescribed particulars.

Section 18(3) provides that the appropriate Government may, by rules made under the Act, provide for issue of wage books or wage slips to employees employed in any scheduled employment in respect of which minimum rates of wages have been fixed and prescribe the manner in which the entries shall be made and authenticated in such wage books or wage slips by the employer or his agent.

Maintaining such registers and records are mandatory. There is no exemption to this mandatory obligation of the employer including any contractor. Therefore every employer, including a contractor who engaged laborers for others who owns the establishment/factory etc., is bound by the provisions of this Act, to comply with the requirements of maintaining registers etc.,



The following are the forms prescribed for registers and records-

- Form – I : Register of Fines;
- Form – II : Register of deductions for damage or loss caused to the employer,  
By the neglect or default of the employed persons;
- Form III : Unified Annual Return;
- Form IV ; Overtime Register for workers;
- Form V : Muster Roll;
- Form IX-A : Notice
- Form X : Register of Wages;
- Form XI : Wage slip.

A wage slip shall be issued by every employer to every person employed by him at least a day prior to the disbursement of wages. Entries in the Register of Wages and wage slips shall be authenticated by the employer or any person authorized by him in this behalf. The registers shall be kept at the work spot and maintained up-to-date. If no fine is imposed for any wage period a NIL entry is to be made. The above documents shall be preserved for a period of three years after the date of last entry made therein.

All registers and records shall be produced on demand before the Inspector during the course of inspection of the establishment. Any infringement of the provisions as noticed and communicated by the Inspector shall be rectified by the employer and compliance report shall be submitted to the Inspector on or before the date specified by him.

Every employer, including a contractor who engages laborers for others who owns the establishment/factory etc., is bound by the provisions of this Act, to comply with the requirement of maintaining registers etc., There is no exemption to this mandatory obligation of the employer including any contractor as held in 'V.V. Surya Rau V. Surendra Ramakrishna Tendulkar' – 1977 (77) FLR 280..

### **Annual Return**

Rule 21 (4A) provides for filing of annual returns by employer. The Annual Return shall be filed by the employer on or before 1<sup>st</sup> of February in each year by uploading the same in Form III on the web portal of the Ministry of Labor and Employment and also filed with the Inspector.

### **Publicity of notice**

Rule 22 provides that notices in Form IXA containing the minimum rates of wages fixed together with the extracts of the Act, the rules made there under and the name and address of the Inspector shall be displayed in English and in a language understood by the majority of the workers in the employment at the main entrances to the establishment and at its office and shall be maintained in a clean and eligible condition. Such notices shall also be displayed on the notice boards of all sub divisional and district officers.

### **Unpaid amount**

Section 22D provides that if the employer could not able to pay the amount due to the employee on account of his death before payment or on account of his whereabouts is not known, the same should be deposited with the prescribed authority who shall deal with the money so deposited in such manner as may be prescribed.

### **Contracting out**

Section 25 of the Act provides that any contract or agreement, whether made before or after the commencement of this Act, whereby an employee either relinquishes or reduces his right to a minimum



rate of wages or any privilege or concession accruing to him under this Act shall be null and void in so far as it purports to reduce the minimum rate of wages fixed under this Act.

The right of minimum wages under this Act is a definite one. In 'Yadav Stores, Nagpur V. Presiding Officer, Labor Court – III' – 1984 Lab IC 756 it was held that in a compromise or a settlement between the employer and employee resulting in the employee relinquishing or reducing his claim with regard to wages under the Minimum wages act is shall be null and void.

### **Penalties**

Section 22 provides punishment for certain offences. The section provides that any employer who-

pays to an employee less than the minimum rates of wages fixed for that employee's class of work, or less than the amount due to him under the provisions of this Act; or

contravenes any rule or order made under Section 13 (fixing hours for normal working days etc..)

shall be punishable with imprisonment for a term which may extend to 6 months, or with fine which may extend to ₹500/- or with both. In imposing any fine for an offence the court shall take into consideration the amount of any compensation already awarded against the accused in any proceedings under Section 20.

Section 22A provides general provision for punishment of other offences. This section provides that any employer who contravenes any provision of this Act or of any rule or order made there under shall, if no other penalty is provided for such contravention by this Act, be punishable with fine which may extend to ₹500.

### **Offences of by companies**

Section 22C provides that if the person coming any offence 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 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.

If the concerned person proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of such offence. If 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 of the company shall also be deemed to be guilty of that offence and shall be proceeded against and punished accordingly.

### **Cognizance of offences**

Section 22B provides that no court shall take cognizance of a complaint against any person for an offence-

under Section 22(a) unless an application in respect of the facts constituting such offence has been presented under Section 20 and has been granted wholly or in part, and the appropriate Government or an officer authorized by it in this behalf has sanctioned the making of the complaint;

under Section 22(b) or under Section 22A, except on a complaint made by, or with the sanction of an Inspector.

No Court shall take cognizance of an offence under Section 22, unless a complaint is made within one month of the grant of sanction and under Section 22A, unless a complaint is made within six months of the date on which the offence is alleged to have been committed.

### **Bar of suits**

Section 24 provides that no Court shall entertain any suit for the recovery of wages for the sum claimed-  
forms the subject of an application under Section 20 which has been presented by or on behalf



of the plaintiff; or  
has formed the subject of a direction under that section in favor of the plaintiff; or  
has been adjudged in any proceeding under that shall not be due to the plaintiff; or  
could have been recovered by an application under that that Act.

### **Powers of appropriate Government**

The following are the powers of the appropriate Government-

Section 26 provides that the appropriate Government may, subject to such conditions, direct that the provisions of this Act shall not apply in relation to the wages payable to disabled employees or all or any class of employees employed in the scheduled employment;

Section 27 gives power to State Government to add any employment in either part of the schedule;

Section 28 gives power to the Central Government to directions to a State Government as to carrying into execution of this Act in the State;

Section 29 gives power to the Central Government to make rules;

Section 30 gives power to appropriate Government to make Rules.

## **CHECK YOUR PROGRESS**

### **Fill in the blanks**

1. Adult is a person who has completed his\_\_\_\_\_year.
2. Any person who is responsible to the owner for the supervision and control of the employee or for the payment of wages is an\_\_\_\_\_.
3. The schedule is divided into two parts. Part I of the schedule has\_\_\_\_\_ entries.
4. The minimum wages shall be paid in\_\_\_\_\_.
5. Where a person provides labor or service to another for remuneration which is less than the minimum wage, such labor is called\_\_\_\_\_.
6. When a worker works more than 9 hours on any day or more than 48 hours a week, he shall be entitled to overtime wages 1.5 times of the ordinary wages in case of employment in\_\_\_\_\_.
7. The minimum wages shall be paid in an establishment in which more than 1000 persons are employed before the expiry of \_\_\_\_\_th day.
8. Total amount of deductions from the wages shall not exceed\_\_\_\_\_of such wages where such deductions are paid to co-operative societies.
9. To set the weekly day of rest the employee has to work for a continuous period for not less than \_\_\_\_\_ days in a week.
10. The claim for minimum wages shall be made in \_\_\_\_\_.



**Choose the correct answer**

1. Schedule II of this Act relates to an employment of –
  - (a) State Government;
  - (b) Central Government;
  - (c) Agriculture;
  - (d) Local authority.
  
2. Minimum wages may be fixed by-
  - (a) The hour;
  - (b) The day;
  - (c) Month;
  - (d) By any of the above method.
  
3. Review of minimum wages is to be done at such interval not exceeding-
  - (a) 3 years;      (b) 5 years;      (c) 7 years;      (d) 10 years.
  
4. No minimum wages cannot be fixed where-
  - (a) Dispute is pending before the Tribunal;
  - (b) Dispute is pending before any authority under any other law for the time being in force;
  - (c) An award in operation;
  - (d) Any one of the above three.
  
5. Wages of a worker shall be paid before the expiry of 7<sup>th</sup> day in the establishment for which less than \_\_\_\_\_ persons are employed.
  - (a) 1000;    (b) 500;      (c) 250;      (d) 100.
  
6. If the authority finds the application for claim of minimum wages is a vexatious one, he may imposed penalty a sum no exceeding-
  - (a) ₹100/-; (b) ₹ 50;      (c) ₹500/-      (d) ₹250/-
  
7. The Central Government proposes the minimum rate of wages at-
  - (a) ₹5000/- (b) ₹7500/- (c) ₹10000/- (d) ₹15,000/-
  
8. A wage slip shall be issued by every employer to every employee-
  - (a) at least a day prior to the disbursement of wages;
  - (b) on the day on which the wages is disbursed;
  - (c) none of the above.



9. Rule 24 provides that the number of hours which shall constitute a normal working day in respect of an adult shall be-  
(a) 4.5 hours; (b) 9 hours; (c) 12 hours; (d) None of the above.
  
11. The appropriate government may fix minimum rate of wages for-  
(a) Time work;  
(b) Piece work;  
(c) Guarantee time rate;  
(d) All the above.

### Model Questions

1. Define the term 'cost of living index number' and 'scheduled employment'.
2. Elaborate the procedure for fixing and revising minimum wages;
3. What are the roles of Advisory Board?
4. What are the deductions that can be made from the wages?
5. List the forms prescribed for registers and records that are to be maintained under this Act.
6. Define 'contracting out'.
7. What are the powers of appropriate Government under this Act?
8. What are the obligations of the employers under this Act?
9. Describe the procedures for an employee to claim the short payment of wages or nonpayment of wages.
10. Under what circumstances fine may be imposed on an employed person.

### Answers:

#### Fill in the blanks

1. 18<sup>th</sup>;
2. Employer;
3. 18;
4. Cash;
5. Forced labor;
6. Agriculture;
7. 10<sup>th</sup> day;
8. 75%;
9. Six;
10. Duplicate.



**Choose the correct answer**

1. C;
2. D;
3. C;
4. D;
5. A;
6. B;
7. C;
8. A;
9. B;
10. D.

**State whether TRUE or FALSE**

1. TRUE;
2. TRUE;
3. FALSE;
4. TRUE;
5. FALSE;
6. TRUE;
7. TRUE;
8. TRUE;
9. FALSE;
10. TRUE.



# Study Note - 12

## PAYMENT OF WAGES ACT, 1936



### This Study Note includes

#### 12.1 Payment of Wages Act, 1936 – Object, Scope and Applicability

#### 12.1 PAYMENT OF WAGES ACT, 1936 – OBJECT, SCOPE AND APPLICABILITY

##### Introduction

The Payment of Wages Act, 1936 regulates the payment of wages to certain classes of persons employed in industry. It was enacted to ensure that the wages payable to employees covered by the Act are disbursed by the employers within the prescribed time limit and that no deductions other than authorized by law are made by the employers. The Act applies *proprio vigore* to the payment of wages to persons employed in any factory or to persons employed in a railway by a railway administration either directly or through a sub contractor. Further the State Governments are empowered to extend the provisions of the Act to cover persons employed in any industrial establishment or any class or group of industrial establishments as defined in the Act.

##### Note:

With effect from 11.09.2012 the employees drawing wages upto ₹18,000 per month is covered under this Act.

##### Applicability of the Act

The Act extends to the whole of India.

##### Effect

The Act came into effect from 28<sup>th</sup> March, 1937.

##### Important definitions

###### Employed person

Section 2(i) defines the expression 'employed person' as including the legal representative of a deceased employed person;

###### Employer

Section 2(ia) defines the term 'employer' as including the legal representative of a deceased employer;

###### Industrial establishment

Section 2(ii) defines the expression 'industrial establishment' as any-

- tramway service, or motor transport service engaged in carrying passengers or goods or both by road, for hire or reward;
- air transport service other than such service belonging to or exclusively employed in the military, naval or air forces of the Union or the Civil Aviation Department of the Government of India;
- Dock, wharf or jetty;
- inland vessel, mechanically propelled;
- mine, quarry or oil-field;
- plantation;



- workshop or other establishment in which articles are produced, adapted or manufactured, with a view to their use, transport or sale;
- establishment in which any work relating to the construction, development or maintenance of buildings, roads, bridges or canals, or relating to operations connected with navigation, irrigation or to the supply of water or relating to the generation transmission and distribution of electricity or any other form of power is being carried on;
- any other establishment or class of establishments which the Central Government or a State Government may have regard to the nature thereof, the need for protection of persons employed therein and other relevant circumstances, specify, by notification, in the Official Gazette.

### **Wages**

Section 2(vi) defines the term 'wages' as all remuneration (whether by way of salary, 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 –

- any remuneration payable under any award or settlement between the parties or order of a court;
- any remuneration to which the person employed is entitled in respect of overtime work or holidays or any leave period;
- any additional remuneration payable under the terms of employment (whether called a bonus or by any other name)
- any sum which by reason of the termination of employment of the person employed is payable under any law, contract or instrument which provides for the payment of such sum whether with or without deductions, but does not provide for the time within which the payment is to be made;
- any sum to which the person employed is entitled under any scheme framed under any law for the time being in force,

but does not include

- any bonus (whether under a scheme of profit sharing or otherwise) which does not form part of the remuneration payable under the terms of employment or which is not payable under any award or settlement between the parties or order of a Court;
- 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;
- any contribution paid by the employer to any pension or provident fund and the interest which may have accrued thereon;
- any travelling allowance or the value of any travelling concession;
- any sum paid to the employed person to defray special expenses entailed on him by the nature of his employment; or
- any gratuity payable on the termination of employment.

### **Responsibility for payment of wages (Section 3)**

Every employer shall be responsible for the payment of all wages required to be paid under this Act to persons employed by him and in case of persons employed,—

- (a) in factories, if a person has been named as the manager of the factory under clause (f) of sub-section (1) of section 7 of the Factories Act, 1948 (63 of 1948);



- (b) in industrial or other establishments, if there is a person responsible to the employer for the supervision and control of the industrial or other establishment;
- (c) upon railways (other than in factories), if the employer is the railway administration and the railway administration has nominated a person in this behalf for the local area concerned;
- (d) in the case of contractor, a person designated by such contractor who is directly under his charge; and
- (e) in any other case, a person designated by the employer as a person responsible for complying with the provisions of the Act; the person so named, the person responsible to the employer, the person so nominated or the person so designated, as the case may be, shall be responsible for such payment.

#### **Fixation of wage period (Section 4)**

In payment of the wages it is important to fix the wage period. Section 4 of the Act provides that every person responsible for the payment of wages shall fix periods in respect of which wages shall be paid. This section further provides that no wage period shall exceed one month. The wage period may be daily, weekly or fortnightly or for any period but the period should not exceed one month.

#### **Time of payment of wages**

Section 5 provides the date on which the payment of wages are to be done.

The wages of every person employed upon or in any railway, factory or industrial or other establishment upon or in which less than one thousand persons are employed, shall be paid before the expiry of the **seventh day**;

**The wages of** every person employed upon or in any other railway, factory or industrial or other establishment, shall be paid before the expiry of the **tenth day**, after the last day of the wage-period in respect of which the wages are payable.

in the case of persons employed on a dock, wharf or jetty or in a mine, the balance of wages found due on completion of the final tonnage account of the ship or wagons loaded or unloaded, as the case may be, shall be paid **before the expiry of the seventh day** from the day of such completion;

Where the employment of any person is terminated by or on behalf of the employer, the wages earned by him shall be paid before the expiry of the second working day from the day on which his employment is terminated;

where the employment of any person in an establishment is terminated due to the closure of the establishment for any reason other than a weekly or other recognized holiday, the wages earned by him shall be paid before the expiry of the second day from the day on which his employment is so terminated.

All payments of wages shall be made on a working day.

#### **Exemption**

Section 5(3) provides that the appropriate Government may by general or special order, exempt to such extent and subject to such conditions as may be specified in the order, the person responsible for the payment of wages to persons employed upon any railway (otherwise than in a factory) or to persons employed as daily-rated workers in the Public Works Department of the appropriate Government from the operation of this section in respect of wages of any such persons or class of such persons.

Provided that in the case of persons employed as daily-rated workers as aforesaid, no such order shall be except in consultation with the Central Government.

**Mode of payment**

Section 6 provides that, 'All wages shall be paid in currency coins or currency notes or by cheque crediting the wages in the bank account of an employee', with or without the consent of the employees.

Provided that the Appropriate Government may by notification in the Official Gazette, 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.

**Deduction from wages**

Section 7 gives the details of deduction from wages. The wages of an employed person shall be paid to him without deductions of any kind except those authorized by or under this Act. Every payment made by the employed person to the employer or his agent shall for the purposes of this Act, be deemed to be a deduction from wages.

Any loss of wages resulting from the imposition, for good and sufficient cause upon a person employed of any of the following penalties, namely:-

- the withholding of increment or promotion (including the stoppage of increment at an efficiency bar);
- the reduction to a lower post or time scale or to a lower stage in a time scale; or
- suspension;

shall not be deemed to be a deduction from wages in any case where the rules framed by the employer for the imposition of any such penalty are in conformity with the requirements if any which may be specified in this behalf by the Appropriate Government by notification in the Official Gazette.

Section 7(2) provides that Deductions from the wages of an employed person shall be made only in accordance with the provisions of this Act and may be of the following kinds only namely:

- fines;
- deductions for absence from duty;
- deductions for damage to or loss of goods expressly entrusted to the employed person 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;
- deductions for house-accommodation supplied by the employer or by government or any housing board set up under any law for the time being in force (whether the government or the board is the employer or not) or any other authority engaged in the business of subsidizing house-accommodation which may be specified in this behalf by the appropriate Government by notification in the Official Gazette;
- deductions for such amenities services supplied by the employer as the Appropriate Government or any officer specified by it in this behalf may by general or special order authorize;
- deductions for recovery of advances of whatever nature (including advances for travelling allowance or conveyance allowance), and the interest due in respect thereof, or for adjustment of over-payments of wages;
- deductions for recovery of loans made from any fund constituted for the welfare of labor in accordance with the rules approved by the appropriate Government and the interest due in respect thereof;
- deductions for recovery of loans granted for house-building or other purposes approved by the appropriate Government and the interest due in respect thereof;



- deductions of income-tax payable by the employed person;
- deductions required to be made by order of a court or other authority competent to make such order;
- deductions for subscriptions to and for repayment of advances from any provident fund to which the Provident Funds Act 1952 applies or any recognized provident funds as defined in section 2(38) of the Indian Income Tax Act 1961 or any provident fund approved in this behalf by the appropriate Government during the continuance of such approval;
- deductions for payments to co-operative societies approved by the appropriate Government or any officer specified by it in this behalf or to a scheme of insurance maintained by the Indian Post Office and
- deductions, made with the written authorisation of the person employed for payment of any premium on his life insurance policy to the Life Insurance Corporation of India established under the Life Insurance Corporation Act, 1956 or for the purchase of securities of the Government of India or of any State Government or for being deposited in any Post Office Saving Bank in furtherance of any savings scheme of any such government.
- deductions made with the written authorization of the employed person, for the payment of his contribution to any fund constituted by the employer or a trade union registered under the Trade Unions Act, 1926 for the welfare of the employed persons or the members of their families, or both, and approved by the appropriate Government or any officer specified by it in this behalf, during the continuance of such approval;
- deductions made, with the written authorisation of the employed person, for payment of the fees payable by him for the membership of any trade union registered under the Trade Unions Act, 1926;
- deductions, for payment of insurance premium on Fidelity Guarantee Bonds;
- deductions for recovery of losses sustained by a railway administration on account of acceptance by the employed person of counterfeit or base coins or mutilated or forged currency notes;
- deductions for recovery of losses sustained by a railway administration on account of the failure of the employed person to invoice, to bill, to collect or to account for the appropriate charges due to that administration, whether in respect of fares, freight, demurrage wharfage and craning or in respect of sale of food in catering, establishments or in respect of sale of commodities in grain shops or otherwise;
- deductions for recovery of losses sustained by a railway administration on account of any rebates or refunds incorrectly granted by the employed person where such loss is directly attributable to his neglect or default;
- deductions, made with the written authorization of the employed person, for contribution to the Prime Minister's National Relief Fund or to such other Fund as the Central Government may, by notification in the Official Gazette specify;
- deductions for contributions to any insurance scheme framed by the Central Government for the benefit of its employees.

Nothing contained in this section shall be construed as precluding the employer from recovering from the wages of the employed person or otherwise any amount payable by such person under any law for the time being in force other than the Indian Railways Act 1890.

### **Limit of deductions**

Section 7(3) provides up to which limit of the wage, the deductions may be made from the wages of the employees. Notwithstanding anything contained in this Act the total amount of deductions which may be made in any wage-period from the wages of any employed person shall not exceed –



- in cases where such deductions are wholly or partly made for payments to co-operative societies - 75% of such wages and
- in any other case – 50% of such wages.

Where the total deductions authorized under sub-section (2) exceed seventy five per cent or as the case may be, fifty per cent of the wages the excess may be recovered in such manner as may be prescribed.

### **Fines**

Section 8 of the Act provides imposing of fines by the employer on the employees. The procedure of imposition of fine is detailed as below:

- No fine shall be imposed on any employed person who is under the age of fifteen years;
- No fine shall be imposed on any employed person save in respect of such acts and omissions on his part as the employer, with the previous approval of the appropriate Government or of the prescribed authority, may have specified by notice;
- A notice specifying such acts and omissions shall be exhibited in the prescribed manner on the premises in which the employment carried on or in the case of persons employed upon a railway (otherwise than in a factory), at the prescribed place or places.
- No fine shall be imposed on any employed person until he 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.
- The total amount of fine which may be imposed in any one wage-period on any employed person shall not exceed an amount equal to three per cent of the wages payable to him in respect of that wage-period.
- No fine imposed on any employed person shall be recovered from him by instalments or after the expiry of 90 days from the day on which it was imposed.
- Every fine shall be deemed to have been imposed on the day of the act or omission in respect of which it was imposed.
- All fines and all realizations thereof shall be recorded in a register to be kept by the person responsible for the payment of wages under section 3 in such form as may be prescribed; and all such realizations shall be applied only to such purposes beneficial to the persons employed in the factory or establishment as are approved by the prescribed authority.

### **Deductions for absence of duty (Section 9)**

Section 9 provides for the deductions from wages of the employed person for his absence from duty. Deductions may be only on account of the absence of an employed person 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. 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.

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.

For the purposes of this section an employed person 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.



In 'United Commercial Bank V. Gujarat Bank Workers Union' – (2003) 1 Lab.L.J. 1046 (Guj) the High Court held that the bank had already issued a notice and also a public notice stating that if any employee of the bank does not report for work or does not work for any part of his working hours, it will be in breach of his service contract and will not earn any salary for that and subsequently need not report for the work for rest of the hours of the day but despite this, the employees resorted to strike and did not work during the banking hours, during which the Bank transacts public business. In such circumstances the bank was justified in deducting the wages for the whole day.

### **Deductions for damage or loss**

Section 10 provides for the deductions to be made from the wages of the employee for the damage or loss caused to the employer by the employee in the course of his work. A deduction shall not exceed the amount of the damage or loss caused to the employer by the neglect or default of the employed person. A deduction shall not be made until the employed person has been given an opportunity of showing cause against the deduction or otherwise than in accordance with such procedure as may be prescribed for the making of such deductions.

### **Register for deductions**

Section 10(2) provides all deductions and all realisations thereof shall be recorded in a register to be kept by the person responsible for the payment of wages under section 3 in such form as may be prescribed.

### **Deduction for services rendered**

A deduction under clause (d) or clause (e) of sub-Section (2) of Section 7 shall not be made from the wages of an employed person, unless the house-accommodation, amenity or service has been accepted by him, as a term of employment or otherwise, and such deduction shall not exceed an amount equivalent to the value of the house-accommodation amenity or service supplied and, in the case of deduction under the said clause shall be subject to such conditions as the Appropriate Government may impose.

### **Deductions for recovery of advances**

Section 12 provides that deductions for the recovery of advances shall be subject to the following conditions namely:

- recovery of an advance of money given before employment began shall be made from the first payment of wages in respect of a complete wage-period, but no recovery shall be made of such advances given for travelling-expenses;
- recovery of an advance of money given after employment began shall be subject to such conditions as the appropriate Government may impose;
- recovery of advances of wages not already earned shall be subject to any rules made by the appropriate Government regulating the extent to which such advances may be given and the installments by which they may be recovered.

### **Deductions for recovery of loans**

Section 12A provides that deductions for recovery of loans granted shall be subject to any rules made by the appropriate Government regulating the extent to which such loans may be granted and the rate of interest payable thereon.

### **Deductions for payments to Co-operative Societies and Insurance Schemes**

Section 13 provides that deductions shall be subject to such conditions as the appropriate Government may impose.

### **Maintenance of Registers and records**

Section 13A provides that every employer shall maintain such registers and records giving such particulars of persons employed by him, the work performed by them the wages paid to them, the



deductions made from their wages, the receipts given by them and such other particulars and in such form as may be prescribed.

Every register and record required to be maintained under this section shall for the purposes of this Act, be preserved for a period of three years after the date of the last entry made therein.

### **Inspectors**

Section 14 provides for the appointment of Inspector for the purposes of this act. An Inspector of Factories appointed under sub-section (1) of section 8 of the Factories Act 1948 shall be an Inspector for the purposes of this Act in respect of all factories within the local limits assigned to him. The appropriate Government may appoint Inspectors for the purposes of this Act in respect of all persons employed upon a railway (otherwise than in a factory) to whom this Act applies. The appropriate Government may, by notification in the Official Gazette, appoint such other persons as it thinks fit to be Inspectors for the purposes of this Act, and may define the local limits within which and the class of factories and industrial or other establishments in respect of which they shall exercise their functions.

### **Powers of Inspectors**

Inspector may,-

- make such examination and inquiry as he thinks fit in order to ascertain whether the provisions of this Act or rules made there under are being observed;
- with such assistance, if any, as he thinks fit, enter inspect and search any premises of any railway, factory or industrial or other establishment at any reasonable time for the purpose of carrying out the objects of this Act;
- supervise the payment of wages to persons employed upon any railway or in any factory or industrial or other establishment;
- require by a written order the production at such place, as may be prescribed, of any register maintained in pursuance of this Act and taken on the spot or otherwise statements of any persons which he may consider necessary for carrying out the purposes of this Act;
- seize or take copies of such registers or documents or portions thereof as he may consider relevant in respect of an offence under this Act which he has reason to believe has been committed by an employer;
- exercise such other powers as may be prescribed:

No person shall be compelled under this sub-section to answer any question or make any statement tending to incriminate himself.

Every employer shall afford an Inspector all reasonable facilities for making any entry inspection supervision examination or inquiry under this Act.

### **Claims arising out of deductions from wages or delay in payment of wages and penalty for malicious or vexatious claims**

Section 15 deals with claims arising out of deductions from wages or delay in payment of wages and penalty for malicious or vexatious claims. It provides that the appropriate Government may, by notification in the Official Gazette, appoint-

- (a) any Commissioner for Workmen's Compensation; or
- (b) Any officer of the Central Government exercising functions as,-
  - (i) Regional Labour Commissioner; or
  - (ii) Assistant Labour Commissioner with at least two years' experience; or
- (c) Any officer of the State Government not below the rank of Assistant Labour Commissioner with at least two years' experience; or





- (d) a presiding officer of any Labour Court or Industrial Tribunal, constituted under the Industrial Disputes Act, 1947 or under any corresponding law relating to the investigation and settlement of industrial disputes in force in the State; or
- (e) any other officer with experience as a Judge of a Civil Court or a Judicial Magistrate, as the authority to hear and decide for any specified area all claims arising out of deductions from the wages, or delay in payment of the wages, of persons employed or paid in that area, including all matters incidental to such claims.

Provided that where the appropriate Government considers it necessary so to do, it may appoint more than one authority for any specified area and may, by general or special order, provide for the distribution or allocation of work to be performed by them under this Act.

Sub-section (2) of section 15 provides that where contrary to the provisions of the Act any deduction has been made from the wages of an employed person or any payment of wages has been delayed such person himself or any legal practitioner or any official of a registered trade union authorised in writing to act on his behalf or any Inspector under this Act or any other person acting with the permission of the authority appointed under subsection(1) may apply to such authority for a direction under sub-section (3)

However, every such application shall be presented within twelve months from the date on which the deduction from the wages was made or from the date on which the payment of the wages was due to be made as the case may be. Any application may be admitted after the said period of twelve months when the applicant satisfies the authority that he had sufficient cause for not making the application within such period.

As per sub-section (3) when any application under sub-section (2) is entertained, the authority shall hear the applicant and the employer or other person responsible for the payment of wages under section 3, or give the man opportunity of being heard, and, after such further enquiry, if any, as may be necessary, may, without prejudice to any other penalty to which such employer or other person is liable under this Act, direct the refund to the employed person of the amount deducted, or the payment of the delayed wages, together with the payment of such compensation as the authority may think fit, not exceeding ten times the amount deducted in the former case and not exceeding three thousand rupees but not less than one thousand five hundred rupees in the latter, and even if the amount deducted or delayed wages are paid before the disposal of the application, direct the payment of such compensation, as the authority may think fit, not exceeding two thousand rupees.

A claim under the Act shall be disposed of as far as practicable within a period of three months from the date of registration of the claim by the authority. It may be noted that the period of three months may be extended if both parties to the dispute agree for any bona fide reason to be recorded by the authority that the said period of three months may be extended to such period as may be necessary to dispose of the application in a just manner.

No direction for the payment of compensation shall be made in the case of delayed wages if the authority is satisfied that the delay was due to-

- (a) a bona fide error or bona fide dispute as to the amount payable to the employed person; or
- (b) the occurrence of an emergency, or the existence of exceptional circumstances, the person responsible for the payment of the wages was unable, in spite of exercising reasonable diligence; or
- (c) the failure of the employed person to apply for or accept payment.

As per sub-section (4) if the authority hearing an application under this section is satisfied that the application was either malicious or vexatious the authority may direct that a penalty not exceeding three hundred seventy-five Rupees be paid to the employer or other person responsible for the payment of wages by the person presenting the application; or in any case in which compensation is directed to be paid under sub-section (3) the applicant ought not to have been compelled to seek redress



under this section the authority may direct that a penalty not exceeding three hundred seventy five Rupees be paid to the State Government by the employer or other person responsible for the payment of wages.

### **Single application in respect of claims from an unpaid group**

Section 16 provides that employed persons are said to belong to the same unpaid group if they are borne on the same establishment and if deductions have been made from their wages in contravention of this Act for the same cause and during the same wage-period or periods or if their wages for the same wage-period or periods have remained unpaid after the day fixed by section 5.

A single application may be presented under section 15 on behalf or in respect of any number of employed persons belonging to the same unpaid group and in such case every person on whose behalf such application is presented may be awarded maximum compensation to the extent specified in sub-section (2) of section 15.

The authority may deal with any number of separate pending applications presented under section 15 in respect of persons belonging to the same unpaid group as a single application presented under sub-section (2) of this section and the provisions of that sub-section shall apply accordingly.

### **Appeal**

Section 17 provides that an appeal against an order dismissing either wholly or in part an application made under section 15(2) or against a direction made under sub-section (3) or sub-section (4) of that section may be preferred within thirty days of the date on which the order or direction was made in a Presidency-town before the Court of Small Causes and elsewhere before the District Court –

- by the employer or other person responsible for the payment of wages under section 3, if the total sum directed to be paid by way of wages and compensation exceeds three hundred rupees or such direction has the effect of imposing on the employer or the other person a financial liability exceeding one thousand rupees or
- by an employed person or any legal practitioner or any official of a registered trade union authorized in writing to act on his behalf or any Inspector under this Act or any other person permitted by the authority to make an application under section 15(2) if the total amount of wages claimed to have been withheld from the employed person exceeds twenty rupees or from the unpaid group to which the employed person belongs or belonged exceeds fifty rupees or
- by any person directed to pay a penalty under section 15(4).

No appeal shall lie unless the memorandum of appeal is accompanied by a certificate by the authority to the effect that the appellant has deposited the amount payable under the direction appealed against. Any order dismissing either wholly or in part an application made under section 15(2) or a direction made under sub-section (3) or sub-section (4) of that section shall be final.

Where an employer prefers an appeal under this section the authority against whose decision the appeal has been preferred may, and if so directed by the Court shall, pending the decision of the appeal withhold payment of any sum in deposit with it.

The Court may if it thinks fit submit any question of law for the decision of the High Court and if it so does shall decide the question in conformity with such decision.

### **Attachment of property of the employer or other person responsible for payment of wages**

Section 17A provides that where at any time after an application has been made section 15(2) the authority, or where at any time after an appeal has been filed under section 17 by an employed person or any legal practitioner or any official of a registered trade union authorized in writing to act on his behalf or any Inspector under this Act or any other person permitted by the authority to make an application under section 15(2) the Court referred to in that section, is satisfied that the employer



or other person responsible for the payment of wages under section 3 is likely to evade payment of any amount that may be directed to be paid under section 15 or section 17 the authority or the Court, as the case may be, except in cases where the authority or court is of opinion that the ends of justice would be defeated by the delay, after giving the employer or other person an opportunity of being heard, may direct the attachment of so much of the property of the employer or other person responsible for the payment of wages as is in the opinion of the authority or Court, sufficient to satisfy the amount which may be payable under the direction.

### Penalties

Section 20 provides for the penalties that are imposable under this Act. Section 20(1) provides that Whoever being responsible for the payment of wages to an employed person contravenes any of the provisions of any of the following sections, namely section 5 except sub-section (4) thereof section 7 section 8 except sub-section (8) thereof, section 9 section 10 except sub-section (2) thereof and section 11 to 13 both inclusive shall be punishable with fine which shall not be less than two hundred rupees but which may extend to ₹1,000.

Section 20(2) provides that whoever contravenes the provisions of section 4 sub-section (4) of section 5 section 6 sub-section (8) of section 8 sub-section (2) of section 10 or section 25 shall be punishable with fine which may extend to ₹3,750/-.

Section 20(3) provides that whoever being required under this Act to maintain any records or registers or to furnish any information or return –

- fails to maintain such register or record; or
- willfully refuses or without lawful excuse neglects to furnish such information or return; or
- willfully furnishes or causes to be furnished any information or return which he knows to be false; or
- refuses to answer or willfully gives a false answer to any question necessary for obtaining any information required to be furnished under this Act

shall for each such offence be punishable with fine which shall not be less than ₹1,500/- but which may extend to ₹7,500/-.

Section 20(4) provides that whoever –

- willfully obstructs an Inspector in the discharge of his duties under this Act; or
- refuses or willfully neglects to afford an Inspector any reasonable facility for making any entry, inspection, examination, supervision or inquiry authorized by or under this Act in relation to any railway, factory or industrial or other establishment; or
- willfully refuses to produce on the demand of an Inspector any register or other document kept in pursuance of this Act; or
- prevents or attempts to prevent or does anything which he has any reason to believe is likely to prevent any person from appearing before or being examined by an Inspector acting in pursuance of his duties under this Act;

shall be punishable with fine which shall not be less than ₹1,500 but which may extend to ₹7,500.

Section 20(5) provides that If any person who has been convicted of any offence punishable under this Act is again guilty of an offence involving contravention of the same provision he shall be punishable on a subsequent conviction with imprisonment for a term which shall not be less than one month but which may extend to six months and with fine which shall not be less than ₹3,750 but which may extend to ₹22,000. No cognizance shall be taken of any conviction made more than two years before the date on which the commission of the offence which is being punished came to the knowledge of the Inspector.



Section 20(6) provides that if any person fails or willfully neglects to pay the wages of any employed person by the date fixed by the authority in this behalf, he shall, without prejudice to any other action that may be taken against him be punishable with an additional fine which may extend to ₹750 for each day for which such failure or neglect continues.

In 'Divisional Superintendent, Northern Railway, Lucknow V. Ram Prasad, Material Checker, Northern Railway, Varanasi, Lucknow' – (2003) 1 Lab. L.J. 93 (All) it was held that against order rejecting the application under Section 20(6) of the Payment of Wages Act, no appeal lies.

### **Bar of suits**

Section 22 provides that no Court shall entertain any suit for the recovery of wages or of any deduction from wages in so far as the sum so claimed –

- forms the subject of an application under section 15 which has been presented by the plaintiff and which is pending before the authority appointed under that section or of an appeal under section 17; or
- has formed the subject of a direction under section 15 in favor of the plaintiff; or
- has been adjudged in any proceeding under section 15 not to be owned to the plaintiff; or
- could have been recovered by an application under section 15.

### **Contracting out**

Section 23 of the Act provides that any contract or agreement whether made before or after the commencement of this Act whereby an employed person relinquishes any right conferred by this Act shall be null and void in so far as it purports to deprive him of such right.

### **Display of the Act**

Section 25 provides that the person responsible for the payment of wages of persons employed in a factory or an industrial or other establishment shall cause to be displayed in such factory or industrial or other establishment a notice containing such abstracts of this Act and of the rules made there under in English and in the language of the majority of the persons employed in the factory, or industrial or other establishment as may be prescribed.

### **Payment of undisbursed wage in case of death of employed person**

Section 25A provides that subject to the other provisions of the Act all amounts payable to an employed person as wages 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 –

- be paid to the person nominated by him in this behalf in accordance with the rules made under this Act; or
- 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 prescribed authority who shall deal with the amounts so deposited in such manner as may be prescribed.

Where, in accordance with the provisions of sub-section (1), all amounts payable to an employed person as wages –

- are paid by the employer to the person nominated by the employer person; or
- are deposited by the employer with the prescribed authority, the employer shall be discharged of his liability to pay those wages.



## CHECK YOUR PROGRESS

### Fill in the blanks

1. The wage period shall not exceed\_\_\_\_\_.
2. The term 'employer' includes the \_\_\_\_\_deceased employer.
3. All payment of wages shall be made on\_\_\_\_\_.
4. The wage of employed person shall be paid to him with deduction of any kind except those \_\_\_\_\_ under this Act.
5. The total amount of fine which may be imposed in any wage period shall not exceed an equal to \_\_\_\_\_ of the wages payable to him in respect of wage period.
6. Every register and record shall be preserved for a period of \_\_\_\_\_ after the date of last entry made therein.
7. The claim for delayed payment of wages for deduction made from the wage is to be made in Form\_\_\_\_\_ in case of individual employed person.
8. The proviso to Section 15(2) provides that an application against the delayed payment of wages is to be filed within \_\_\_\_\_ months to the authority from the date on which the payment is due.
9. The wages in respect of any person terminated shall be payable before the expiry of \_\_\_\_\_ working day from the date of termination.
10. The limitation for a claim would always start from the date on which the wage is \_\_\_\_\_.

### Choose the correct answer

1. The payment of wages Act applies to wages payable to an employed person in respect of wage period if such wages for that wage period do not exceed ₹\_\_\_\_\_ per month.  
(a) ₹6500/- (b) ₹10000/- (c) ₹18,000/- (d) ₹25,000/-
2. Payment of wages shall be made-  
(a) In current coins;  
(b) By currency notes;  
(c) Cheque;  
(d) By crediting in bank account;  
(e) Any of the above.
3. No fine shall be imposed on the employees under the age of –  
(a) 10 (b) 15 (c) 18 (d) None of the above
4. The authorization to act on behalf of an employed person or persons for the claim of delayed payment of wages is to be given to the authority in Form No. –  
(a) A (b) B (c) C (d) D
5. In appeal against the order of the authority may be filed to the District Court within-  
(a) 30 days;  
(b) 45 days;  
(c) 60 days;  
(d) 90 days;



6. The wages of employed persons in an establishment where less than 1000 persons are employed, shall be paid before-
  - (a) 7<sup>th</sup> day;
  - (b) 10<sup>th</sup> day;
  - (c) 15<sup>th</sup> day;
  - (d) Second working day.
7. No fine shall be recovered after the expiry of \_\_\_\_ days from the day on which it was imposed.
  - (a) 30;
  - (b) 60;
  - (c) 90;
  - (d) 1 year.
8. Which shall be deemed to be absent by an employed person?
  - (a) Refused to work;
  - (b) Participating in work;
  - (c) None of the above;
  - (d) Either (a) or (b).
9. The Authority may refuse to entertain an application for the claim-
  - (a) That the applicant is not entitled to present the application;
  - (b) That the application is barred by limitation;
  - (c) That the applicant shows no sufficient cause for making a direction;
  - (d) Any of the above.
10. If the employee does not attend the hearing the application will be-
  - (a) Dismissed;
  - (b) Decided as *ex-parte*;
  - (c) None of the above.

**State whether TRUE or FALSE**

1. All deductions and all realizations shall be recorded in a registered to be kept open by the person responsible for the payment of wages.
2. Every payment made by the employed person to the employee shall be deemed to be a deduction from wages.
3. Any loss of wage, resulting the suspension of an employee amounts to deduction of wages.
4. If the application for the claim of wrong deduction is filed beyond limitation period, the authority would reject the application.
5. The term 'employed person' includes the legal representatives of a deceased employed person.
6. Every employer shall be responsible for the payment of wages to be paid under the Act to persons employed by him.



7. A notice is not required to be issued before imposing fines on the employed person.
8. Fine may be recovered from the employed person by installments.
9. No recovery shall be made of advances given before employment against the advance given for travelling expenses.
10. The application for claim of delayed payment of wages should be filed in duplicate. One copy shall bear such Court fee as may be prescribed.

### Model Questions

1. What is the procedure in imposition of fine on the employee under this Act?
2. What are the remedies available against wrong deductions?
3. Describe the procedure to claim the delayed payment of wages or deductions made from the wages.
4. What are the kinds of deductions that can be made from the wages?
5. Whether a property of an employer can be attached for nonpayment of wages? Discuss the procedure involved in this regard.
6. What is the punishment imposable-
  - (a) If the employer fails to maintain registers;
  - (b) Willfully obstructs an Inspector in the discharge of his duties under this Act by any person.
7. Describe the procedure for filing of nomination for the purpose of this Act.
8. Elaborate the provisions of Section 5 which deals with the time within which wages shall be paid.
9. Define the terms 'wages' and 'wage period'.

### Answer:

#### Fill in the blanks

1. One month;
2. Legal representative;
3. A working day;
4. Authorized;
5. 3%
6. 3 years;
7. A;
8. 12 months;
9. Second;
10. Accrues.



**Choose the correct answer**

1. C;
2. E;
3. B;
4. D;
5. A;
6. A;
7. C;
8. D;
9. D;
10. A.

**State whether TRUE or FALSE**

1. TRUE;
2. TRUE;
3. FALSE;
4. FALSE;
5. TRUE;
6. TRUE;
7. FALSE;
8. FALSE;
9. TRUE;
10. TRUE.



# Study Note - 13

## PENSION FUND REGULATORY AND DEVELOPMENT AUTHORITY ACT, 2013



### This Study Note includes

#### 13.1 Introduction

#### 13.2 National Pension System

### 13.1 INTRODUCTION

Short title, extent and commencement

1. This Act may be called the Pension Fund Regulatory and Development Authority Act, 2013.
2. It extends to the whole of India.
3. It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint:

Provided that different dates may be appointed for different provisions of this Act and any reference in any such provision to the commencement of this Act shall be construed as a reference to the coming into force of that provision.

### Definitions

In this Act, unless the context otherwise requires,—

- (a) **“Authority”** means the Pension Fund Regulatory and Development Authority established under sub-section (1) of Section 3;
- (b) **“Central recordkeeping agency”** means an agency registered under Section 27 to perform the functions of recordkeeping, accounting, administration and customer service for subscribers to schemes;
- (c) **“Chairperson”** means the Chairperson of the Authority;
- (d) **“Document”** shall include any matter written, expressed or described upon any substance by means of letters, figures or marks, or by more than one of those means, in printed or in electronic version, which is intended to be used, or which may be used, by the Interim Pension Fund Regulatory and Development Authority, or Authority or an intermediary or any other entity connected with the National Pension System, for the purpose of recording that matter;
- (e) **“Individual pension account”** means an account of a subscriber, executed by a contract setting out the terms and conditions under the National Pension System;
- (f) **“intermediary”** includes pension fund, central recordkeeping agency, National Pension System Trust, pension fund adviser, retirement adviser, point of presence and such other person or entity connected with collection, management, recordkeeping and distribution of accumulations;
- (g) **“member”** means a member of the Authority and includes its Chairperson;



- (h) **“National Pension System”** means the contributory pension system referred to in Section 20 whereby contributions from a subscriber are collected and accumulated in an individual pension account using a system of points of presence, a central record-keeping agency and pension funds as may be specified by regulations;
- (i) **“National Pension System Trust”** means the Board of Trustees who hold the assets of subscribers for their benefit;
- (j) **“Notification”** means a notification published in the Official Gazette;
- (k) **“Pension fund”** means an intermediary which has been granted a certificate of registration under sub-section (3) of Section 27 by the Authority as a pension fund for receiving contributions, accumulating them and making payments to the subscriber in the manner, as may be specified by regulations;
- (l) **“Pension Regulatory and Development Fund”** means the fund constituted under sub-section (1) of Section 40;
- (m) **“Point of presence”** means an intermediary registered with the Authority under sub-section (3) of Section 27 as a point of presence and capable of electronic connectivity with the central recordkeeping agency for the purposes of receiving and transmitting funds and instructions and pay out of funds;
- (n) **“Prescribed”** means prescribed by rules made under this Act;
- (o) **“Regulated assets”** means the assets and properties, both tangible and intangible, owned, leased or developed by and other rights belonging to, the central recordkeeping agency;
- (p) **“Regulations”** means the regulations made by the Authority under this Act;
- (q) **“Scheme”** means a scheme of pension fund approved by the Authority under this Act;
- (r) **“Securities Appellate Tribunal”** means a Securities Appellate Tribunal established under sub-section(1) of Section 15-K of the Securities and Exchange Board of India Act, 1992;
- (s) **“Subscriber”** includes a person who subscribes to a scheme of a pension fund;
- (t) **“Trustee Bank”** means a banking company as defined in the Banking Regulation Act, 1949.

## 13.2 NATIONAL PENSION SYSTEM

### National Pension System [Section 20]

- (1) The contributory pension system notified by the Government of India in the Ministry of Finance vide notification number F. No. 5/7/2003-ECB & PR, dated the 22nd December, 2003, shall be deemed to be the National Pension System with effect from the 1st day of January, 2004, and such National Pension System may be amended from time to time by regulations.
- (2) Notwithstanding anything contained in the said notification, the National Pension System shall, on the commencement of this Act, have the following basic features, namely:—
  - (a) every subscriber shall have an individual pension account under the National Pension System;
  - (b) withdrawals, not exceeding twenty-five per cent of the contribution made by the subscriber, may be permitted from the individual pension account subject to the conditions, such as purpose, frequency and limits, as may be specified by the regulations;
  - (c) the functions of recordkeeping, accounting and switching of options by the subscriber shall be effected by the central recordkeeping agency;



- (d) there shall be a choice of multiple pension funds and multiple schemes:  
Provided that—
- (a) the subscriber shall have an option of investing up to hundred per cent of his funds in Government Securities; and
  - (b) the subscriber, seeking minimum assured returns, shall have an option to invest his funds in such schemes providing minimum assured returns as may be notified by the Authority;
- (e) there shall be portability of individual pension accounts in case of change of employment;
- (f) collection and transmission of contributions and instructions shall be through points of presence to the central recordkeeping agency;
- (g) there shall not be any implicit or explicit assurance of benefits except market-based guarantee mechanism to be purchased by the subscriber;
- (h) a subscriber shall not exit from the National Pension System except as may be specified by the regulations; and
- (i) at exit, the subscriber shall purchase an annuity from a life insurance company in accordance with the regulations.
- (3) In addition to the individual pension account mentioned in Clause (a) of sub-section (2), a subscriber may also, at his option, have an additional account under the National Pension System having the features mentioned in Clauses (c) to (g) of sub-section (2) and also having the additional feature that the subscriber shall be free to withdraw part or all of his money at any time from the additional account.

### **Central Recordkeeping Agency [Section 21]**

- (1) The Authority shall, by granting a certificate of registration under sub-section (3) of Section 27, appoint a central recordkeeping agency:

Provided that the Authority may, in public interest, appoint more than one central recordkeeping agency.

- (2) The central recordkeeping agency shall be responsible for receiving instructions from subscribers through the points of presence, transmitting such instructions to pension funds, effecting switching instructions received from subscribers and discharging such other duties and functions, as may be assigned to it under the certificate of registration or as may be determined by regulations.

- (3) All the assets and properties owned, leased or developed by the central record-keeping agency, shall constitute regulated assets and upon expiry of certificate of registration or earlier revocation thereof, the Authority shall be entitled to appropriate and take over the regulated assets, either by itself or through an administrator or a person nominated by it in this behalf:

Provided that the central recordkeeping agency shall be entitled to be compensated the fair value, to be ascertained by the Authority, of such regulated assets as may be determined by regulations:

Provided further that where the earlier revocation of the certificate of registration is based on violation of the conditions in the certificate of registration or the provisions of this Act or regulations, unless otherwise determined by the Authority, the central recordkeeping agency shall not be entitled to claim any compensation in respect of such regulated assets.



### **Point of presence [Section 22]**

- (1) The Authority may, by granting a certificate of registration under sub-section (3) of Section 27, permit one or more persons to act as a point of presence for the purpose of receiving contributions and instructions, transmitting them to the Trustee Bank or the central recordkeeping agency, as the case may be, and paying out benefits to subscribers in accordance with the regulations made by the Authority from time to time in this regard.
- (2) A point of presence shall function in accordance with the terms of its certificate of registration and the regulations made under this Act.

### **Pension funds [Section 23]**

- (1) The Authority may, by granting a certificate of registration under sub-section (3) of Section 27, permit one or more persons to act as a pension fund for the purpose of receiving contributions, accumulating them and making payments to the subscriber in such manner as may be specified by regulations.
- (2) The number of pension funds shall be determined by regulations and the Authority may, in public interest, vary the number of pension funds:  
Provided that at least one of the pension funds shall be a Government company.  
EXPLANATION. — For the purposes of this sub-section, the expression "Government Company" shall have the meaning assigned to it in Section 617 of the Companies Act, 1956.
- (3) The pension fund shall function in accordance with the terms of its certificate of registration and the regulations made under this Act.
- (4) The pension fund shall manage the schemes in accordance with the regulations.

### **Certain restrictions on foreign companies or individual or association of persons [Section 24]**

The aggregate holding of equity shares by a foreign company either by itself or through its subsidiary companies or its nominees or by an individual or by an association of persons, whether registered or not under any law of a country outside India taken in aggregate in the pension fund shall not exceed twenty-six per cent of the paid-up capital of such fund or such percentage as may be approved for an Indian insurance company under the provisions of the Insurance Act, 1938, whichever is higher.

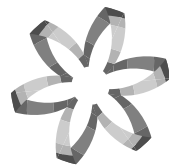
EXPLANATION. — For the purposes of this section, the expression "foreign company" shall have the meaning assigned to it in Clause (23-A) of Section 2 of the Income Tax Act, 1961.

### **Prohibition of investment of funds of subscribers outside India [Section 25]**

No pension fund shall, directly or indirectly invest outside India, the funds of subscribers.

### **Eligibility norms of the central recordkeeping agency, etc. [Section 26]**

The central recordkeeping agency, points of presence and pension funds, shall satisfy the eligibility norms as may be specified by the regulations, including minimum capital requirement, past track-record including the ability to provide guaranteed returns, costs and fees, geographical reach, customer base, information technology capability, human resources and such other matters.



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# **Section C**

## **Corporate Laws**

**(Syllabus - 2016)**

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# Study Note - 14

## COMPANIES ACT, 2013



### This Study Note includes

#### 14.1 Company Types, Promotion, Formation and Related Procedures

#### 14.2 Directors

### 14.1 COMPANY TYPES, PROMOTION, FORMATION AND RELATED PROCEDURES

#### Introduction

In tune with multifaceted global development in international trade and commerce, the Companies Act 2013 was enacted in India which forms the primary source of Indian company law. The Companies Act, 2013 has been enacted to consolidate and amend the law relating to the companies. The changes in the existing company law (i.e., the Companies Act, 1956) were indispensable due to change in the national and international economic environment and for expansion and growth of economy of our country. The Central Government decided to replace the Companies Act, 1956 with a new legislation to meet the changed national and international economic environment and to further accelerate the expansion and growth of our economy. 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, strengthens the interests of minority investors and for the first time legislates the role of whistle-blowers. Thus, the enactment is making our corporate regulations more contemporary.

#### Meaning and Definition of a Company

The word 'company' is derived from the Latin word (Com=with or together; panis=bread), and it originally referred to an association of persons who took their meals together. In popular parlance, a company denotes an association of likeminded 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.

In terms of the Companies Act, 2013 a "company" means a company incorporated under this Act or under any previous company law [Section 2(20)].

Lord Justice Lindley has defined a company as "an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business and who share the profit and loss arising there from. The common stock so contributed is denoted in money and is the capital of the company. The persons who contributed in it or form it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his "share". The shares are always transferable although the right to transfer them may be restricted."

#### Salient features of '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. 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 the corporate veil". The Court will look behind the corporate entity and take action as though no entity separate 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.

<b>Protection of Revenue</b>	The Court may ignore the Separate Legal Entity status of a Company, where it is used for tax invasion or circumventing tax obligation.
<b>Determination of enemy character of the Company</b>	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.)
<b>Prevention of fraud</b>	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)
<b>Protection of public policy</b>	The Court shall lift the Corporate Veil without any hesitation to protect the public policy and prevent transaction opposed to public policy.
<b>Company mere sham or cloak</b>	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)
<b>Where a Company acts as an agent of its shareholders</b>	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.
<b>Avoidance of Welfare Legislation</b>	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.)
<b>To punish for contempt of Court</b>	Company being an artificial person cannot disobey the orders of the Court. Therefore, the persons at fault should be identified.





## **TYPES OF COMPANIES**

Companies are of various types. The companies are classified under various categories.

### **On the basis of liability**

The companies are classified according to their liabilities into the following-

- Company limited by shares;
- Company limited by guarantees;
- Unlimited companies.

#### **Company limited by share**

Section 2(22) defines 'company limited by share' as a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them.

#### **Company limited by guarantee**

Section 2(21) defines 'company limited by guarantee' as a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.

#### **Unlimited Company**

Section 2(92) defines 'unlimited company' as a company not having any limit on the liability of its members.

### **On the basis of number of members**

The companies are classified on the basis of number of members as-

- Public companies;
- Private companies; and

#### **Public Company**

Section 2(71) defines 'public company' as a company which is not a private company. A company which is a subsidiary of a company, not being a private company, shall be deemed to public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles.

#### **Private Company**

Section 2(68) defines 'private company' as a company having a minimum paid up share capital as may be prescribed and company 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 200;
- (iii) prohibits any invitation to the public to subscribe for any securities of the company.

Where two or more persons hold one or more share in a company jointly, they shall, for the purposes of this clause treated as a single member.

The following shall not be included in the number of members-

- persons who are in the employment of the company; and
- 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.



### **On the Basis of Control**

The companies are classified on the basis of control as-

- holding company;
- subsidiary company.

#### **Holding Company**

As per Section 2(46) 'holding company' in relation to one or more other companies, means a body corporate of which such companies are subsidiary companies.

#### **Subsidiary Company**

Section 2(87) defines 'subsidiary company' in relation to any other body corporate as a company in which the holding company-

- (i) controls the composition of the Board of Directors; or
- (ii) exercises or controls more than one half of the total voting power.

### **On the basis of listing of shares**

The public limited companies are eligible for listing its shares on the stock exchanges. On this basis, the public limited companies are classified as-

- listed company;
- unlisted company;

#### **Listed Company**

Section 2(52) defines 'listed company' as a company which has any of its securities listed on any recognised stock exchange.

#### **Unlisted company**

A public company which is not listed its shares on any stock exchange is called a non listed company.

### **On the basis of Government Control**

The companies are classified on the basis of the control of the Government over the company as-

- Government company;
- Non Government company.

#### **Government Company**

Section 2(45) defines 'Government Company' as any company in which not less than 51% of the paid up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

#### **Non Government company**

A company in which either of the Government has no paid up share capital is called as the non Government company.

### **Other types of companies**

The other types of companies are as follows-

- Associate Company;
- Banking company;
- Foreign company;
- One person company;



- Small company;
- Section 8 company;
- Dormant company;
- Inactive company;
- Producer company;
- Investment company; and
- Statutory company.

#### **Associate Company**

Section 2(6) of the Act defines the term 'Associate Company' in relation to another company, a company in which that other company has a **significant influence**, but which is not a subsidiary company of the company having such influence. It includes a joint venture company. The explanation to this section defines the term 'significant influence' as control of at least 20% of total share capital or of business decisions under an agreement.

#### **Banking Company**

Section 2(9) defines the term 'banking company' as a banking company defined in Section 5(c) of Banking Regulation Act, 1949.

#### **Foreign Company**

Section 2(42) defines 'foreign company' as any company or body corporate, incorporated outside India which-

- (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
- (b) conducts any business activity in India in any other manner.

#### **One Person Company**

Section 2(62) defines 'One Person Company' as a company which has only one person as a member. It is also considered as a private company.

#### **Small Company**

Section 2(85) defines 'small company' as a company, other than a public company-

- (i) paid up share capital of which does not exceed ₹50 lakh rupees or such higher amount as may be prescribed which shall not be more than ₹10 crore; and
- (ii) turnover of which is as per its profit and loss account for the immediately preceding Financial Year does not exceed ₹2 crores or such higher amount as may be prescribed which shall not be more than ₹100 crores.

This definition shall not apply to-

- a holding company or a subsidiary company;
- a company registered under Section 8; or
- a company or body corporate governed by any special Act.

#### **Section 8 company**

Such type of company is to be registered with Registrar of Companies and also to obtain licence from the Central Government. If a person or association of person proposed to be registered under the Companies Act, 2013 as a limited company-

- has its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;
- intends to apply its profits, if any, or other income in promoting its objects; and



- intends to prohibit the payment of any dividend to its members.

The Central Government may allow that person or association of persons to be registered as a limited company without the addition to its name the word "Limited", or the words "Private Limited", as the case may be.

### **Dormant company**

Section 455 of the Act provides that where a company is formed and registered under the Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar for obtaining the status of a dormant company.

### **Inactive company**

Explanation (i) to Section 455 defines 'inactive company' as a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years.

### **Producer Company**

According to the provisions as prescribed under Section 581A(l) of the Companies Act, 1956, a producer company is a body corporate having objects or activities specified in Section 581B and which is registered as such under the provisions of the Act. The membership of producer companies is open to such people who themselves are the primary producers, which is an activity by which some agricultural produce is produced by such primary producers

### **Investment Company**

Explanation (a) to Section 186 defines the term 'investment company' as a company whose principal business is the acquisition of shares, debentures or other securities.

### **Statutory company**

Companies set up by special Acts of Parliament or State Legislatures are called statutory companies. Eg., Reserve Bank of India is set up under the Reserve Bank of India Act. Likewise LIC,UTI etc., are the examples of a statutory company.

## **CHECK YOUR PROGRESS**

### **Model Questions**

1. What are the salient features of a company?
2. Differentiate between a private company and a public company.
3. Define-
  - (a) Small Company;
  - (b) Producer Company;
  - (c) Section 8 Company;
  - (d) One Person Company.
4. How the companies are classified on the basis of liability?
5. Write short notes on-
  - (a) Foreign Company;
  - (b) Dormant Company;
  - (c) Government Company.



## ONE PERSON COMPANY

One Person Company ('OPC' for short) is defined under Section 2(62) of the Act which has only one person as a member. Section 3 of the Act indicates that OPC is a private limited company.

### 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 or 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 ₹5000/- 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 110 – Postal Ballot;
- 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 of 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.

## CHECK YOUR PROGRESS

### Model Questions

1. What are the salient features of One Person Company?
2. What are the conditions stipulated in the Act in formation of One Person Company?
3. Discuss the provisions about the 'nominated member' of One Person Company.
4. Which provisions of the Act in regard to Management and Administration are not applicable to One Person Company?

## FORMATION AND INCORPORATION OF COMPANIES

### Formation of a company

Section 3 of the Act provides for the formation of a company. This section provides that the company may be formed for any lawful purpose. The company cannot be formed for illegal purposes or unlawful purposes. The section further provides the number of members required for the formation of a company. The public company requires seven or more persons. The minimum for the public company is seven and there is no limit for the higher number of persons. The private company requires two or more persons. The minimum for the private company is two and the maximum number of members is 200. One Person Company requires one person. The One Person Company is treated as private company. The proviso to this section requires that the memorandum of One Person Company shall indicate the name of other person, with his prior written consent who shall, in the event of the subscriber's death or in capacity to contract, become the member of the company.

The required persons for the formation of the above category of companies shall subscribe their names or his name to a memorandum and comply with the requirements of the Act in respect of registration.



Section 3(2) provides that a company so formed may be either-

- A company limited by shares; or
- A company limited by guarantee; or
- An unlimited company.

### **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.

### **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 such 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)
  - (1) he is not convicted of any offence in connection with the promotion, formation or management of any company, or
  - (2) 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
  - (3) 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 struck 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—
    - (A) 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
    - (B) 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 *ultra vires*:**

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**

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 apostilled 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 of 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;
  - the dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.
- 10. Registrar to certify the registration on the alteration of the objects:** The Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of 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 ₹1000/- 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.

Section 16 (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 ₹1000/- 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 ₹5000/- 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.

For the purposes, the term 'electronic communication' means a communication-

(a) delivered by-

- facsimile telecommunication or electronic mail when directed to the facsimile number or electronic mail address, respectively, which the company or the officer has provided from time to time for sending communications to the company or the officer respectively;
- posting of an electronic message board or network that the company or the officer 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 company or the officer 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.

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

### **CHECK YOUR PROGRESS**

#### **Model Questions**

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.

**Model Questions**

1. What are the documents to be submitted to Registrar of Companies for incorporation of a company?
2. Write notes on-
  - (a) Memorandum of Association;
  - (b) Articles of Association.
3. In which manner the memorandum and Articles are to be signed on behalf of the company.
4. What is the effect of memorandum and articles of the company on their registration?
5. Discuss the procedure for alteration of memorandum.
6. Discuss the procedure for alteration of articles.
7. What is the procedure for rectification of name of a company?
8. Which copies of documents may be furnished to the members at their request?
9. Write notes on 'Integrated process for incorporation'.
10. Discuss the procedure for service of documents on a company or its officers.

**Answers:****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.

**SECTION 8 COMPANIES****Introduction**

Under Section 8 a company is given licence by the Central Government which is akin to the Section 25 companies under Companies Act, 1956 formed for non profit motive.

**Features**

The following are the features for Section 8 companies:

- has its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;
- intends to apply its profits, if any, or other income in promoting its objects; and



- intends to prohibit the payment of any dividend to its members;
- the company registered under this Section shall enjoy all the privileges and be subject to all the obligations of the limited company;
- a firm may be a member of the company registered under this section;
- a company registered under this Section shall not alter the provisions of its memorandum and articles except with the previous approval of the Central Government.
- a company registered under this section may convert itself into a company of any other kind only after complying with such conditions as may be prescribed.

### **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.

## **CHECK YOUR PROGRESS**

### **Model Questions**

1. What are the features of companies registered under Section 8 of the Companies Act, 2013?
2. Discuss the procedure for obtaining a licence from the Government by Section 8 Companies.
3. Discuss on which grounds the licence issued may be revoked.
4. What action may be taken by the Central Government on revocation of licence of Section 8 companies?

## **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.

### **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 six 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.

## **CHECK YOUR PROGRESS**

### **Model Questions**

1. What are the conditions for a company registered under Section 8 into a company of any other type?
2. Describe the procedure for conversion of OPC into a public company or a private company.
3. Discuss the provisions relating to conversion of a private company into OPC.



## **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 the company; 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 hundies, 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. INC.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 are 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 ₹1000/- for every day during which the default continues but not exceeding ₹ 1 lakh.

## CHECK YOUR PROGRESS

### Model Questions

1. The registered office shall be opened within \_\_\_\_\_ from the date of incorporation of the company.
2. The notice of every change in the situation of registered office shall be given to the Registrar of Companies within \_\_\_\_\_ of the change.
3. 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.
4. The Regional Director shall communicate the confirmation of shifting of registered office within \_\_\_\_\_ of receipt of the application.
5. The company shall furnish to the Registrar, verification of its registered office within \_\_\_\_\_ from the date of its incorporation in \_\_\_\_\_ along with fee.

### Model Questions

1. What are the documents to be attached along with Form No. INC 22 for verification of registered office?
2. In which way the company is to publish its name?
3. Discuss the procedure involved in shifting the Registered Office within the State and in between the States.

### Answers:

#### Fill in the blanks

1. 15 days;
2. 15 days;
3. Form No. INC – 23, Regional Director;
4. 30 days;
5. 30 days, INC – 22.

**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

**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, 1956 and 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 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.

### **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 ₹1000/- 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 ₹1000/- for each day during such default continues or ₹1 lakh, whichever is less.

### **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.

### **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.



### 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.

## CHECK YOUR PROGRESS

### Fill in the blanks

1. 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.
2. The promoters of every public company making a public offer of any convertible securities may hold such securities only in \_\_\_\_\_ form.
3. 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.
4. The Information Memorandum shall be deemed to be a \_\_\_\_\_.
5. \_\_\_\_\_ is a prospectus which does not include complete particulars of the quantum or price of the securities included therein.

### Model Questions

1. What are the information to be stated in a prospectus?
2. Write notes on – Shelf prospectus and Red herring prospectus.
3. What is the liability for mis-statement in the prospectus?
4. Explain the provisions relating to pay commission in connection with the subscription to the securities, by a company.
5. What are the attachments to be made along with the Annual Return in Form PAS – 3.

### Answers:

#### Fill in the blanks

1. 5;
2. Dematerialized form;
3. PAS 2, one month;
4. Prospectus;
5. Red herring prospectus.



## 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 alongwith subscription money paid either by cheque or demand draft or other banking channel and not by cash:

\*Provided that a company shall not utilise monies raised through private placement unless allotment is made and the return of allotment is filed with the Registrar.

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 sixty days from the date of receipt of the application money for such securities and if the company is not able to allot the securities within that period, it shall repay the application money to the subscribers within fifteen days from the expiry of sixty days and if the company fails to repay the application money within the aforesaid period, it shall be liable to repay that money with interest at the rate of twelve per cent. per annum from the expiry of the sixtieth day:

provided that monies received on application under this section shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than—

- (a) for adjustment against allotment of securities; or
- (b) for the repayment of monies where the company is unable to 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 fifteen days from the date of the allotment in such manner as may be prescribed, including a complete list of all allottees, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed.

Section 42(9) provides that i-f a company defaults in filing the return of allotment within the period prescribed under sub-section (8), the company, its promoters and directors shall be liable to a penalty



for each default of one thousand rupees for each day during which such default continues but not exceeding twenty-five lakh rupees.

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 two crore rupees, whichever is lower, and the company shall also refund all monies with interest as specified in sub-section (6) to subscribers within a period of thirty days of the order imposing the penalty.

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.

Rule 14 (3) provides that a private placement offer cum application letter shall be in the form of an application in <sup>1</sup>[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.



## CHECK YOUR PROGRESS

### Fill in the blanks

1. The private placement shall be made, not more than \_\_\_\_\_ persons in aggregate in a financial year.
2. 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.
3. The company making an offer or invitation shall allot securities within \_\_\_\_\_ from the date of receipt of the application money for such securities.
4. If the company is not able to allot securities, the application money shall be refunded within \_\_\_\_\_ days from the date of completion of \_\_\_\_\_ days.
5. 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 60<sup>th</sup> day.

### Model Questions

1. What are the requirements for private placement?
2. Write notes on 'Deemed Public Offer'.
3. What are the conditions stipulated in the Act for private placement?
4. Describe the procedure of offer, allotment of securities under private placement scheme.

### Answers:

#### Fill in the blanks

1. 200;
2. ₹20,000/- ;
3. 60;
4. 15, 60;
5. 12%.

## SHARE CAPITAL

### 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 ₹10000/-. Every officer of the company who is in default shall be liable to pay a penalty of ₹1000/- 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 pursuant 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 of 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) of 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 of 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 indicated 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.

### **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 of 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 fifty percent of its paid up capital upto five 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 its 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 not 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% of 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 Debentures) Rules, 2014 provides that the companies granting option to its employees pursuant 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:

- options 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 or 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 two years or more, such preference share holders 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 six 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 give 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 its 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 ₹1000/- 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.

### **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 of 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 of 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 six months or with fine which shall not be less than ₹1 lakh but which may extend to ₹ 5lakhs, 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.

### **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.

### **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.

### **CHECK YOUR PROGRESS**

1. A share capital of the company includes \_\_\_\_\_.
2. The share capital of a company limited by shares shall be of two kinds namely, \_\_\_\_ and \_\_\_\_\_.
3. Equity share capital is of two types, \_\_\_\_\_, and \_\_\_\_\_.
4. The company shall maintain a Register of Employee Stock Option in Form No.\_\_\_\_\_.
5. 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.
6. 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.
7. Any share issued by a company at a discounted price shall be \_\_\_\_\_.
8. The share certificate shall be delivered by a company within a period of \_\_\_\_\_ from the date of allotment.
9. An instrument of transfer of securities, in physical form shall be filed in Form No. \_\_\_\_\_.
10. The company shall not issue sweat equity shares for more than \_\_\_\_\_ of the existing paid up share capital in a year.

### **Choose the correct answer**

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.

**State whether TRUE or FALSE**

1. The company shall not convert its existing equity shares with voting rights into equity share capital 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 deposits accepted 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 share holders 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.



**Model Questions**

1. What are the conditions to issue equity shares with differential rights as to dividend, voting?
2. What is the procedure for issue of renewed share certificate?
3. When a shareholder may get a duplicate certificate? Discuss the procedure for the issue of duplicate share certificate.
4. Sweat equity shares are issued to directors or employees at a discount or for consideration other than cash. – Discuss.
5. What is bonus share? How it is issued to the existing share holders?
6. Write a note on 'Employees Stock Option'.
7. Explain the provisions to voting rights of share holders.
8. Write short notes on-
  - (a) Alteration of share capital;
  - (b) Reduction of share capital.
9. What is the procedure for transfer and transmission of shares?
10. What is the remedy available for refusal of transfer of shares?

**Answers:****Fill in the blanks**

1. Stock;
2. Equity share capital, preference share capital;
3. With voting rights, with differential rights as to dividend, voting;
4. SH – 6;
5. 10%;
6. 30;
7. Void;
8. Two months;
9. SH-4;
10. 15%.

**Choose the correct answer**

1. A;
2. C;
3. B;
4. D;
5. D;

**State whether TRUE or FALSE**

1. TRUE;
2. FALSE;
3. TRUE;
4. FALSE;
5. TRUE;
6. TRUE;
7. FALSE;
8. TRUE;
9. TRUE;
10. FALSE.

**PREFERENCE SHARE****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 thirty years, subject to the redemption of a minimum ten percent of such preference shares per year from the twenty first 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 of 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.

### CHECK YOUR PROGRESS

1. Preference share capital is not entitled to \_\_\_\_\_ and \_\_\_\_\_.
2. A preference share shall be redeemed within a period not exceeding \_\_\_\_\_ from the date of their issue.
3. The issue of further redeemable share or redemption of preference shares shall not be deemed to be an \_\_\_\_\_ or \_\_\_\_\_ in the share capital.
4. The particulars of the issue of preference share holders shall be noted in the \_\_\_\_\_.
5. The resolution for issue of preference share shall indicate the payment of dividend on \_\_\_\_\_ or \_\_\_\_\_ basis.



### Model Questions

1. Define 'Preference Share'.
2. What are the conditions to issue preference shares?
3. What are the conditions for 'redemption of preference shares'?
4. Write note on issue and redemption of preference shares.
5. What is the procedure for further issue of redeemable preference shares.

### Answers:

#### Fill in the blanks

1. Dividend, any surplus in the winding up proceedings;
2. 20 years;
3. Increase, reduction;
4. Register of Members;
5. Cumulative, non cumulative.

## BUY BACK OF SHARES

### Buy back of shares

Section 68(2) provides that a company shall purchase its 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 buyback 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 one 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 be able to meet its liabilities as and when they fall due and shall not be rendered insolvent within a period of one year from the date on 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 six 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 one year from that date.

#### **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 Form 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 buyback 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 six 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 back its shares; and
- 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.

### CHECK YOUR PROGRESS

#### Fill in the blanks

1. 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.
2. The company shall file with the Registrar of Companies a letter of offer in Form No. \_\_\_\_\_ before the buyback of shares.
3. 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.
4. The company shall destroy the share or securities bought back within \_\_\_\_\_ of the last date of completion of buy back.
5. After buy back a company shall not make a further issue of shares within a period of \_\_\_\_\_.

#### Model Questions

1. A company shall purchase its own shares or specified securities – Comment.
2. 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?
3. Write short notes on-
  - (a) Solvency certificate;
  - (b) Source for buy back of shares;
  - (c) Letter of offer.



4. What are the obligations of a company in respect of buy back of shares?
5. What are the prohibitions of buy back spelt out in Section 70 of the Act?

**Answers:****Fill in the blanks**

1. One year;
2. SH-8;
3. One year;
4. 7 days;
5. Six months.

**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 ten 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) © 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 matter 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 three 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 sixty 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.

### CHECK YOUR PROGRESS

#### Fill in the blanks

1. No company shall issue any debenture carrying \_\_\_\_\_.
2. Debentures shall be the \_\_\_\_\_ property.
3. 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.
4. Every company required to create Debenture Redemption Reserve on or before \_\_\_\_\_ in each year.
5. For unlisted companies issuing debentures on private placement basis, the Debenture Redemption Reserve will be \_\_\_\_\_ of the value of the debentures.

#### Model Questions

1. What are the conditions for the issue of secured debentures?
2. Who may not be appointed as debenture trustee?
3. What are the duties of debenture trustee?
4. Write notes on 'Debenture Redemption Reserve'.
5. What is the procedure for conversion of debentures into shares?
6. What are the conditions for the appointment of debenture trustee?

#### Answers:

#### Fill in the blanks

1. Voting rights;
2. Moveable;
3. Three fourth;
4. 30<sup>th</sup> day of April;
5. 25%.



## 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 or 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;
- omitted;
- 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 occurred, 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 or 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.

If it is proved that the officer of the company, who is in default, has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, he shall be liable for action under Section 447.

## CHECK YOUR PROGRESS

### Fill in the blanks

- 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.
- 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.
- The minimum investment rating grade to be obtained from Brickwork Ratings India Private Limited is \_\_\_\_\_.
- The company shall execute a deposit \_\_\_\_\_ in Form No. \_\_\_\_\_ at least 7 days before issuing circular or circular in the form of an advertisement.
- 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.
- 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.

### Model Questions

- Define the term 'deposit'.
- What are the terms and conditions for acceptance of deposits?
- Who cannot be appointed as trustee?
- Write the provisions on the appointment and removal of trustee.
- What are the particulars to be entered in the Register of Deposits?
- What are the duties of trustee?
- Write note on deposit insurance.
- Explain the method of issuing advertisements or circular for the acceptance of deposits.

### Answers:

#### Fill in the blanks

- ₹100 crores, ₹500 crores;
- 30; charge;
- BWRFBBB
- Trust deed, DPT – 2;
- 21 days;
- 1%.



## 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 Secretaryto 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;
- Until the redemption of depository receipts, the name of the overseas depository bank shall be entered in the Register of Members.

## CHECK YOUR PROGRESS

### Fill in the blanks

1. For issue of global depository receipt, a company is to pass \_\_\_\_\_ resolution in the general meeting.
2. 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.
3. The provisions relating to \_\_\_\_\_ is not applicable to global depository receipt issue.

### Model Questions

1. What are the conditions in issuing global depository receipt?
2. Briefly discuss the voting rights of the holder of global depository receipt.
3. How is the global depository receipts issued?

### Answers:

### Fill in the blanks

1. Special;
2. India; Indian;
3. Issue of public share or debentures.



## **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](http://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 three hundred 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 ₹ 1lakh, 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.



## CHECK YOUR PROGRESS

### Fill in the blanks

1. The charge may be within \_\_\_\_\_ or \_\_\_\_\_ on the properties of the companies situated outside India.
2. The time limit for registration of charge is \_\_\_\_\_ days from the date of creation of charge.
3. 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.
4. The application for condonation of delay shall be made in Form No. \_\_\_\_\_.
5. 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.

### Model Questions

1. Write the provision for rectification by Government in register of charges.
2. Write short notes-
  - (a) Register of chargers;
  - (b) Satisfaction of charges;
  - (c) Modification of charges;
3. What is the procedure for registration of charges?
4. Discuss the provisions for certificate of registration.
5. When the holder of charge can file registration?
6. What are the powers of Registrar in registering the charges?

### Answers:

#### Fill in the blanks

1. India, outside India;
2. 30;
3. 300;
4. CHG -1 ;
5. CHG- 4, 30.



## 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 Act, 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 by 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 or 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 ₹1000 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 ₹50000/- and where the failure is a continuing one, with a further fine which may extend to ₹1000/- 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 ₹1000/- and where the failure is a continuous one, with a further fine which may extend to ₹1000/- 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 ₹5000/- for every day subject to a maximum of ₹ 1lakh during which the register is kept closed.

Section 94(4) provides that if any inspection or the making of any extract or copy is refused, the company and every officer of the company, who is in default, shall be liable, for each default, to a penalty of ₹1000/- for every day subject to a maximum of ₹1lakh during which the refusal or default continues.

## CHECK YOUR PROGRESS

### Fill in the blanks

1. Every company limited by shares shall keep and maintain the Register of Members in Form No. \_\_\_\_\_.
2. The Registration shall be preserved for a period of \_\_\_\_\_.
3. A company may close the Register of Members/Debentures etc., for any period not exceeding in the aggregate of \_\_\_\_\_ days in each year.
4. 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.
5. The existing companies shall comply with the particulars within \_\_\_\_\_ from the date of commencement of the Rules.

### Model Questions

1. Discuss the provisions on foreign register.
2. What particulars are to be entered in the Register of Members?
3. Write notes on the maintenance of Register of Members.
4. Write short notes on-
  - (a) Closure of Registers;
  - (b) Preservation of Register;
  - (c) Inspection of Register.
5. By whom the Registers can be authenticated under Rule 8?

### Answers:

#### Fill in the blanks

1. MGT – 1;
2. 8 years;
3. 45;
4. Duplicate, 30;
5. 6 months.



## **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 crore 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 ₹50000/- 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 ₹50000/- 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 ₹50000/- 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 ₹1000/- 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.

**CHECK YOUR PROGRESS****Fill in the blanks**

1. Every company shall prepare Annual Return in Form \_\_\_\_\_.
2. The Annual Return shall be signed by \_\_\_\_\_ and \_\_\_\_\_.
3. Every company shall file the Annual Return with the Registrar within \_\_\_\_\_ from the date on which Annual General Meeting is held.
4. 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.
5. 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.

**State whether TRUE or FALSE**

1. Where there is no Company Secretary, the Annual Return shall be signed by a practicing Company Secretary.
2. Annual Return filed by the listed company shall be certified by a practicing Company Secretary stating the Annual Return discloses the facts correctly and adequately and that the company has complied with all the provisions of the Act.
3. Annual Return is not required to attach with the Board's Report.
4. Copies of Annual Return may be furnished to any member or other person on payment of fee specified in the Articles, subject to a maximum of ₹5/- per page.
5. Annual Returns shall be *prima facie* evidence of any matter directed or authorized to be inserted therein by or under this Act.

**Model Questions**

1. Indicate what are the particulars to be incorporated in the Annual Return?
2. Where the returns to be kept by the company and what are its preservation period?
3. Explain the provisions relating to inspection of returns.

**Answers:****Fill in the blanks**

1. MGT – 7;
2. A director, Company Secretary;
3. 60 days;
4. 8 years;
5. MGT – 10, 15.

**State whether TRUE or FALSE**

1. TRUE;
2. TRUE;
3. FALSE;
4. FALSE;
5. TRUE.



## 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 ninety-five per cent. of the members entitled to vote thereat; and
- (ii) in the case of any other general meeting, by members of the company—
  - (a) holding, if the company has a share capital, majority in number of members entitled to vote and who represent not less than ninety-five per cent. of such part of the paid-up share capital of the company as gives a right to vote at the meeting; or
  - (b) having, if the company has no share capital, not less than ninety-five per cent. 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**

Section 102(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 ₹50000/- 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 ₹5000/-

The instrument of proxy shall be deposited with the registered office of the company forty eight 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 of 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 of any shares registered in his name on which any calls or other sums presently payable by him have not been paid, or in regard to which the company has exercised any right of lien. 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 of 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 also attend 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 remote 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, email 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 despatch 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 servicefor 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 that 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 ₹5000/-.

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 ₹25000/- 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 ₹25000/- . Every officer of the company who is in default shall be liable to a penalty of ₹5000/- for each such refusal or default, as the case may be.

In case of any such refusal or default, the Tribunal may, without prejudice to any action being taken, by order, direct an immediate inspection of the minute books or direct that copy required shall forthwith be sent to the person requiring it.

## CHECK YOUR PROGRESS

### Fill in the blanks

1. A general meeting may be called by giving not less than clear \_\_\_\_ days notice either in writing or through electronic mode.
2. In case of a private company \_\_\_\_ members personally present shall be the quorum for a meeting of a company.
3. A person can act as proxy on behalf of members not exceeding \_\_\_\_ and holding in the aggregate not more than \_\_\_\_ of the total share capital of the company carrying voting rights.
4. At any general meeting, a resolution put to the vote of the meeting shall be decided on \_\_\_\_.
5. \_\_\_\_ shall be appointed to scrutinize the poll process.
6. The polling form shall be in Form No. \_\_\_\_.



7. The report of the scrutinizers shall be submitted to the Chairman within \_\_\_\_ from the date of poll is taken.
8. Postal ballot means voting by post within a period of \_\_\_\_ days from the date of dispatch of letter.
9. A copy of every resolution is to be filed with Registrar within \_\_\_\_ of the passing of the resolution.
10. Any member shall be entitled to be furnished within \_\_\_\_ of the request on payment of fee, with a copy of minutes.

**Choose the correct answer**

1. The quorum for a public company having the number of members more than 5000 is-  
(a) 2(b) 5(c) 15(d) 30
2. 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.
3. In case of e-voting notice shall be sent as attachment in –  
(a) PDF (b) word file (c) excel (d) access
4. In the case of an adjourned meeting the company shall give not less than \_\_\_\_ notice to the members.  
(a) 1 days (b) 3 days (c) 7 days (d) None of the above.
5. 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.
6. 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) Postal ballot;  
(e) None of the above.
7. 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.
8. 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.



9. 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
10. 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.

**State whether TRUE or FALSE**

1. A general meeting may be called after giving a shorter notice if consent is given in writing by not less than 50% of members entitled to vote at such meeting.
2. Notice of every meeting of the company shall be given to the auditor of the company.
3. The Articles of the company shall provide the quorum for a meeting.
4. If the quorum is not there within half an hour in a meeting called by requisitionists, shall stand adjourned to the same day in the next week at the same time and place.
5. A member of a company, not having share capital is entitled to appoint a proxy.
6. President of India may appoint such person as he thinks fit to act as his representative at any meeting of the company.
7. A demand for poll may be withdrawn at any time by the persons who made the demand.
8. 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.
9. Once the resolution is cast by the member by e-voting, he is again allowed to vote in the meeting.
10. OPC and other companies having up to 200 members are not required to transact any business through postal ballot.

**Model Questions**

1. What are the various types of meeting of a company? Write notes on them.
2. Describe the procedure of sending notice through electronic means.
3. What is the quorum of meeting? What is the consequence of the quorum is not present in the meeting?
4. Discuss the role of proxies in a general meeting.
5. Discuss briefly the methods of voting in a meeting.
6. What is the procedure for conducting a poll in a meeting?
7. What are the businesses that can be transacted through postal ballot?
8. What are the types of resolutions? Give a brief note of them.
9. Briefly discuss the procedure of recording of minutes of a meeting.
10. Any member shall be entitled to inspect minutes of general meeting. – Discuss.





**Answers:**

**Fill in the blank**

1. 21;
2. 2;
3. 50, 10%;
4. A show of hands;
5. Scrutinizer;
6. MGT 12;
7. 7;
8. 30;
9. 30;
10. 7 working days.

**Choose the correct answer**

1. D;
2. C;
3. A;
4. B;
5. C;
6. E;
7. D;
8. A;
9. C;
10. B.

**State whether TRUE or FALSE**

1. FALSE;
2. TRUE;
3. TRUE;
4. FALSE;
5. FALSE;
6. TRUE;
7. TRUE;
8. TRUE;
9. FALSE;
10. TRUE.



## **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 six 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 nine 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 there under with respect to calling, convening and conducting the meeting;



- 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 ₹5000/- for every day during which such default continues.

## **CHECK YOUR PROGRESS**

### **Fill in the blanks**

1. Every company other than an \_\_\_\_\_ shall in each year held a general meeting as its AGM.
2. First AGM is to be conducted within \_\_\_\_\_ from the date of the first financial year of the company.
3. The report of AGM shall be filed with the Registrar within \_\_\_\_\_ of the conclusion of AGM.
4. AGM is not to be conducted on a \_\_\_\_\_.

### **Model Questions**

1. Describe the powers of Tribunal in calling for AGM?
2. In which form the report of AGM is to be prepared?
3. When is the first AGM is to be conducted? Describe the procedure of the same.
4. Discuss the procedure of the conduct of AGM as to the place and time.

### **Answers:**

#### **Fill in the blanks**

1. OPC;
2. Nine months;
3. 30 days;
4. A National Holiday.

**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 requisitionists 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 requisitionists 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 21<sup>st</sup> 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.



## CHECK YOUR PROGRESS

### Fill in the blanks

1. 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.
2. The Board is to proceed to call a EGM within \_\_\_\_\_ days of the receipt of a valid requisition.
3. The EGM shall be conducted by the Board within \_\_\_\_ from the date of receipt of a valid requisition.
4. If the Board does not conduct the EGM, the requisitionists themselves conduct the meeting within \_\_\_\_\_ from the date of requisition.
5. 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.

### Model Question

1. Discuss the procedure in detail for the conduct of Extra ordinary general meeting.

### Answers:

### Fill in the blanks

1. One tenth, paid up share capital;
2. 21;
3. 45 days;
4. 3 months;
5. 45 days.

## 14.2 DIRECTORS

Section 2(34) of the Act defines the term 'director' as a director appointed to the Board of a company. Section 2(10) of the Act defines the term 'Board' or 'Board of Directors' in relation to a company as the collective body of the directors of the company.

### Company to have Board of Directors

Section 149 (1) of the Act provides that every company shall have a Board of Directors consisting of individuals as directors.

### Number of directors

The Board shall have a minimum number of three directors in the case of public company and two directors in the case of a private company and in case of One Person Company one director.

The maximum number of directors shall be fifteen. A company may appoint more than 15 directors after passing a special resolution.

### Obligation of the company

Every company existing or before the date of commencement of the Companies Act, 2013 shall within one year is required to appoint Board of directors with the requisite number including one woman



director by the prescribed company. The further requirement is that every company shall have at least one director who has stayed in India for a total period of not less than 182 days during the financial year.

### **Types of Directors**

The directors may be of various types such as woman director, independent director, nominee director, Managing Director, Whole time Director, executive director, non executive director, small shareholders director, first directors etc.,

### **Women Director**

Second proviso to Section 149(1) read with Rule 3 of Companies (Appointment and Qualification of Directors) Rules, 2014 provides that the following classes of companies shall appoint at least one woman director-

- every listed company;
- every other public company having-
  - paid up share capital ₹100 crores or more; or
  - turnover of ₹300 crores or more.

For this purpose, the paid capital or turnover as on the last date of latest audited financial statements shall be taken into account. A company incorporated under the Companies Act, 2013 and covered under provisions of second proviso to Section 149(1) shall comply with such appointment of woman director within a period of six months from the date of its incorporation. Any intermittent vacancy of a woman director shall be filled up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy whichever is later.

### **Independent director**

Section 149 (4) provides that every listed company is required to appoint at least one third of the total number of directors as independent directors. Any fraction contained in such one third numbers shall be rounded off as one. In case the Board contains total 10 directors in a company, the company is required to appoint 4 independent directors ( $10/3=3.1$ ; fraction is rounded off to 4).

The Central Government may prescribe minimum number of independent directors in case of any class or classes of public companies. Rule 4 provides that the following class or classes of companies shall have at least 2 directors as independent directors-

- the Public companies having paid up share capital of ₹10 crores or more; or
- the Public companies having turnover of ₹100 crores or more; or
- the Public companies which have, in aggregate, outstanding loans, debentures and deposits exceeding ₹50 crores.

Section 149 (5) provides that every listed company existing on or before the commencement of the Act shall comply with the provisions for appointing independent director within one year from such commencement of the Act.

The term 'independent director' is defined under Section 149(6) of the Act as a director other than a Managing Director or a whole time director or a nominee director-

- who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;
- he shall not be a promoter of the company or its holding, subsidiary or associate company;
- he shall not be related to the promoters or directors in the company, its holding, subsidiary or associate company;



- he shall not have any pecuniary relationship other than remuneration as such director or having transaction not exceeding ten per cent. of his total income or such amount as may be prescribed with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;
- none of whose relatives—
  - (i) is holding any security of or interest in the company, its holding, subsidiary or associate company during the two immediately preceding financial years or during the current financial year:  
 Provided that the relative may hold security or interest in the company of face value not exceeding fifty lakh rupees or two per cent. of the paid-up capital of the company, its holding, subsidiary or associate company or such higher sum as may be prescribed;
  - (ii) is indebted to the company, its holding, subsidiary or associate company or their promoters, or directors, in excess of such amount as may be prescribed during the two immediately preceding financial years or during the current financial year;
  - (iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, its holding, subsidiary or associate company or their promoters, or directors of such holding company, for such amount as may be prescribed during the two immediately preceding financial years or during the current financial year; or
  - (iv) has any other pecuniary transaction or relationship with the company, or its subsidiary, or its holding or associate company amounting to two per cent. or more of its gross turnover or total income singly or in combination with the transactions referred to in sub-clause (i), (ii) or (iii);
- neither he or any of his relatives-
  - holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company, in any of the three financial years immediately preceding the financial year;
  - is or has been an employee or proprietor or partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of-
    - a firm of auditors or company secretaries in practice or cost auditors of the company; or
    - any legal or a consulting firm that has or had any transaction with the company, amounting to 10% or more of the gross turnover of such firm.
  - holds together with his relatives 2% or more of the total voting power of the company; or
  - is a Chief Executive or Director of any nonprofit organization that receives 25% or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds 2% or more of the total voting power of the company; or
- who possess such other qualifications as may be prescribed.

### Qualification

Rule 5 prescribes the qualifications of independent directors. An independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business.

Section 149, further provides that an independent director shall not be entitled to any stock option. He may receive remuneration by way of sitting fee and the reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members. An independent director shall hold office for a term of office up to five consecutive years on the Board of a company. He shall be eligible for re-appointment on passing a special resolution by the company.



The Board's report shall disclose the same. No independent director shall hold office for more than two consecutive terms. He shall be eligible for appointment after the expiration of three years of ceasing to become an independent director. The provisions for retirement of directors by rotation shall not be applicable to independent directors.

Independent directors may be selected from a data bank containing the details of persons who are eligible and willing to act as independent directors maintained by any agency as notified by the Central Government. The appointment of independent director shall be approved by the company in general meeting.

### **Nominee Director**

As per Section 161(3) of Companies Act, 2013 Subject to the articles of a company, the Board may appoint any person as director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its shareholding in a Government Company.

For the purposes of section 149 of Companies Act, 2013, a nominee director means a director nominated by any financial institution.

### **Managing Director**

Section 2(54) defines the term 'Managing Director' as a director, who by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of Managing Director, by whatever name called.

### **Whole time Director**

Section 2(94) of the Act defines the term 'whole time director' as including a director in the whole time employment of the company.

### **Appointment of director elected by small share holders**

'Small shareholders' means a shareholder holding shares of nominal value of not more than ₹20000/- or such other sum as may be prescribed. A listed company may have one director elected by small shareholders.

Rule 7 requires that a listed company, may upon notice of not less than 1000 small shareholders or one tenth of the total number of such shareholders, whichever is lower, have a small shareholders' director elected by small shareholders.

Such director shall not be liable to retire by rotation. The tenure shall not exceed a period of three consecutive years and on the expiry of the tenure such director shall not be eligible for re-appointment. A disqualified person for the appointment of director shall not be eligible for such appointment. No person shall hold the position of small shareholder's director in more than two companies at the same time. A small shareholders' director shall not, for a period of 3 years from the date on which he ceases to hold office as a small shareholders' director in a company, be appointed in or be associated with such company in any other capacity either directly or indirectly.

### **First directors**

Section 152 (1) provides that where no provision is made in the articles of a company for the appointment of first director, the subscribers to the memorandum who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed. In One Person Company an individual being member shall be deemed to be its first director until the director or directors are duly appointed by the member.





### **Additional Director**

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

### **Alternate director**

Section 161(2) provides that the Board of Directors of a company may, if so authorized by its articles or by a resolution passed by the company in general meeting, appoint a person not being a person holding any alternate directorship for any other director in the company or holding directorship in the same company, to act as an alternate director for a director during his absence for a period not less than 3 months from India.

### **Appointment of Directors**

Every director, save as otherwise expressly provided in the Act, shall be appointed by the company in general meeting. The main requirement for the appointment of a director is that he is to obtain Director Identification Number ('DIN' for short). A person to be appointed as director shall furnish his DIN and a declaration that he is not disqualified to become a director under the Act. The said person is to give his consent to act as a director in Form – DIR -2. The company shall, within 30 days of the appointment of a director, file such consent with the Registrar in Form – DIR-12 along with the fee prescribed.

### **Rotation of directors**

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

- be persons whose period of office is liable to determination by retirement of directors by rotation; and
- save as otherwise expressly provided in the Act, be appointed by the company in general meeting.

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

The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment, but as between persons who became directors on the same day, those who are to retire shall, in default of and subject to any agreement among themselves, be determined by lot. The company may fill up the vacancy by appointing the retired director or some other person thereto.

### **Re-appointment of Director**

A director liable to be retired may be re appointed in the general meeting. Section 164(2) provides that no person who is or has been a director of a company which-

- has not filed financial statements or annual returns for any continuous period of 3 financial years; or
- has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for 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 5 years from the date on which the said company fails to do so.



### Director Identification Number

Every individual, who intends be appointed as director of a company shall make an application electronically in Form No. DIR-3 to the Central Government for allotment of DIN along with the prescribed fees.

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

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

- photograph;
- proof of identity;
- proof of residence;
- board resolution proposing his appointment as director in an existing company;
- Specimen signature duly verified.

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

On application, the system shall generate an application number. The Central Government shall process the application and decide on the approval or rejection and communicate the same to the applicant along with the DIN allotted in case of approval by way of a letter by post or electronically or in any other mode within 30 days from the receipt of such application.

If any defect is found in the application the Central Government shall give intimation of such defect or incompleteness to the applicant by placing it on its web site and by email to the applicant to rectify such defects within 15 days from the date of intimation. If the same has not been rectified, the Government shall reject the application directing to file a fresh application. In case of rejection or invalidation of application, the fee so paid with the application shall neither be refunded nor adjusted with any other application.

The DIN allotted to a director before the commencement of this Act shall be deemed to be the DIN allotted under the present Act. The DIN allotted shall be valid up to the life time of the Director. The said number shall not be allotted to any other person. Similarly, a person shall be allotted only one DIN.

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

Every company shall, within 15 days of the receipt of intimation, furnish the same with the Registrar in Form DIR-3C. If a company fails to furnish DIN, the company shall be punishable with fine which shall not be less than ₹25,000/- but which may extend to ₹1 lakh. Every officer of the company who is default shall be punishable with fine which shall not be less than ₹25,000/- but which may extend to ₹1 lakh.

Section 159 provides that if any individual or director of a company, contravenes any of the provisions of Section 152 (dealing with the appointment of directors), Section 155 (dealing with prohibition to obtain more than one DIN) and Section 156 (Director to intimate DIN), such individual or director shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to ₹50,000/-. If the contravention is a continuing one, further fine will be imposed which may extend to ₹500/- for every day after the first during which the contravention continues.



The Central Government may prescribe any identification number which shall be treated as Director Identification Number for the purposes of this Act and in case any individual holds or acquires such identification number, the requirement of section 153 shall not apply or apply in such manner as may be prescribed.

#### **Disqualifications for appointment of director**

Section 164 of the Act details the disqualification of a person for the appointment as a Director. 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 to imprisonment for not less than 6 months and a period of 5 years has not elapsed from the date of expiry of the sentence;

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

- (e) an order disqualifying him for appointment as a director has been passed by the 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 obtain DIN.

A private company may by its articles provide for any disqualifications for appointment as a director in addition to the above disqualifications.

The disqualifications referred under (d), (e) and (g) above shall continue to apply even if the appeal or petition has been filed against the order of conviction or disqualification.

#### **Vacation of office of a director**

Section 167 provides that the office of a Director shall become vacant in case-

- (a) he incurs any of the disqualifications specified in Section 164; Provided that where he incurs disqualification under sub-section (2) of section 164, the office of the director shall become vacant in all the companies, other than the company which is in default under that sub-section.
- (b) he absents himself from all the meetings of the Board of Directors held during a period of 12 months with or without seeking leave of absence of the Board;
- (c) he acts in contravention of the provisions of Section 184 relating to entering into contracts or arrangements in which he is directly or indirectly interested.
- (d) he fails to disclose his interest in any contract or arrangement in which he is directly or indirectly interested, in contravention of the provisions of Section 184;
- (e) he becomes disqualified by an order of a Court or Tribunal;
- (f) he is convicted by a court of any offence, whether involving moral turpitude or otherwise and sentenced in respect thereof to imprisonment for not less than 6 months.



Provided that the office shall not be vacated by the director in case of orders referred under (e) and (f)-

- (i) for thirty days from the date of conviction or order of disqualification;
  - (ii) where an appeal or petition is preferred within thirty days as aforesaid against the conviction resulting in sentence or order, until expiry of seven days from the date on which such appeal or petition is disposed of; or
  - (iii) where any further appeal or petition is preferred against order or sentence within seven days, until such further appeal or petition is disposed of.
- (g) he is removed in pursuance of the provisions of the Act;
- (h) he, having been appointed a director by virtue of his holding any office or other employment in the holding, subsidiary or associate company, ceases to hold such office or other employment in that company.
- (i) he breaches the limits of maximum directorship allowed.

A private company may, by its articles, provide any other ground for the vacation of the office of a director in addition to the above.

Where all the directors of a company vacate their offices under any of the disqualifications, the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting.

If a person, functions as a director even when he knows that the office of director held by him has become vacant on account of any of the disqualifications, he shall be punishable with imprisonment for a term which may extend to 1 year or with fine which shall not be less than ₹1 lakh but which may extend to ₹5 lakhs or with both.

### **Resignation of a director**

Section 168 provides the procedure for the resignation of a director as detailed below:

- A director may resign from his office by giving a notice in writing to the company;
- He shall within 30 days from the date of resignation, forward to the Registrar a copy of his resignation along with the reasons for the resignation, in Form No. DIR – 11 along with the fee;
- A foreign director may authorize in writing a practicing Chartered Accountant or Cost Accountant in practice or Company Secretary in practice or any other resident director of the company to sign the Form No. DIR – 11 and file the same on his behalf intimating the reasons for the resignation;
- The Board shall on receipt of such notice take notice of the same;
- The company shall intimate the Registrar in Form No. DIR-12 within one month from the date of receipt of such notice;
- The said information is to be posted on the website of the company;
- The fact of the resignation shall be included in the report of directors laid in immediately following general meeting by the company;
- 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;
- The director who has resigned shall be liable even after his resignation for the offences which occurred during his tenure;

Where all directors of a company resign from their offices the promoter or, in his absence, the Central Government shall appoint the required number of directors, who shall hold the office till the directors are appointed by the company in general meeting.



## Removal of Directors

Section 169 deals with the procedure of removal of directors. A company may remove a director by passing ordinary resolution. A company cannot remove a director appointed by the Tribunal. The following is the procedure to remove a director and to appoint another director in the place of removed director:

- A special notice of any resolution, shall be sent for a meeting in which the director is to be removed, to the company;
- On receipt of notice of a resolution to remove a director, the company shall send a copy of it to the director concerned;
- The director, whether he is a member or not, is entitled to be heard on the resolution at the meeting;
- The director concerned may make his representation in writing to the company;
- The director may request the company to send his representation to the members of the company;
- The Company, shall if the time permits it to do so-
  - in any notice of the resolution given to members of the company, state the fact of the representation having been made; and
  - send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before or after receipt of the representation of the company.

If a copy of the representation is not sent due to insufficient time or for the company's default, the director may require that the representation shall be read out at the meeting.

The copy of the representation need not be sent out and read out at the meeting if, on the application either of the company or of any other person who claims to be aggrieved, the Tribunal is satisfied that the rights conferred by this section are being abused to secure needless publicity for defamatory matter. The Tribunal may order the company's costs on the application to be paid in whole or in part by the director notwithstanding that he is not a party to it.

A vacancy created by the removal of the director may be filled by the appointment of another director in his place at the meeting at which he is removed. Provided special notice of the intended appointment has been given. The new director so appointed shall hold office till the date up to which his predecessor would have held office if he had not been removed. If the vacancy is not filled, it may be filled as casual vacancy in accordance with the provisions of the Act.

The removed director shall not be reappointed as director by the Board of Directors. Nothing in this section shall be taken as depriving a person removed under this section of any compensation or damages payable for his removal as director, as per the terms of contract or terms of his appointment as director or of any other appointment terminating with that as director or as derogating from any power to remove a director under other provisions of the Act.

## Register of Directors and Key managerial personnel

Every company is to keep a register of directors and key managerial personnel at its registered office. The register shall contain the following details-

- Director Identification Number (optional for key managerial personnel);
- name and surname;
- any former name or surname in full;
- father's name, mother's name and spouse's name (if married) and surnames in full;
- date of birth;
- present and permanent residential address;



- nationality;
- occupation;
- date of board resolution in which the appointment was made;
- date of appointment and reappointment in the company;
- date of cessation of office and reasons therefor;
- office of director or key managerial personnel held or relinquished in any other body corporate;
- membership number of the Institute of Company Secretaries of India, in case of Company Secretary, if applicable; and
- permanent Account Number (mandatory for key managerial personnel if not having DIN).

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

- the number, description and nominal value of securities;
- the date of acquisition and the price or other consideration paid;
- date of disposal and price and other consideration received;
- cumulative balance and number of securities held after each transaction;
- mode of acquisition of securities;
- mode of holding-physical or in dematerialized form; and
- whether securities have been pledged or any encumbrance has been created in the securities.

### **Return**

A return containing the particulars of the appointment of directors and key managerial personnel and changes therein shall be filed with the Registrar in Form No. DIR – 12 along with the fee within 30 days of such appointment or change by the company.

### **Inspection of register**

Section 171(1) provides that the register of directors and key managerial personnel shall be kept open for inspection during business hours. The members are having a right to take extracts and copies at free of cost, which shall be supplied within 30 days of the request made by the members. The same shall be kept open at every annual general meeting of the company and made accessible to any person attending the meeting.

Section 171 (2) provides that if any inspection is refused or any copy is not sent, the Registrar shall, on an application made to him, order immediate inspection and supply of copies required.

### **Punishment**

Section 172 provides that if a company contravenes any of the provisions of Chapter XI and for which no specific punishment is provided, the company and every offices of the company, who is in default, shall be punishable with fine, which shall not be less than ₹50000/- but which may be extend up to ₹5 lakhs.

### **Appointment of Managing Director, whole time director**

Section 196(1) provides that a company shall not appoint a managing director and a manager at the same time. A company shall appoint or re-appoint a managing director, whole time-director or manager for tenure of five years only at a time.

The minimum age limit for appointment of Managing Director and the Whole time director is 21 years. The maximum age limit is 70 years. He may not continue after 70 years. The appointment of a person



who has attained the age of 70 years may be made by passing a special resolution. For this purpose the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such person.

The disqualifications for appointment of a Managing Director or Whole Time Director, under Section 196 (3) are as follows-

- if he is an undischarged insolvent or has at any time been adjudged as an insolvent;
- has at any time suspended payment to his creditors or makes, or has at any time made, a composition with them; or
- has at any time been convicted by a court of an offence and sentenced for a period of more than six months.

A Managing Director or a Whole Time Director shall be appointed, subject to the terms and conditions of such appointment and remuneration payable, to be approved by the Board of Directors at a meeting which shall be subject to approval by a resolution in the next general meeting of the company. The approval of the Central Government is required in case such appointment is varied to the conditions specified in Part I of Schedule V.

Part I of Schedule V imposed the following additional conditions to be fulfilled for the appointment of a Managing Director or a Whole time director without the approval of the Central Government-

- (a) he had not been sentenced to imprisonment for any period, or to a fine exceeding ₹1000/- for the conviction of any offence under any of the following Acts-
- the Indian Stamps Act, 1899;
  - the Central Excise Act, 1944;
  - the Industries (Development and Regulation) Act, 1951;
  - the Prevention of Food Adulteration Act, 1954;
  - the Essential Commodities Act, 1955;
  - the Companies Act, 2013 or any previous Company Law;
  - the Securities Contracts (Regulation) Act, 1956;
  - the Wealth Tax Act, 1957;
  - the Income Tax Act, 1961;
  - the Customs Act, 1962;
  - the Competition Act, 2002;
  - the Foreign Exchange Management Act, 1999;
  - the Sick Industrial Companies (Special Provisions) Act, 1985;
  - the Securities Exchange Board of India Act, 1992;
  - the Foreign Trade (Development and Regulation) Act, 1922;
  - the Prevention of Money-Laundering Act, 2002.
- (b) He had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974;
- (c) Where he is a managerial person in more than one company, he draws remuneration from one or more companies subject to the ceiling provided in Part II of this schedule;
- (d) He is resident of India.



Where an appointment of a Managing Director or Whole time director is not approved by the company at a general meeting, any act done by him before such approval shall not be deemed to be invalid.

A return in Form No. MR-11 shall be filed indicating the appointment of a Managing Director or Whole time director within 60 days of such appointment along with the fee.

### **Remuneration of directors**

#### **Overall remuneration**

Section 197 (1) provides that the total managerial remuneration payable by a public company to its directors, including Managing Director and a Whole time director in respect of any financial year shall not exceed 11% of the net profits of the company. The company, in general meeting may, authorize the payment of remuneration exceeding 11% of the net profits of the company. Where the company has defaulted in payment to bank/PFI or NCD or any secured creditor, prior approval of the bank/PFI shall be obtained before the special resolution.

If any director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed or without approval required under this section, he shall refund such sums to the company and until such sum is refunded hold it in trust for the company.

#### **Remuneration to MD or WTD**

The second proviso to Section 197(1) provides that the remuneration payable to any one Managing Director or whole time director or manager shall not exceed 5% of the net profits of the company. If there are more than one whole time director remuneration shall not exceed 10% of the net profits to all such directors and manager taken together.

#### **Remuneration payable to directors**

The remuneration payable to directors, who are neither Managing Directors nor Whole Time directors, shall not exceed 1% of the net profits, if there is a Managing Director or Whole time director or manager. In other cases it shall not exceed 3% of the net profits.

#### **Remuneration when there is no profit**

Section 197(3) provides that if, in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors including Managing Directors or whole time director by way of remuneration any sum exclusive of any fees payable. Remuneration may be payable in such a situation in accordance with the provisions of Schedule V.

#### **Sitting fees**

A director may receive fee for attending the meetings of the Board or Committee thereof or for any other purpose whatsoever as may be decided by the Board. Such fees shall not exceed one lakh rupees per meeting of the Board or Committee thereof. The independent directors and women directors may receive the fees not less than the fee payable to other directors.

#### **Professional fee**

Any remuneration for services rendered by any such director in other capacity shall not be included if the services rendered are of a professional nature and in the opinion of the Nomination and Remuneration Committee or the Board of Directors, the director possesses the requisite qualification for the practice of the profession.

#### **Periodicity of payment**

Section 197(6) provides that a director may be paid remuneration either by way of monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by other.

#### **Insurance premium**

Section 197 (13) provides that where any insurance is taken by a company on behalf of its managing





director, whole time director for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to such director. If such person is proved to be guilty, the premium paid on such insurance shall be treated as part of remuneration.

### **Recovery of remuneration**

Section 199 provides that where a company is required to re-state its financial statements due to fraud or non-compliance with any requirement, the company shall recover from any past or present Managing Director or Whole time director, who during the period for which the financial statements are required to be re-stated, received the remuneration, including the stock option in excess of what would have been payable to him as per the re-statement of financial statements.

### **Duties of a Director**

Section 166 of the Act prescribes the duties of a director under the provisions of this Act as detailed below:

- A director of a company shall act in accordance with the articles of the company;
- A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment;
- A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment;
- A director 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;

If a director of the company contravenes the provisions of Section 166 such director shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

## **POWERS OF THE BOARD OF DIRECTORS**

### **Powers of the Board: Section 179**

Section 179 of the Act deals with the powers of the board. 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 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.

The following (section 179(3) read with Rule 8 of Companies (Meetings of Board and its Power) Rules, 2014 powers of the Board of directors shall be exercised only by means of resolutions passed at meetings of the Board, namely :-

- (1) to make calls on shareholders in respect of money unpaid on their shares;
- (2) to authorise buy-back of securities under section 68;
- (3) to issue securities, including debentures, whether in or outside India;



- (4) to borrow monies;
- (5) to invest the funds of the company;
- (6) to grant loans or give guarantee or provide security in respect of loans;
- (7) to approve financial statement and the Board's report;
- (8) to diversify the business of the company;
- (9) to approve amalgamation, merger or reconstruction;
- (10) to take over a company or acquire a controlling or substantial stake in another company;
- (11) to make political contributions;
- (12) to appoint or remove key managerial personnel (KMP);
- (13) to appoint internal auditors and secretarial auditor;

The Board may, by a resolution passed at a meeting, delegate to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office, the powers specified in (4) to (6) above on such conditions as it may specify.

The banking company is not covered under the purview of this section. The company may impose restriction and conditions on the powers of the Board specified in this section.

#### **Section 180: Restrictions on powers of Board**

The Board can exercise the following powers only with the consent of the company by special resolution, namely –

- (a) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings;
- (b) to invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation;
- (c) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital, free reserves and securities premium, apart from temporary loans obtained from the company's bankers in the ordinary course of business;
- (d) to remit, or give time for the repayment of, any debt due from a director.

The special resolution relating to borrowing money exceeding paid up capital, free reserves and securities premium share specify the total amount up to which the money may be borrowed by Board.

The title of buyer or other person who buys or takes on lease any property, investment or undertaking in good faith cannot be affected and also in case if in the ordinary business of the company comprises such selling or leasing.

The resolution may also stipulate the conditions of such sale and lease, but this doesn't authorise the company to reduce its capital except in accordance with the provisions contained in this Act.

The debt incurred by the company exceeding the paid up capital, free reserves and securities premium is not valid and effectual, unless the lender proves that the loan was advanced in good faith and also having no knowledge that limit imposed had been exceeded.

#### **Section 181 : Contributions to Charitable Funds and Political Parties**

The power of making contribution to 'bona fide' charitable and other funds is available to the Board subject to certain limits. Further, the permission of company in general meeting is required if such contribution in any financial year exceeds five percent of its average net profits for the three immediately preceding financial years



### Section 182 : Prohibitions and Restrictions Regarding Political Contributions

According to Section 182 of the Act, a company, other than a Government company and a company which has been in existence for less than three financial years, may contribute any amount directly to any political party.

The contribution must be authorised by Board in its meeting by resolution and such resolution shall be deemed to be the justification in law for such contribution.

The donation may be directly or indirectly. If the contribution so made is likely to affect the public support for a political party shall also be deemed to be the contribution for political purpose. The expenditure incurred on advertisement in any publication souvenir, brochure, tract, pamphlet or the like is also deemed as political contribution, if such publication is by or on behalf of political party or if not, then for the advantage to such political party for a political purpose.

Every company shall disclose in its profit and loss account the total amount contributed by it under this section during the financial year to which the account relates. The contribution under this section shall not be made except by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account.

#### Penalty for Contravention

For contribution in contravention of the provisions of this section, the company shall be punishable for an amount which may extend to five times of the amount so contributed and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months and with fine which may extend to five times of the amount so contributed.

### Section 183: Power of Board and other Persons to make Contributions to National Defence

#### Fund, etc.

The Board is authorised to contribute such amount as it thinks fit to the National Defence Fund or any other fund approved by the Government for the purpose of national defence. The company is required to disclose in its profit and loss account the total amount or amounts contributed by it during the financial year to which the amount relates.

## CHECK YOUR PROGRESS

### Fill in the blanks

1. The Board shall have a minimum number of \_\_\_\_\_ directors in the case of private company.
2. The maximum number of directors shall be \_\_\_\_\_.
3. Small shareholder means a share holder holding shares of nominal value not more than ₹\_\_\_\_\_.
4. The company shall, within \_\_\_\_\_ days of the appointment of a director, file consent of director with the Registrar.
5. DIN stands for \_\_\_\_\_.
6. 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.
7. The maximum age limit of Managing Director is \_\_\_\_\_ years.
8. 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.



9. Sitting fees shall not exceed \_\_\_\_\_ per meeting of the Board or Committee.
10. 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.

**Choose the correct answer**

1. The minimum number of directors for a public company is-  
(a) 1 (b) 2 (c) 3 (d) 7
2. 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.
3. The appointment of an independent director shall be approved by the-  
(a) Board meeting;  
(b) General meeting;  
(c) Registrar of Companies;  
(d) Central Government.
4. 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.
5. No independent director shall hold office for more than \_\_\_\_ consecutive terms.  
(a) 2 (b) 3 (c) 4 (d) 5
6. 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.
7. 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.
8. 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.
9. 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.
10. The minimum age prescribed for the appointment of Managing Director is-
- (a) 18 years; (b) 21 years (c) 30 years (d) 70 years.

#### State whether TRUE or FALSE

1. A company may appoint more than 15 directors after passing a resolution.
2. All companies are required to appoint one woman director.
3. An independent director shall not be entitled to any stock option.
4. Whole time director is not the employee of the company.
5. Additional director shall hold office up to the date of next AGM.
6. The DIN allotted to a director before the commencement of this Act shall be deemed to be the DIN allotted under the new Act.
7. Non obtaining of DIN does not amount to disqualification of a director.
8. The Board may accept the resignation of a Director on his submission of his application for resignation.
9. The removed directors shall not be reappointed as director by the Board of Directors.
10. In any financial year, if a company has no profits or its profits are inadequate, the company shall not pay remuneration to its directors.

#### Model Questions

1. Define 'independent director'.
2. Write on various types of directors.
3. Discuss the procedure for rotation of directors and re-appointment of directors.
4. Director Identification Number – discuss the provisions relating to this.
5. What are the disqualifications for the appointment of director?
6. When the office of a Director shall become vacant?
7. Can a director be removed? If so give the procedure in detail.
8. Write notes on-
  - (a) Overall remuneration payable by a public company;
  - (b) Remuneration payable to Managing Director or Whole Time Director.
  - (c) Remuneration payable to Directors.
9. Which will not form part of the remuneration of a Director?
10. What are the duties of a director in a company?



**Answers:**

**Fill in the blanks**

1. 2;
2. 15;
3. 20000;
4. 30;
5. Director Identification Number;
6. 30;
7. 70;
8. 11%;
9. ₹ 1 lakh;
10. 12 months.

**Choose the correct answer**

1. C;
2. A;
3. B;
4. C;
5. A;
6. D;
7. B;
8. C;
9. B;
10. B.

**State whether TRUE or FALSE**

1. TRUE;
2. FALSE;
3. TRUE;
4. FALSE;
5. TRUE;
6. TRUE;
7. FALSE;
8. FALSE;
9. TRUE;
10. TRUE.



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**Section D**  
**Ethics**  
**(Syllabus - 2016)**

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# Study Note - 15

## BUSINESS ETHICS



### This Study Note includes

- 15.1 Ethics – Meaning, Importance, Nature and Relevances to Business**
- 15.2 Values and attitudes of Professional Accountants**
- 15.3 Seven Principles of Public Life**
- 15.4 Ethics in Business**

### 15.1 ETHICS – MEANING, IMPORTANCE, NATURE AND RELEVANCES TO BUSINESS

#### 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 in turn are adopted by corporates and become corporate values. Corporate ethics, therefore, is choosing, adopting and practicing good things and avoiding bad things. Right and wrong varies from company to company but there are 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 the 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 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 honesty 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 numbers 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.

## 15.2 VALUES AND ATTITUDES OF PROFESSIONAL ACCOUNTANTS

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 is to invest sufficient resources to enhance customer satisfaction. But every action of the organization has to result in 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;

### 15.3 SEVEN PRINCIPLES OF PUBLIC LIFE

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 any one 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 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.

## 15.4 ETHICS IN BUSINESS

### 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.

### Importance

- Improving consumer confidence
- Business become conscious of social responsibilities;
- Create good image of business;
- Goodwill;



- Profitability;
- Survival of heated competition
- Safety from legal perspectives

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.

### **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 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.





### **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 optimal 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, strategy and pende;

#### **Disadvantage of business ethics**

- It negativates the object of the business concerns in maximizing the profits;
- Diversity in achievements;
- The company has to incur extra expenditure.

#### **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.

#### **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 careful, 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.

## CHECK YOUR PROGRESS

### Fill in the blanks

1. The term ethics is derived from latin word \_\_\_\_\_.
2. Ethics of a three types viz., \_\_\_\_\_, \_\_\_\_\_ and \_\_\_\_\_.
3. The ethical operation of a company is directly related to \_\_\_\_\_ in both short and long term.
4. Meta ethics deal with the nature of \_\_\_\_\_.
5. Continuous improvement or \_\_\_\_\_ is a popular theme.

### Model Questions

1. What is the role of management accounting in ethics?
2. What are the standards of ethical conduct for practitioners fixed by The Institute of Cost Accountants of India?
3. Describe the seven principles of public life.
4. What are the needs for business ethics?
5. What are the advantages and disadvantages of the principles of business ethics.
6. Define 'Business ethics'.
7. What are the areas in business ethics and write note of the same.
8. A competent professional accountant in business is an invaluable asset to the company – Discuss.

### Answers:

#### Fill in the blanks

1. Ethos;
2. Meta ethics, normative ethics and applied ethics.
3. Profitability;
4. Moral judgment;
5. Kaizen.



**PREVIOUS TERMS QUESTION PAPERS**

**INTERMEDIATE EXAMINATION**

**June 2019**

**P-6(LNE)  
Syllabus 2016**

**Laws & Ethics**

Time Allowed: 3 Hours

Full Marks: 100

The figures in the margin on the right side indicate full marks.

This question paper has two Sections A and B.

Both the Sections are to be answered subject to instructions given against each.

Wherever necessary, candidates may make appropriate assumptions and clearly state them.

Please: (1) Answer all bits of a question at one place.

(2) Open a new page for answer to a new question.

**Section - A**

Section A contains Question No. 1

All parts of this questions are compulsory.

1. Answer all the following questions:

- (a) Choose the correct answer from the given alternatives (you may write only the Roman numeral and the alphabet chosen for your answer): 1x10=10
- (i) Anu threaten to kidnap Binu's daughter if she does not sell her house worth ₹ 90 Lakh to her for ₹ 20 Lakh. This Contract is void due to —
- (A) inadequacy of Consideration  
(B) absence of Free Consent  
(C) incompetence of Parties  
(D) None of the above
- (ii) The Latin Maxim "Nemo Dat Quod non Habet" means
- (A) no man can pass a better title than he has  
(B) let the Buyer beware  
(C) no consideration – No contract  
(D) ignorance of law is no excuse
- (iii) As per the RBI Act, which of the following negotiable Instruments can be payable to the bearer on demand?
- (A) Cheque  
(B) Hundai  
(C) Bank Draft  
(D) Promissory Note



- (iv) When a partnership firm is continued even after the expiry of fixed term, it is called
- (A) Partnership at Will
  - (B) Perpetual Partnership
  - (C) Fixed Partnership
  - (D) Particular Partnership
- (v) The amount of gratuity payable to an employee shall not exceed
- (A) Ten months' pay
  - (B) Twelve months' pay
  - (C) Twenty months' pay
  - (D) Twenty-five months' pay
- (vi) No female child shall be allowed to work in any factory except between
- (A) 8 AM to 7 PM
  - (B) 6 AM to 6 PM
  - (C) 6 AM to 7 PM
  - (D) 10 AM to 5 PM
- (vii) In case of a private company, mention the number of members personally present to form the quorum of a meeting of the company.
- (A) One member
  - (B) Two members
  - (C) Three members
  - (D) Four members
- (viii) Which of the following is not a valid medium of sending notice to all shareholders?
- (A) By registered post or speed post
  - (B) Through public advertisement
  - (C) Through registered email-id
  - (D) Through courier service
- (ix) If any default is made in filing refund of money, the company and every officer, who is in default shall be liable to a penalty maximum up to
- (A) ₹ 50,000
  - (B) ₹ 75,000
  - (C) ₹ 1,00,000
  - (D) ₹ 1,25,000
- (x) Value chain as a strategic framework for analysis of competitive advantaged was promoted by
- (A) Peter Drucker
  - (B) F. W. Taylor
  - (C) Michael Porter
  - (D) Tom Peters



(b) Match and pair:

1x5=5

	Column I		Column II
1.	Occupier	(A)	P purchases goods from S, he has no intention of paying for it.
2.	Section 92 of the Companies Act, 2013	(B)	Annual Return.
3.	Meta ethics	(C)	Person having ultimate control
4.	Fraud	(D)	Control of at least 20 per cent of total share capital
5.	Significant influence	(E)	Nature of moral judgement

(c) State whether the following statements are True or False:

1x5=5

- (i) An agreement which is impossible is void.
- (ii) In case of expulsion of a partner, the provisions of retired partners will be applicable to such expelled partner.
- (iii) Sickness benefit is paid up to a maximum day of 60 days in a year.
- (iv) A director in the whole time employment of the Company is called Whole Time Director.
- (v) Contribution to pension scheme is recoverable when employee crosses 58 year of age.

(d) Fill in the blanks:

1x5=5

- (i) When the consent is caused by \_\_\_\_\_, the agreement is voidable at the option of the party whose consent was so caused.
- (ii) All payments of wages shall be made on a \_\_\_\_\_ day.
- (iii) Whenever a company makes any allotment of securities, it shall file a return of allotment with the Registrar within \_\_\_\_\_ days of allotment.
- (iv) The application for the purpose of Alteration of Articles is to be filed in Form No. \_\_\_\_\_.
- (v) Business ethics must safeguard different rights of the \_\_\_\_\_.

### Section – B

**Answer any five questions from question numbers 2 to 8**

**Each question carries 15 marks.**

2. (a) Sunil, aged 16 years, was studying in a Medical College. On 1st March, 2017 he took a loan of ₹ 3 lakhs from Anil for the payment of his college fee and agreed to pay by 31st May, 2018. Sunil possesses assets worth ₹15 lakhs. On due date Sunil fails to pay back the loan to Anil. Anil now wants to recover the loan from Sunil out of his assets. Whether Anil would succeed? Decide, referring to the provisions of the Indian Contract Act, 1872.
- (b) State the essential elements of a contract of bailment. Distinguish between the contract of bailment and contract of pledge. 6+9=15
3. (a) Himadri sells 400 Kgs. of tea to Rahul and sends 200 Kgs. by lorry and 200 Kgs. By Railway. Rahul receives delivery of 200 Kgs. sent by lorry, but before he receives the delivery of the tea sent by railway, he becomes bankrupt. Himadri being still unpaid, stops the goods in transit. The official receiver, on Rahul's insolvency claims the goods. Decide the case with reference to the provisions of the Sale of Goods Act, 1930.



- (b) Ajay draws a bill on Anoop. Anoop accepts the bill without any consideration. The bill is transferred to Udit without consideration. Udit transferred it to Vicky for value.
- Decide-
- (i) Whether Vicky can sue the prior parties of the bill?
- (ii) Whether the prior parties other than Vicky have any right of action intense? 7+8=15
4. (a) Describe the procedures for an employee to claim the short payment of wages or non-payment of wages under Minimum Wages Act, 1948.
- (b) What are the basic features of the national pension system as contained in the Pension Fund Regulatory and Development Authority Act, 2013? 7+8=15
5. (a) What is meant by Lifting of Corporate Veil? In which circumstances the corporate veil can be lifted by court?
- (b) State the procedure for shifting of a registered office of the company from one state to another state under the provisions of the Companies Act, 2013. 8+7=15
6. (a) Describe the procedure for the resignation of Director under the Companies Act, 2013.
- (b) Discuss the rules of appointment of director elected by small shareholders in a company. 10+5=15
7. (a) "Ethics is the first line of defence against corruption, while law enforcement is remedial and reactive. However, both fail to achieve the desired aim in the Indian set-up." Do you agree? Give reasons in support of your answer..
- (b) Deepak is employed in Assam Coffee Estate Ltd., a seasonal establishment. The factory was in operation for four months only during the financial year 2018-19. Deepak was not in continuous service during this period. However, he has worked only 60 days. Referring to the provisions of The Payment of Gratuity Act, 1972, decide whether Deepak is entitled to gratuity payable under the Act. Would your answer be the same in case Deepak works for 100 days? 10+5=15
8. Write short notes on any three of the following terms: 5×3=15
- (a) Agreement without consideration
- (b) Red herring prospectus
- (c) Importance of ethics
- (d) Annual Leave under the Factories Act, 1948





**INTERMEDIATE EXAMINATION  
December 2018**

**P-6(LNE)  
Syllabus 2016**

**Laws & Ethics**

Time Allowed: 3 Hours

Full Marks: 100

The figures in the margin on the right side indicate full marks.

This question paper has two Sections A and B.

Both the Sections are to be answered subject to instructions given against each.

Wherever necessary, candidates may make appropriate assumptions and clearly state them.

**SECTION - A**

Section A contains Question No. 1 All parts of this questions are compulsory.

1. Answer all the following questions:

Choose the correct answer from the given alternatives (you may write only the Roman numeral and the alphabet chosen for your answer): 1×10=10

(a) Multiple Choice Questions:

- (i) A proposal may be revoked at any time before
  - (A) the communication of acceptance
  - (B) the payment of consideration
  - (C) signing the agreement
  - (D) execution of the proposal
- (ii) Which of the following is not to be taken care while admitting a new partner?
  - (A) Computation of new profit sharing ratio and sacrifice ratio
  - (B) Accounting treatment of goodwill
  - (C) Professional qualification of admitting partner
  - (D) Revaluation of assets and liabilities
- (iii) Where goods are delivered to the buyer and he refuses to accept them, the buyer is not bound to
  - (A) retain them with him.
  - (B) look-after the goods.
  - (C) return them to the seller.
  - (D) store them in his godown.



- (iv) No child shall be allowed to work in a factory unless he has completed his
- (A) 12th year
  - (B) 14th year
  - (C) 16th year
  - (D) 18th year
- (v) Gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than
- (A) three years
  - (B) five years
  - (C) seven years
  - (D) ten years
- (vi) The Employees' State Insurance Corporation is
- (A) Hindu Undivided Family
  - (B) Local Authority
  - (C) Charitable Institution
  - (D) Body Corporate
- (vii) The annual return of an OPC shall be signed by the company secretary or where there is no company secretary, by the
- (A) Senior executive of the company
  - (B) Auditor of the company
  - (C) Director of the company
  - (D) Advocate of the company
- (viii) If there is any mis-statement in the prospectus then it would attract the liability on
- (A) The printer
  - (B) The issuer
  - (C) The publisher
  - (D) The proof-reader
- (ix) Every company limited by shares shall keep and maintain the Register of Members in Form No.
- (A) MGT-1
  - (B) MGT-3
  - (C) MGT-7
  - (D) MGT-12



(x) Ethics are the set of moral principles that guide a person's

- (A) Behaviour
- (B) Philosophy
- (C) Religion
- (D) Profession

(b) Match and Pair:

1×5=5

	Column I		Column II
(1)	Wagering contract	(A)	Voting through electronics means
(2)	Coercion	(B)	War, animal rights and capital punishment
(3)	Consensus ad-idem	(C)	Committing any act forbidden by the Indian Penal Code
(4)	Section 108 of Companies Act, 2013	(D)	Identity of minds
(5)	Applied ethics	(E)	Promise to pay ₹1,000 if it rains today

(c) State whether the following statements are True or False:

1×5=5

- (i) Goods to be manufactured or produced or acquired by the seller after making of the contract of sale are called future goods.
- (ii) The first endorsement of an instrument can be made by the Banker.
- (iii) Payment of Gratuity Act, 1972 applies to every shop and establishment employing seven or more persons.
- (iv) In case of e-voting, notice shall be sent as attachment in word file.
- (v) Ethics is a requirement for human life.

(d) Fill in the blanks:

1×5=5

- (i) The dishonor of the instrument may be due to Non-acceptance and \_\_\_\_\_ .
- (ii) The term of the office of the representative members of Medical Benefit Council shall be \_\_\_\_\_ years from the date on which the appointment is notified.
- (iii) The company shall have the \_\_\_\_\_ to specify the lock-in-period for the shares issued in pursuant to exercise such option.
- (iv) A director may resign from his office by giving a notice in writing to the \_\_\_\_\_.
- (v) The Seven Principles of Public Life were set out by \_\_\_\_\_ for the first time in the year 1995.

**SECTION - B**

Answer any five questions from question numbers 2 to 8.

Each question carries 15 marks.

15×5=75

2. (a) Explain the meaning of 'Quasi-Contracts'. State the circumstances which are identified as quasi-contracts by the Indian Contract Act, 1872.
- (b) C is the wife of A. She purchased some sarees on credit from B. B demanded the amount from A. A refused. B filed a suit against A for the said amount. Decide in the light of provisions of the Indian Contract Act, 1872, whether B would succeed. 10+5=15
3. (a) A limited liability partnership wants to shift its registered office from Mumbai in the State of Maharashtra to Kolkata in the State of West Bengal. What procedure the corporate has to follow under Limited Liability Partnership Act, 2008?
- (b) Rahul draws a cheque payable to 'sell or order'. Before he could encash the cheque, one of his creditors, Samrat approaches him for payment. Rahul endorses the same cheque in Samrat's favour. The banker refuses payment to Samrat on account of insufficiency of funds in the account. Can Rahul be made liable to penalties for dishonor of cheque due to insufficiency of funds in the account under section 138 of Negotiable Instruments Act, 1881? 8+7=15
4. (a) Explain the procedure for fixing and revising minimum wages under Minimum Wages Act, 1948.
- (b) Mention the benefits that are entitled to the insured persons under the Employees' State Insurance Act, 1948. 9+6=15
5. (a) What are the features of companies registered under section 8 of the Companies Act, 2013?
- (b) Discuss the provisions of the Companies Act, 2013 regarding issue of bonus shares. 7+8=15
6. (a) Discuss the powers of the Board of Directors of a company as per the Companies Act, 2013.
- (b) Enumerate the provisions of the Companies Act, 2013 relating to women director in a company. 10+5=15
7. (a) Discuss the nature and relevance of Ethics to the Business.
- (b) Mr. Gill, an employee of M/s Sonabheel Tea Ltd., continued to occupy the quarter of the company for eight months after superannuation, company decided to forfeit the amount of gratuity of Mr. Gill. Examine the decision taken by the company to forfeit the amount of gratuity in the light of the Payment of Gratuity Act, 1972. 10+5=15
8. Write short notes on any three of the following terms: 5×3=15
- (a) E-Contracts
- (b) Small Companies
- (c) Improving ethical behaviour in business
- (d) 'Overtime' under Minimum Wages Act, 1948



**INTERMEDIATE EXAMINATION  
June 2018**

**P-6(LNE)  
Syllabus 2016**

**Laws & Ethics**

Time Allowed: 3 Hours

Full Marks: 100

The figures in the margin on the right side indicate full marks.

This question paper has two Sections A and B.

Both the Sections are to be answered subject to instructions given against each.

Wherever necessary, candidates may make appropriate assumptions and clearly state them.

**SECTION - A**

Section A contains Question No. 1. All parts of this question are compulsory.

1. Answer all the following questions:

(a) Choose the correct answer from the given alternatives (you may write only the Roman numeral and the alphabet chosen for your answer): 1x10=10

(i) The main feature of e-contract is

- (a) Cost and acceptability
- (b) Purity and clarity
- (c) Speed, accurate and reliable
- (d) Perfection and attractive

(ii) Which of the following is not an unpaid seller's right against the goods?

- (a) The right of retention
- (b) The right of stoppage in transit
- (c) The right of seeking claim for damage
- (d) The right of resale

(iii) Where the endorser does not want that the endorsee or any other holder to incur any expense on his account is called

- (a) Restrictive endorsement
- (b) Sans frais endorsement
- (c) Conditional endorsement
- (d) Unwanted endorsement

(iv) The liability of the partners will continue for the acts done before the dissolution, even after the dissolution, until

- (a) Public notice is given of the dissolution
- (b) Partners are getting the final payment
- (c) Claim is demanded by the creditors
- (d) The death of partners



- (v) Every employee shall be entitled to receive bonus from his employer in an accounting year if he has worked for not less than
- (a) Ten working days
  - (b) Twenty working days
  - (c) Thirty working days
  - (d) Forty working days
- (vi) Under Employee's State Insurance Act, 1948, the term of the office of the members of Medical Benefit Council shall be
- (a) 2 Years
  - (b) 4 Years
  - (c) 5 Years
  - (d) 10 Years
- (vii) 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
- (viii) The appointment of an independent director shall be approved by the
- (a) Board meeting
  - (b) General meeting
  - (c) Registrar of Companies
  - (d) Central Government
- (ix) The sweat equity shares shall be locked in for a period of \_\_\_\_\_ years from the date of allotment.
- (a) One
  - (b) Two
  - (c) Three
  - (d) Four
- (x) 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



(b) Match the statement in column I with the most appropriate statement in Column II:

1x5=5

	Column I		Column II
1.	Legal Representative of the contractor	(A)	Welfare measures taken in a factory.
2.	Where the seller makes a false representation and buyer relies on it.	(B)	Certificate of incorporation.
3.	Creches	(C)	Extract of the annual return of a company.
4.	MGT-9	(D)	Exception to the Doctrine of Caveat Emptor.
5.	Form No. INC-11	(E)	He who is not the Principal Employer.

(c) State whether the following statements are True or False (you may write only the Roman numeral and whether True or False without copying the statements into the answer books):

1x5=5

- (i) Gratuitous bailment continues even after the death of either of the bailor or bailee.
- (ii) A holder is not having right to duplicate of lost bill, before it is overdue.
- (iii) Fine may be recovered from the employed person by installments
- (iv) Share certificate is a negotiable instrument.
- (v) The businessmen who do not follow business ethics will have short term success, but they will fail in the long run.

(d) Fill in the blanks suitably (you may write only the Roman numeral and the content filling the blanks):

1x5=5

- (i) The liability of surety arises only when the principal debtor fails to pay the debt to the \_\_\_\_\_.
- (ii) Goods to be manufactured or produced or acquired by the seller after making of the contract of sale is called \_\_\_\_\_ good.
- (iii) If there is a dispute as to the amount of gratuity payable to the employee, the employer shall deposit the gratuity with the \_\_\_\_\_.
- (iv) The time limit for registration of charge is \_\_\_\_\_ days from the date of creation of charge.
- (v) The ethical operation of a company is directly related to \_\_\_\_\_ in both short and long term.

### SECTION – B

**Answer any five questions from question numbers 2 to 8**

**Each question carries 15 marks.**

15x5=75

2. (a) Mr. X, a businessman has been fighting a long drawn litigation with Mr. Y, another businessman. To support his legal campaign Mr. X enlists the services of Mr. Z, a legal expert, stating that an amount of ₹ 10 lakhs would be paid, if Mr. Z does not take up the brief of Mr. Y. Mr. Z agrees, but at the end of the litigation Mr. X refuses to pay.

Decide whether Mr. Z can recover the amount promised by Mr. X under the provisions of the Indian Contract Act, 1872.

- (b) State the circumstances when an agent is personally liable for the contracts entered into by him on behalf of the principal?

5+10=15



3. (a) M/s. Tea Enterprises agreed to supply 2,200 Kgs. of Tea to M/s. Gopal Enterprises at ₹ 1,200/- per Kg. by 30th April, 2018. On 1st March, 2018 M/s. Tea Enterprises informs Gopal Enterprises that they are not willing to supply the Tea as the price of Tea increased to ₹ 1,400/- per Kg. Examine the right of M/s. Gopal Enterprises.
- (b) Anil draws a bill of exchange payable to himself on Sushil, who accepts the bill without consideration just to accommodate Anil. Anil transfers the bill to Ajay for good consideration.

State the rights of Anil and Ajay. Would your answer be different if Anil transferred the bill to Ajay after maturity? 8+7=15

4. (a) Critically examine the duties of certified surgeon under the Factories Act, 1948.
- (b) Enumerate the Central Record Keeping Agency under Pension Fund Regulatory and Development Act 2013? 8+7=15

5. (a) Discuss the procedure for conversion of private company into One Person Company.
- (b) What are the procedures of sending notice through electronic mode under the Companies Act, 2013? 7+8=15

6. (a) Discuss the provisions of the Companies Act, 2013 regarding disqualifications for appointment of director.
- (b) "Directors are agents of the company." — Discuss. 10+5=15

7. (a) What are the areas in business ethics? Write a note of the same.
- (b) Kelson Limited has two separate units at Delhi and Mumbai in India. Every unit of the said company prepares and maintains separate Balance Sheet and Profit and Loss Account. Delhi unit is incurring continuous losses and hence bonus is not paid to the employees of this unit.

Decide, under the Payment of Bonus Act, 1965 whether the employees of the said unit can claim bonus on the ground that the unit incurring loss is a part of one single establishment? 10+5=15

8. Write short notes on any three of the following terms: 5×3=15
- (a) Undue Influence
- (b) Alteration of Share Capital
- (c) Consumer movement and Ethics
- (d) Manufacturing process under the Factories Act, 1948.

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