PRACTICE MANUAL

Intermediate (IPC) Course

PAPER : 2

BUSINESS LAWS, ETHICS AND COMMUNICATION

VOLUME – II

BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

This practice manual has been prepared by the faculty of the Board of Studies. The objective of the practice manual is to provide teaching material to the students to enable them to obtain knowledge and skills in the subject. Students should also supplement their study by reference to the recommended text books. In case students need any clarifications or have any suggestions to make for further improvement of the material contained herein, they may write to the Director of Studies.

All care has been taken to provide interpretations and discussions in a manner useful for the students. However, the practice manual has not been specifically discussed by the Council of the Institute or any of its Committees and the views expressed herein may not be taken to necessarily represent the views of the Council or any of its Committees.

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A WORD ABOUT PRACTICE MANUAL

The Board of Studies, the academic wing of the Institute of Chartered Accountants of India has been taking proactive initiatives in imparting the distance education to the students pursuing the Chartered Accountancy Course. Keeping in view of the requirements of the curriculum, the time available with the students, integration of training vis-à-vis industrial expectation, it is necessary that students should have a holistic learning and not a mere rote learning. CA students have a wide choice in learning the subject through the mode of text books, study modules, compilation of answers to the past years examination questions, revisionary test papers, supplementary study material on the subject updates, teleconference classes and other reference inputs. Despite the various options, it is found that when it comes to the examination requirements, most of them do not come to the expectation level even though students have put in their best efforts. There may be several causes as to their performance in the examination and it is therefore necessary that a student from the very beginning of his career need to know as to what is the best way of approaching the examination.

The plan, preparation and proceeding with each of the subject differ widely and therefore one should customize his study accordingly. At the Intermediate (IPC) level, Paper-2 deals with Business Laws, Ethics and Communication, where the level of knowledge prescribed is that of 'Working knowledge'. The paper consists of three parts, Part I relating to Business Laws carrying a weightage of 60 marks with the objective that students are 'able to analyze and apply various provisions of the Business Laws constituting the Indian Contract Act,1872, the Negotiable Instruments Act,1881,the Payment of Bonus Act,1965,the Employees' Provident Funds and Miscellaneous Provisions Act,1952,the Payment of Gratuity Act,1972 and the Companies Act, 1956 in practical situations' . Part II relating to Ethics carrying weightage of 20 marks dealing with issues relating to business ethics and the objective is 'to have understanding of ethical issues in business'. Part III consisting of Communication carrying weightage of 20 marks including the communication in general, in business environment along with the drafting of simple deeds and documents relating to business. Accordingly, preparation should be proceeded with care, concern and caution.

The study material serves as a basic input for the subject and the student's study is complete when he synchronizes with other related publications of the institute as mentioned above. It is in this context, the Board of Studies thought it fit that there should be a common material which should provide him all the inputs at one place and for this purpose, a new avatar of study requirements have been introduced for the benefit of students community, which is known as 'Practice Manual'.

What is Practice Manual?

As the name suggests, that examination is an art, where you require constant practice in solving as many problems as possible. After studying the basic study material, a student has to synchronize it with examination. It is in this context, the Practice Manual will fill up the gap. As the name suggests, the practice manual contains lot of solved questions and some practical exercises with

hints wherever necessary. It is in fact a compilation of various practical problems whether it is from past years or practical or based on amendments in relevant laws and other problems culled from different sources. As compared to the study material, this practice manual proceeds with the subject from beginning to end. In other words, since it is a law subject, chapterization in this Practice Manual has been done topic-wise as given under the study material. You will come across definition clauses, important provisions which have bearing on application and interpretation and so forth. By this method of study you will know the genesis of

- The analysis part
- The application part
- The interpretation part
- The judgement part
- The sequence part
- The logical part
- The clarity part
- The concise part
- The secretarial part
- And above all the conclusion part.

Contents of Practice Manual

This practice manual is segregated into 19 Chapters dealing with the Business Laws starting from Chapter on the Indian Contract Act,1872 and ending with Chapter on the Companies Act,1956. Besides there is a chapter on Ethics and Communication. All the questions given in the practice manual goes topic -wise that have been arranged and given in the respective study material. Before reading the question, remember the sequence of the chapter in the study material and its subject-matter. This will help you in not only having a grasp of the subject, your grip in the subject will ultimately be reflected. Problems have been carefully chosen from various sources so that you come across different application and its implication in practical situations.

This revised Practice Manual contains the questions and answers of 2012(May & November) attempts as well updations in relevance to the answer as per the recent amendments made in the law. Any kind of modification or changes carried out in the Practice Manual are laid down in the bold italics, for the making out the difference.

Your valuable suggestions

All steps have been taken to make reading of practice manual, resourceful and useful. Since amendments in law are a continuous process, we endeavor to update the answers in tune with the changes wherever necessary. In case if you have any suggestions for fine tuning, mail us at nisha.gupta@icai.in , megha.goel@icai.in or shradhha.saxena@icai.in

To end

Remember the words of Sir Francis Bacon, 'Reading maketh a full man, Conference a ready man, and Writing an exact man. We hope the Practice Manual will facilitate the students in understanding where they lack in their self-study and steps to overcome them. Read the practice manual wholly with diligence and attention.

We wish you a resourceful reading and good luck .

Happy Reading and Best Wishes!

Paper – 2: Business Laws, Ethics and Communication

Statement showing topic-wise distribution of Examination Questions along with Marks

Topics		Term of Examination										Total Marks	Avg. Marks
		May 2010		Nov. 2010		May 2011		Nov. 2011		May 2012			
No.	Chapter Name	Q	M	Q	M	Q	M	Q	M	Q	M		
1	The Indian Contract Act, 1872	1(c)(i) 1(a) 1(b)(ii) 1(c)(ii)	1 5 1 1	1(b)(II)(iii) 1(b)(I)(ii) 1(b)(I)(i) 1(b)(II)(i) 1(b)(II)(ii) 1(a)	1 1 1 1 1 5	1(b)(I)(i) 1(b)(II)(i) 1(a) 1(b)(II)(ii) 1(b)(II)(iii)	1 1 5 1 1	1(a), 3(a), 6(c)(i), 6(c)(ii)	5 8 1 1	1(a) 3(a) 6(c)(i) 6(c)(ii)	5 8 1 1	57	11.4
2	The Negotiable Instruments Act,1881	1(c)(iii) 3	1 5	5(a)	8	1(b)(I)(ii) 5(a)	1 8	5(a)	8	5(a)	8	39	7.8
3	The Payment of Bonus Act, 1965	1(b)(i) 4	1 5	2(a)	8	2(a)	8	2(a)(i),	4	2(a)(i)	4	30	6.0
4	The Employees' Provident Funds and Miscellaneous Provisions Act,1952	5	5	7(a)	4	7(a)	4	7(a)	4	7(a)	4	21	4.2
5	The Payment of Gratuity Act,1972	6	5	3(a)	8	3(a)	8	2(a)(ii)	4	2(a)(ii)	4	29	5.8
6	The Companies Act,1956												
	Preliminary	2(a) 2(c)(i) 8	5 1 8	7(b)	4	1(c) 1(d) 6(a) 7(b)	5 5 8 4	4(a), 5(b) 6(c)(iii) 6(c)(iv), 7(b)	8 4 1 1 4	4(a) 6(a) 6(c)(iii)	8 8 1	75	15
	Prospectus	2(c)(ii)	1	1(c)	5	7(b)	4	1(b),	5	6(c)(iv)	1	35	7

				1(d)(I)(i) 1(d)(I)(ii) 1(d)(II)(iii) 4(a) 7(b)	1 1 1 8 4			6(a), 7(c)	8 4	7(b)	4		
	Shares & Share Capital	2(b)(i) 7	1 5			4(a)	8			1(b) 5(b)	5 4	23	4.6
	Meetings	2(b)(ii) 2(c)(iii) 9 10	1 1 5 5	1(d)(I)(i) 1(d)(II)(ii) 6(a)	1 1 8					7(c)	4	26	5.2
7	Principles of Business Ethics			2(b) 3(b) 5(b)(ii)	4 4 2			2(b)	4			14	2.8
8	Corporate Governance and Corporate Social Responsibility	11(a) 13(i)	2 ½ 2 ½	7(c)	4	5(b)(i)	2	3(b) 7(d)	4 4	7(d)	4	23	4.6
9	Workplace Ethics			4(b) 7(c)	4 4	2(b) 6(b)	8 4	4(b)	4	1(c)(1) 1(c)(2) 4(b)	2 ½ 2 ½ 4	33	6.6
10	Environment and Ethics	11(b) 13(ii)	2 ½ 2 ½	5(b)(i)	2	5(b)(ii) 7(c)	2 4	1(c)(2)	2 ½	3(b)	4	19 ½	3.9
11	Ethics in Marketing and Consumer Protection			6(b)	4			1(c)(1) 6(b)	2 ½ 4	2(b)	4	14 ½	2.9
12	Ethics in Accounting and Finance	12	5			4(b) 7(c)	4 4			7(e)	4	17	3.4
13	Essentials of communication			4(c) 7(d)	4 4	4(c) 5(c) 7(d)	4 4 4	3(c) 5(c) 7(e)	4 4 4	1(d) 3(c) 5(c)	5 4 4	45	9
14	Interpersonal communication	14(a)	5	6(c)	4	3(b)	8	2(c)	4	4(c)	4	25	5

	skills												
15	Group Dynamics					6(c) 7(d)	4 4	4(c)	4			12	2.4
16	Communication Ethics							1(d)	5	2(c)	4	9	1.8
17	Communicating Corporate Culture, Change and Innovative			5(c)	4							4	0.8
18	Communication in Business Environment	14(b)	5									5	1
19	Basic understanding of Legal deeds and Documents	15 16	5 5	2(c) 7(d)	4 4					6(b)	4	22	4.4

Note: 'Q' represents question numbers as they appeared in the question paper of respective examination. M represents the marks which each question carries.

The question papers of all the past attempts of IPCC can be accessed from the BOS Knowledge Portal on the Institute's website www.icai.org.

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1

The Indian Contract Act, 1872

UNIT – 1: BACKGROUND

What is a contract?

Question 1

Define Contract?

Answer

An agreement which is legally enforceable is a contract. Agreements which are not legally enforceable are not contracts but remain as void agreements or as voidable agreements which are enforceable by only one of the parties to the agreement.

Question 2

Ram invites Madhuri (a well-known film actress) to his daughter's engagement and dinner party. Madhuri accepts the invitation and promised to attend. Ram made special arrangements for Madhuri at the party but she did not turn up. Ram enraged with Madhuri's behaviour, wanted to sue for the loss incurred in making special arrangements. Ram is seeking your advice.

Answer

No. 'Ram" cannot sue 'Madhuri' for his loss. Because the agreement was a kind of social nature and lacked the intention to create legal relationship.

Question 3

State with reason whether there is any contract made in the following case as per the Indian Contract Act, 1872:

"J accepts an invitation to dinner but fails to attend"

Answer

There is no contract in this case as the parties do not intend that the contract should be attended by legal consequences.

Question 4

Cash is withdrawn by the customer of a bank from the automatic teller machine is an example of:

(a) Express contract *(b) Void contract*

(c) Tacit contract *(d) Illegal contract.*

Answer

Answer (c). Reason: Tacit Contracts are those that are inferred through the conduct of parties. Hence, this is a tacit contract.

Essentials of Valid Contract

Question 5

'All contracts are agreements, but all agreements may not be contracts'.

Answer

Correct

Question 6

Father promised to pay his son a sum of ₹ one lakh if the son passed C.A. examination in the first attempt. The son passed the examination in the first attempt, but father failed to pay the amount as promised. Son files a suit for recovery of the amount. State along with reasons whether son can recover the amount under the Indian Contract Act, 1872.

Answer

Problem asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in section 10. According to the provisions there should be an intention to create legal relationship between the parties. Agreements of a social nature or domestic nature do not contemplate legal relationship and as such are not contracts, which can be enforced. This principle has been laid down in the case of *Balfour vs. Balfour (1912 2 KB. 571).* Accordingly, applying the above provisions and the case decision, in this case son cannot recover the amount of ₹ 1 lakh from father for the reasons explained above.

Proposal/Offer

Question 7

Define an offer. Explain the rules of an offer. How an offer is different from an invitation to offer?

Answer

Definition: The word Proposal and offer are used interchangeably and it is defined under Section 2(a) of the Indian Contract Act, 1872 as 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.

Rules: The following are important rules of an offer: -

- Must be capable of creating legal relation.

- Must be certain, definite and not vague.
- May be expressed or implied.
- May be general or specific.
- Must be communicated.

Offer and an Invitation to an offer: An offer is definite and capable of converting an intention into a contract. Where as, an invitation to an offer is only a circulation of an offer, it is an attempt to induce offerer to precedes for a definite offer. Acceptance of an invitation to an offer does not result contract and only an offer emerges in the process of negotiation.

Question 8

State with reason whether there is any contract made in the following case as per the Indian Contract Act, 1872:

"J takes a seat in public bus"

Answer

As per Section 9 of the Indian Contract Act, 1872, in this case there is an implied offer to public at large by the transport company to carry passengers from one destination to another. When J takes a seat in the bus, there is an implied acceptance of the offer on his part, and there comes into existence a valid contract.

Question 9

State with reason whether there is any contract made in the following case as per the Indian Contract Act, 1872:

"J tells M that N has expressed his willingness to marry her (M)".

Answer

In the instant case, there is no contract as the essential element of communication of offer by one party and its acceptance by the other party is missing.

Question 10

State with reason whether there is any contract made in the following case as per the Indian Contract Act, 1872:

"J bids at a public auction"

Answer

Bidding at a public auction just amounts to an offer by the bidder and till it is accepted by the auctioneer by some customary method, as fall of hammer, no concluded contract comes into existence.

Question 11

State with reason whether there is any contract made in the following case as per the Indian Contract Act, 1872:

"J puts three one rupee coins in the slot of a platform ticket vending machine at the Railway Station"

Answer

In this case there comes into existence a valid contract as soon as J puts three one rupee coins in the slot of the ticket vending machine. This amounts to acceptance on the part of J, of an implied offer by the owner of the ticket vending machine.

Question 12

What is invitation to offer?

Answer

An invitation to offer is an act precedent to making an offer. It is done with intent to generally induce and negotiate. An invitation to offer gives rise to an offer after due negotiation and it cannot be per se accepted.

In an invitation to offer there is no expression of willingness by the offeror to be bound by his offer. It is only a proposal of certain terms on which he is willing to negotiate. It is not capable of being accepted as it is.

Question 13

Shambhu Dayal started "self service" system in his shop. Smt. Prakash entered the shop, took a basket and after taking articles of her choice into the basket reached the cashier for payments. The cashier refuses to accept the price. Can Shambhu Dayal be compelled to sell the said articles to Smt. Prakash? Decide.

Answer

Invitation to offer

The offer should be distinguished from an invitation to offer. An offer is the final expression of willingness by the offeror to be bound by his offer should the party chooses to accept it. Where a party, without expressing his final willingness, proposes certain terms on which he is willing to negotiate, he does not make an offer, but invites only the other party to make an offer on those terms. This is the basic distinction between offer and invitation to offer.

The display of articles with a price in it in a self-service shop is merely an invitation to offer. It is in no sense an offer for sale, the acceptance of which constitutes a contract. In this case, Smt. Prakash by selecting some articles and approaching the cashier for payment simply made an offer to buy the articles selected by her. If the cashier does not accept the price, the interested buyer cannot compel him to sell. [*Fisher V. Bell (1961) Q.B. 394 Pharmaceutical society of Great Britain V. Boots Cash Chemists].*

Question 14

What are the circumstances under which an offer gets revoked or lapses?

Answer

An offer may come to an end by revocation, lapse, or rejection.

Revocation or lapse of offer. Section 6 deals with various modes of revocation of offer. According to it, an offer is revoked-

By communication of notice of revocation by the offeror at any time before its acceptance is complete as against him [Section 6(1)].

By lapse of time if it is not accepted within the prescribed time. If however, no time is prescribed, it lapses by the expiry of a reasonable time [Section 6(2)].

By non-fulfillment by the offeree of a condition precedent to acceptance [Section6(3)].

By death or insanity of the offeror provided the offeree comes to know of it before acceptance [Section 6(4)].

If he accepts an offer in ignorance of the death or insanity of the offeror, the acceptance is valid. In addition to the above cases dealt with in Section 6, an offer is also revoked, if a counter-offer is made to it [*U.P State Electricity Board v. Goel Electric Stores., A.I.R (1977) All. 494, 497*]. Where an offer is accepted with some modification in the terms of the offer or with some other condition not forming part of the offer, such qualified acceptance amounts to a counter-offer. An offeree agreed to accept half the quantity of goods offered by the offeror on the same terms and conditions as would have applied to the full contract. Held, there was no contract as there was counter-offer to the offer [*Tinn v. Hoffman, (1873) 29 L.T. 71*].

If an offer is not accepted according to the prescribed or usual mode, provided the offeror gives notice to the offeree within a reasonable time that the acceptance is not according to the prescribed or usual mode. If the offeror keeps quiet, he is deemed to have accepted the acceptance [Section7(2)].

If the law is changed. An offer comes to an end if the law is changed so as to make the contract contemplated by the offer illegal or incapable of performance. An offer can however be revoked subject to the following rules:

(1) It can be revoked at any time before its acceptance is complete as against the offeror.

(2) Revocation takes effect only when it is communicated to the offeree.

(3) If the offeror has agreed to keep his offer open for a certain period, he can revoke it before the expiry of that period only-

  (a) If the offer has in the meantime not been accepted, or

  (b) If there is no consideration for keeping the offer open.

Acceptance

Question 15

State whether the following statement is correct or incorrect:

A specific offer can be accepted only by that person to whom offer has been made.

Answer

Correct

Question 16

A sends an offer to B to sell his second-car for ₹ 40,000 with a condition that if B does not reply within a week, he (A) shall treat the offer as accepted. Is A correct in his proposition? What shall be the position if B communicates his acceptance after one week?

Answer

Acceptance to an offer cannot be implied merely from the silence of the offeree, even if it is expressly stated in the offer itself. Unless the offeree has by his previous conduct indicated that his silence amount to acceptance, it cannot be taken as valid acceptance. So in the given problem, if B remains silent, it does not amount to acceptance.

The acceptance must be made within the time limit prescribed by the offer. The acceptance of an offer after the time prescribed by the offeror has elapsed will not avail to turn the offer into a contract. (*Ramsgate Victoria Hotel (v) Montefiore*).

Question 17

Examine what is the legal position, as to the following :

(i) M offered to sell his land to N for ₹ 28,000/-. N replied purporting to accept the offer and enclosed a cheque for ₹ 8,000/-. He also promised to pay the balance of ₹ 20,000/- in monthly installments of ₹ 5,000/- each.

(ii) A offered to sell his house to B for ₹ 10000/-. B replied that he can accept the house for only ₹ 8,000/-. A rejected B's counter offer to buy the house for ₹ 8,000/-. B later changed his mind and is now willing to buy the house for ₹ 10,000/-.

Answer

To conclude a contract between the parties, the acceptance must be communicated in some perceptible form. Any conditional acceptance or acceptance with varying or too deviant conditions is no acceptance. Such conditional acceptance is a counter proposal and has to be accepted by the proposer, if the original proposal has to materialize into a contract. Further when a proposal is accepted, the offeree must have the knowledge of the offer made to him. If he does not have the knowledge, there can be no acceptance. The acceptance must relate specifically to the offer made. Then only it can materialize into a contract. With the above rules in mind, we may note that the following is the solution to the given problems:

(i) It is not a valid acceptance and no contract can come into being. In fact this problem is similar to the facts of *Neale vs. Merret [1930] W.N 189*, where M offered to sell his land to N for ₹ 28,000/-. N replied purporting to accept the offer but enclosed a cheque for ₹ 8,000/- only. He promised to pay the balance of ₹ 20,000 by monthly installments of ₹ 5,000. It was held that N could not enforce his acceptance because it was not an unqualified one.

(ii) This problem is similar to the facts of *Union of India v. Bahulal (AIR 1968 Bombay 294)* case, wherein A offered to sell his house to B for ₹ 10,000/-, to which B replied that, "I can pay ₹ 8,000 for it". Consequently, the offer of 'A' is rejected by 'B' as the acceptance is not unqualified. But when B later changes his mind and is prepared to pay ₹ 10,000/-, it becomes a counter offer and it is up to A whether to accept it or not.

Question 18

Explain in brief the rules relating to 'Acceptance' of an offer under the provisions of the Indian Contract Act, 1872.

Answer

Following are the general rules regarding acceptance under the Indian Contract Act, 1872.

(i) Acceptance must be absolute and unqualified. As per section 7 of the Act, acceptance is valid only when it is absolute and unqualified or unconditional.

(ii) Acceptance must be in the prescribed manner. If the offer is not accepted in the prescribed manner, then the offeror may reject the acceptance within a reasonable time.

(iii) Acceptance must be communicated to the offeror. If acceptance is communicated to the person, other than the offeror, it will not create any legal relationship. Thus, to conclude a contract between the parties, the acceptance must be communicated in some perceptible form.

(iv) Acceptance must be given by the party to whom the offer is made.

(v) Acceptance must be given within the prescribed time or within a reasonable time.

(vi) Acceptance cannot be given before communication of an offer

(vii) Acceptance must be made before the offer lapses or is withdrawn.

(viii) Acceptance must show intention to fulfill the promise.

(ix) Acceptance cannot be presumed from silence

(x) Acceptance by conduct/performance of condition : Acceptance may also be by performance of some condition / act as required by the Offeror.

Revocation of offer and acceptance

Question 19

Ramaswami proposed to sell his house to Ramanathan. Ramanathan sent his acceptance by post. Next day, Ramanathan sends a telegram withdrawing his acceptance. Examine the validity of the acceptance in the light of the following:

(i) The telegram of revocation of acceptance was received by Ramaswami before the letter of acceptance.

(ii) The telegram of revocation and letter of acceptance both reached together.

Answer

The problem is related with the communication and time of acceptance and its revocation. As per Section 4 of the Indian Contract Act, 1872, the communication of an acceptance is a complete as against the acceptor when it comes to the knowledge of the proposer.

An acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards.

Referring to the above provisions

(i) Yes, the revocation of acceptance by Ramanathan (the acceptor) is valid.

(ii) If Ramaswami opens the telegram first (and this would be normally so in case of a rational person) and reads it, the acceptance stands revoked. If he opens the letter first and reads it, revocation of acceptance is not possible as the contract has already been concluded.

Question 20

X offered to sell his house to Y for ₹ 50,000. Y accepted the offer by E-mail. On the next day Y sent a fax revoking the acceptance which reached X before the E-mail. Is the revocation of acceptance valid? Would it make any difference if both the E-mail of acceptance and the fax of revocation of acceptance reach X at the same time?

Answer

Yes, the revocation of acceptance is valid because the acceptor may revoke his acceptance at any time before the letter of acceptance reaches the offeror. If the letter of acceptance (E-mail) and the Fax of revocation of acceptance reach X at the same time, the formation of contract will depend on the fact that which of the two is opened first by X. If X reads the Fax letter first, revocation is valid but if he reads the E-mail first, revocation is not possible.

Question 21

State whether the following statements are correct or incorrect:

A proposal may be revoked by the proposer before the posting of the letter of acceptance by the acceptor.

Answer

A proposal may be revoked by the proposer before the posting of the letter of acceptance by the acceptor. This statement is correct

EXERCISE

1. *A father and daughter agrees to go for a morning walk every day. Is there any agreement in the following case?*

   [Hint: No, it is a social agreement]

2. *X offers to donate ₹ 5,000 to a orphanage. The orphanage accepts the offer. Can it recover the amount?*

   [Hint: No, as the agreement is without consideration and hence void]

3. *A sends his servant to trace his missing nephew. In the mean time A announced a reward of ₹ 1000 who traces his nephew. The servants traces the nephew. Can servant claim for the reward?*

   [Hint: No, as communication of offer was not there]

4. *Though a void contract is valid when it is made, subsequently it becomes unenforceable. Why?*

   [Hint: Because of subsequent illegality]

5. *A voidable contract is voidable at the option of the aggrieved party and remains valid until rescinded by him. Is it correct?*

   [Hint: Yes]

6. *There is a contract to commit crime, what type of contract is this?*

   [Hint: Illegal Contract]

7. *When in a contract due to technical defects, one or both the parties cannot sue upon it, the contract is called* ---------

   [Hint: Unenforceable contract]

UNIT – 2: CONSIDERATION

What is consideration?

Question 1

Explain the term 'Consideration'?

Answer

The expression 'consideration' has to be understood as a price paid for an obligation. In *curie vs misa 1875 10 Ex 130* is was held (in UK) that consideration is "some right, interest, profit or benefit accruing to one party or forbearance, detriment, loss, or responsibility given, suffered or under taken by the other". The judgment thus refers to the position of both the promisor, and the promisee in an agreement.

Section 2 (d) of the Indian Contract Act,1872 defines 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 abstain from doing something, such an act or abstinence or promise is called consideration for the promise".

Question 2

Whether gratuitous promise can be enforced?

Answer

The word 'gratuitous' means 'free of cost' or 'without expecting any return'. It can therefore be inferred that a gratuitous promise will not result in an agreement in the absence of consideration. For instance a promise to subscribe to a charitable cause cannot be enforced.

Question 3

State whether the following contract can be enforced.

"Where an orphanage wishes to enforce a promise made by a philanthropist to donate a specified sum".

Answer

A gratuitous promise such as a promise to donate money lacks consideration and cannot be enforced.

Legal requirements regarding consideration

Question 4

Mr. Singh, an old man, by a registered deed of gift, granted certain landed property to A, his daughter. By the terms of the deed, it was stipulated that an annuity of ₹ 2, 000 should be paid every year to B, who was the brother of Mr. Singh. On the same day A made a promise to B and executed in his favour an agreement to give effect to the stipulation. A failed to pay the

stipulated sum. In an action against her by B, she contended that since B had not furnished any consideration, he has no right of action.

Examining the provisions of the Indian Contract Act, 1872, decide, whether the contention of A is valid?

Answer

Problem as asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in section 2(d) and on the principle 'privity of consideration'. Consideration is one of the essential elements to make a contract valid and it can flow from the promisee or any other person. In view of the clear language used in definition of 'consideration' in Section 2(d) "…. the promisee or any other person…..", it is not necessary that consideration should be furnished by the promisee only. A promise is enforceable if there is some consideration for it and it is quite immaterial whether it moves from the promisee or any other person. The leading authority in the decision of the *Chinnaya Vs. Ramayya (1882) 4 Mad 137*., held that the consideration can legitimately move from a third party and it is an accepted principle of law in India.

In the given problem, Mr. Singh has entered into a contract with A, but Mr. B has not given any consideration to A but the consideration did flow from Mr. Singh to A and such consideration from third party is sufficient to the enforce the promise of A, the daughter, to pay an annuity to B. Further the deed of gift and the promise made by A to B to pay the annuity were executed simultaneously and therefore they should be regarded as one transaction and there was sufficient consideration for it.

Thus, a stranger to the contract cannot enforce the contract but a stranger to the consideration may enforce it.

Question 5

Comment on 'To form a valid contract, consideration must be adequate''.

Answer

The law provides that a contract should be supported by consideration. So long as consideration exists, the Courts are not concerned to its adequacy, provided it is of some value. The adequacy of the consideration is for the parties to consider at the time of making the agreement, not for the Court when it is sought to be enforced (*Bolton v. Modden*). Consideration must however, be something to which the law attaches value though it need not be a equivalent in value to the promise made.

According to Explanation 2 to Section 25 of the Indian Contract Act, 1872, 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.

Suit by a Third Party

Question 6

X transferred his house to his daughter M by way of gift. The gift deed, executed by X, contained a direction that M shall pay a sum of ₹ 5,000 per month to N (the sister of the executor). Consequently M executed an instrument in favour of N agreeing to pay the said sum. Afterwards, M refused to pay the sum to N saying that she is not liable to N because no consideration had moved from her. Decide with reasons under the provisions of the Indian Contract Act, 1872 whether M is liable to pay the said sum to N.

Answer

As per Section 2 (d) of the Indian Contract Act, 1872, in India, it is not necessary that consideration must be supplied by the party, it may be supplied by any other person including a stranger to the transaction.

The problem is based on a case *"Chinnaya Vs. Ramayya"* in which the Court clearly observed that the consideration need not necessarily move from the party itself, it may move from any person. In the given problem, the same reason applies. Hence, M is liable to pay the said sum to N and cannot deny her liability on the ground that consideration did not move from N.

Question 7

State whether the following contract can be enforced.

Where there is a family settlement in writing and a family member who is not a party to the settlement wishes to enforce his claim.

Answer

As per the judgment in *Shuppu Vs Subramanian 33 Mad. 238*, a family settlement in writing, may be enforced by a member of the family who was not a party to the settlement.

Validity of an agreement without consideration

Question 8

State whether the following contract can be enforced.

"An agreement to create an agency, in which consideration is absent."

Answer

According to Section 185, of the Indian Contract Act,1872 an agreement creating an agency though devoid of consideration, is valid and can be enforced.

Question 9

What do you understand by the term 'Consideration'? Are there any circumstances under which a contract, under the provisions of the Indian Contract Act, 1872, without consideration is valid? Explain.

Answer

Meaning of consideration: The expression 'consideration' in general means price paid for an obligation. According to Section 2 (d) of the Indian Contract Act, 1872 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 abstain from doing something, such an act or abstinence or promise is called consideration for the promise. Thus, on analyzing the above definition, the following ingredients are essential in understanding the meaning of the term consideration :-

(i) An act i.e. doing something

(ii) An abstinence or forbearance i.e. abstaining or refraining from doing something, and

(iii) A return promise.

The general rule is that an agreement made without consideration is void. Sections 25 and 185 of the Indian Contract Act, 1872, provide for exceptions to this rule where an agreement without consideration is valid. These are :

(1) Love & Affection [Section 25 (1)]

Where an agreement 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 the parties standing in near relation to each other, the agreement is enforceable, even through, the consideration is absent.

(2) Compensation for voluntary service [Section 25 (2)]

A promise to compensate, wholly or in part, a person who has already voluntarily done something for the promissor, is enforceable even without consideration.

(3) Promise to pay, a time – barred Debt [Section 25 (3)]

The agreement is valid provided it is made in writing and is signed by the debtor or by his agent authorized in that behalf.

(4) Completed Gift – [Explanation 1 to Section 25]

As per explanation 1 to section 25, nothing in section 25 shall affect the validity as between donor and donee, on any gift actually made.

(5) Agency (Section 185)

No consideration is necessary to create an agency.

EXERCISE

1. *A fire broke out in X's house. He offered to pay an amount of ₹ 5,000 to anyone who brought out his trapped son Y safe. A fireman brought out Y alive. Is X bound to pay?*

   [Hint: Yes, the fireman had done more than what his official duty demanded]

2. *R owed to M ₹ 5,000. The debt was barred by the Limitation Act. R signed a written promise to pay ₹ 2,000 to M on account of this debt. Can M claim it?*

   [Hint: Yes, as per Section 25(3) of the Indian Contract Act,1872]

3. *R gave his property to his uncle in return of her promise that she would pay ₹ 2000 P.M. to her uncle all his life. Later, she refused to pay. Can uncle recover money from him?*

   [Hint: No, because she gave no promise to the uncle]

4. *Study the following example and answer the questions.*

   (i) A promises to sell his house to B for ₹ 5,00,000/- Here who is the promisor and who is the promisee?

   (ii) B agrees to buy a house from A for ₹ 5,00,000/- Here who is the promisor and who is the promisee?

   [Hints: (i) A (Promisor), B(Promisee)], (ii) B(Promisor), A(Promisee)]

5. *A pays ₹ 5000/- requesting B to deliver certain quantity of rice to which B agrees. What is the position of consideration as "executed" or "executory" regarding A and B?*

   [Hints: For 'A' executed & for 'B' executory]

6. *While a third party to consideration can sue, a third party to a contract cannot sue. In the case of family settlement, if the terms of settlement are reduced in writing, members of the family who were not a party to the settlement can also enforce the claim. Is it correct?*

   [Hints: Yes, it is an exception given under Para 1.11 of the study module]

7. *Should consideration be adequate to the value of the promise?*

   [Hints: No, as per the Para 1.10 point (v) of the study module]

UNIT – 3 : OTHER ESSENTIAL ELEMENTS OF A CONTRACT

Free Consent

Question 1

A student was induced by his teacher to sell his brand new car to the later at less than the purchase price to secure more marks in the examination. Accordingly the car was sold. However, the father of the student persuaded him to sue his teacher. State whether the student can sue the teacher?

Answer

Yes, A can sue his teacher on the ground of undue influence under the provisions of Indian Contract Act, 1872. A contract brought as a result of coercion, undue influence, fraud or misrepresentation would be voidable at the option of the person whose consent was caused.

Capacity to contract

Question 2

Discuss briefly the position of a minor with regard to the contracts entered into by him.

Answer

Position of a minor: A minor is a person who has not completed eighteen years of age. The Contract Act puts minor in a different position as compared to others which may be discussed as under:

(i) A contract by a minor is altogether void. *(Mohiri Bibi* vs. *Dharmodas Ghose).* A minor is incapable of giving a promise imposing a legal obligation.

(ii) A minor can be a promisee or a beneficiary. He can hold other parties liable for the performance of their promise.

(iii) A minor cannot be a partner in a firm. However, be may be admitted to the benefits of partnership with the consent of all the partners.

(iv) There is no estoppel against the minor. He can always plead minority in a suit attempting to hold him liable, no matter he might have earlier misrepresented himself to be major in age.

(v) A minor cannot ratify contracts which he might have made during minority, after becoming major.

(vi) A minor's agreement being void cannot be specifically enforced. However, the estate of a minor can be held liable for the necessities supplied to him or to his dependents suited to his status in life.

(vii) Though the agreement of a minor is void, his guardian can, under certain circumstances and for the benefit of minor, enter into contracts.

(viii) A minor can be an agent, but not a principal.

(ix) A minor can hold property, fully paid shares and can seek contracts of employment or apprenticeship.

(x) The principle of restitution does not apply against a minor.

(xi) A person giving guarantee for a minor debtor can be held liable as surety on the default of the minor.

(xii) A minor can never be adjudicated insolvent.

Question 3

State with reason whether the following statement is correct or incorrect:

'An agreement entered into with a minor may be ratified on his attaining majority'.

Answer

Incorrect. In accordance with the provisions of the Indian Contract Act, 1872 as contained in Section 11, "every person is competent to contract who is of the age of majority ……." Accordingly, a person who is minor is incompetent to contract. The law declares that an agreement entered into with a minor is void. As a minor's agreement is void ab initio, he cannot validate it by ratification on attaining his majority. Ratification in law is treated as equivalent to a validation of previous authority, and it follows that, as a general rule, a person or body of persons, not competent to authorize an act, can not give it validity by ratifying it. Of course, such a person (minor) can enter into a fresh agreement, but the earlier amount received cannot be treated as consideration for the new agreement. (Relevant cases on this point are *Mohiri Bibi vs. D.D. Ghosh* and *Nazir Ahmed vs. Jeevandas*).

Question 4

State with reason whether the following statement is correct or incorrect.

'A promissory note duly executed in favour of minor is void'.

Answer

Incorrect: As per the Indian Contract Act,1872 ,minor is not competent to contract, but he can be a beneficiary. In this case, the minor is a beneficiary. Hence the Promissory Note is not void and the minor at his option can enforce it.

Question 5

Choose the correct answer from the following :

Which one of the following statements is not true about minor's position in the firm:

(a) He can not become a partner in the firm.

(b) A minor and a major can enter into an agreement of partnership.

(c) He can be admitted to the benefits in the firm.

(d) He can become a partner on becoming a major.

Answer

(b) A minor and a major can enter into an agreement of partnership.

Question 6

'An agreement with an alien friend is valid but an agreement with an alien enemy is void'.

Answer

(i) Correct

Question 7

Ramesh, aged 16 years, was studying in an engineering college. On 1 March, 2011 he took a loan of ₹1 lakh from Suresh for the payment of his college fee and agreed to pay by 30th May, 2012. Ramesh possesses assets worth ₹10 lakhs. On due date Ramesh fails to pay back the loan to Suresh. Suresh now wants to recover the loan from Ramesh out of his assets. Whether Suresh would succeed? Decide, referring to the provisions of the Indian Contract Act, 1872.

Answer

According to Section 11 of the Indian Contract Act, 1872, a person who is of the age of majority to the law to which he is subject is competent to enter into any contract. A person who has completed the age of 18 years is a major and otherwise he will be treated as minor. Thus Ramesh who is a minor is incompetent to contract and any agreement with him is void [Mohori Bibi Vs Dharmodas Ghose 1903, 30 Cal, 539 (PC)]. Section 68 of the Indian Contract Act, 1872 however, prescribes the liability of a minor for the supply of the things which are the necessaries of life to him. It says that though minor is not personally liable to pay the price of necessaries supplied to him or money lent for the purpose, the supplier or lender will be entitled to claim the money/price of goods or services which are necessaries suited to his condition of life provided that the minor has a property. The liability of minor is only to the extent of the minor's property. This type of contract is called a Quasi-contract and the right of the supplier/lender is based on the principle of equity. Thus, according to the above provision, Suresh will be entitled to recover the amount of loan given to Ramesh for payment of the college fees from the property of the minor.

Difference between Coercion and Undue Influence

Question 8

What do you understand by "coercion" and "undue influence" under the provisions of the Indian Contract Act, 1872? What are the differences between them?

Answer

Coercion and Undue Influence – Meaning and Differences: "Coercion" is the committing, or threatening to commit any act forbidden by the Indian Penal Code 1860, 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. (Section 15, The Indian Contract Act, 1872).

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 of the other. A person is deemed to be in a position to dominate the will of the other, when he holds authority, real or apparent over the other, or when he stands in a fiduciary relation to other (Section 16, The Indian Contract Act, 1872)

Differences between Coercion and Undue Influence

Nature of action: Coercion involves physical force and sometimes only threat. Undue influence involves only moral pressure.

Involvement of criminal action: Coercion involves committing or threatening to commit any act prohibited or forbidden by law, or detention or threatening to detain a person or property. In undue influence there is no such illegal act involved.

Relationship between parties: In coercion there need not be any relationship between parties; whereas in undue influence, there must be some kind of relationship between parties, which enables to exercise undue influence over the other.

Exercise by whom: Coercion need not proceed from the promisor. It also need not be directed against the promisee. Undue influence is always exercised by one on the other, both of whom are parties to a contract.

Enforceability: Where there is coercion, the contract is voidable at the option of the party whose consent has been obtained by coercion. Where there is undue influence the contract is voidable or court may set it aside or enforce it in a modified form.

Position of benefits received: In case of coercion, where the contract is rescinded by the aggrieved party any benefit received has to be restored back. In the case of undue influence, the court has discretion to pass orders for return of any such benefit or not to give any such directions.

Question 9

What is meant by 'Undue Influence'? 'A' applies to a banker for a loan at a time where 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. Whether the contract is induced by undue influence? Decide.

Answer

Meaning of Undue Influence: Section 16 of the Indian Contract Act, 1872, states that a contract is said to be induced by undue influence where the relations subsisting between the parties are such that the parties are in a position to dominate the will of the other and used that position to obtain an unfair advantage over the other.

A person is deemed to be in that position:

(a) where he holds real or apparent authority over the other or stands in a fiduciary relation to him;

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

(c) where a man who is in position to dominate the will of the other enters into contract with him and the transaction appears to be unconscionable, the burden of proving that it is fair, is on him, who is in such a position.

When one of the parties who has obtained the benefits of a transaction is in a position to dominate the will of the other, and the transaction between the parties appears to be unconscionable, the law raises a presumption of undue influence [section 16(3)]. Every transaction where the terms are to the disadvantage of one of the parties need not necessarily be considered to be unconscionable. If the contract is to the advantage of one of the parties but the same has been made in the ordinary course of business the presumption of under influence would not be raised.

In the given problem, A applies to the 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. As between parties on an equal footing, the court will not hold a bargain to be unconscionable merely on the ground of high interest. Only where the lender is in a position to dominate the will of the borrower, the relief is granted on the ground of undue influence. But this is not the situation in this problem, and therefore, there is no undue influence.

Fraud

Question 10

Do the following statements amount to involvement of fraud?

(i) Where the vendor of a piece of land told a prospective purchaser that, in his opinion, the land can support 2000 heads of sheep whereas, in truth, the land could support only 1500 sheep.

(ii) X bought shares in a company on the faith of a prospectus which contained an untrue statement that one Z was a director of the company. X had never heard of Z and the untrue statement of Z being a director was immaterial from his point of view. Can X claim damages on grounds of fraud?

Answer

(i) The problem is based on the facts of the case *Bisset vs Wilkinson* (1927). In the given problem the vendor says that in his opinion the land could support 2000 heads of sheep. This statement is only an opinion and not a representation and hence cannot amount to fraud.

(ii) The problem is based on the facts of the case *Smith vs Chadwick* (1884). In the problem though the prospectus contains an untrue statement that untrue statement was not the one that induced X to purchase the shares. Hence X cannot claim damages.

Misrepresentation

Question 11

Explain the concept of 'misrepresentation' in matters of contract. Sohan induced Suraj to buy his motorcycle saying that it was in a very good condition. After taking the motorcycle, Suraj complained that there were many defects in the motorcycle. Sohan proposed to get it repaired and promised to pay 40% cost of repairs. After a few days, the motorcycle did not work at all. Now Suraj wants to rescind the contract. Decide giving reasons.

Answer

Misrepresentation: According to Section 18 of the Indian Contract Act, 1872, misrepresentation is present:

1. When a person positively asserts that a fact is true when his information does not warrant it to be so, though he believes it to be true.
2. When there is any breach of duty by a person, which brings an advantage to the person committing it by misleading another to his prejudice.
3. When a party causes, however, innocently, the other party to the agreement to make a mistake as to the substance of the thing which is the subject of the agreement.

The aggrieved party, in case of misrepresentation by the other party, can avoid or rescind the contract [Section 19, Indian Contract Act, 1872]. The aggrieved party loses the right to rescind the contract if he, after becoming aware of the misrepresentation, takes a benefit under the contract or in some way affirms it. Accordingly in the given case, Suraj could not rescind the contract, as his acceptance to the offer of Sohan to bear 40% of the cost of repairs impliedly amounts to final acceptance of the sale [*Long v. Lloyd, (1958)].*

Mistake

Question 12

M purchased a wrist watch from N, both believed that it was made with gold plaque. Hence, M paid a very high price for that. Later it was found that the wrist watch was not made so. State the validity of the contract.

Answer

The contract is absolutely void as there is a mutual mistake of both parties. In case of bilateral mistake of essential fact, the agreement is void ab-initio, as per Section 20 of the Indian Contract Act, 1872.

Question 13

X buys from Y a painting which both believe to be the work of an old master and for which X pays a high price. The painting turns out to be only a modern copy .Discuss the validity of the contract?

Answer

The contract is absolutely void as there is a mutual mistake of both the parties as to the substance or quality of the subject-matter going to be the very root of the contract. In case of bilateral mistake of essential fact, the agreement is void ab initio, as per section 20 of the Indian Contract Act, 1872.

Question 14

Choose the correct answer from the following and give reason.

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

(a) Valid *(b) Voidable*

(c) Void *(d) Illegal.*

Answer

Answer (c) Reason: If both the parties to an agreement are under a mistake (i.e. the mistake is bilateral) regarding a matter of fact, which is essential to the agreement, the agreement is void (*Couturiers Vs. Hasite*).

Unlawful Object

Question 15

Point out with reason whether the following agreements are valid or void:

(i) Kamala promises Ramesh to lend ₹ 50,000 in lieu of consideration that Ramesh gets Kamala's marriage dissolved and he himself marries her.

(ii) Sohan agrees with Mohan to sell his black horse. Unknown to both the parties, the horse was dead at the time of agreement.

(iii) Ram sells the goodwill of his shop to Shyam for ₹ 4,00,000 and promises not to carry on such business forever and anywhere in India.

(iv) In an agreement between Prakash and Girish, there is a condition that they will not institute legal proceedings against each other without consent.

(v) Ramamurthy, who is a citizen of India, enters into an agreement with an alien friend.

Answer

Validity of agreements

(i) *Void Agreement*: As per Section 23 of the Indian Contract Act, 1872 an agreement is void if the object or consideration is against the public policy.

(ii) *Void Agreement*: As per Section 20 of the Indian Contract Act, 1872 the contracts caused by mistake of fact are void. There is mistake of fact as to the existence of subject-matter.

(iii) *Void Agreement*: As per Section 27 of the Indian Contract Act, 1872 an agreement in restraint of trade is void. However, a buyer can put such a condition on the seller of good will, not to carry on same business. However, the conditions must be reasonable regarding the duration and the place of the business.

(iv) *Void Agreement*: An agreement in restraint of legal proceedings is void as per Section 28 of the Indian Contract Act, 1872.

(v) *Valid Agreement*: An agreement with alien friend is valid, but an agreement with alien enemy is void.

Question 16

Explain the validity of agreements in restraint of trade.

Answer

An agreement which interferes with the liberty of a person to engage himself in any lawful trade, profession or vocation is called 'an agreement in restraint of trade'. Section 27 of the Indian Contract Act, 1872 renders agreement in restraint of trade as void. The section applies even when the restraint is for a limited period only or is confined to a particular area. But contracts by which in the exercise of his profession, trade or business, a person enters into ordinary agreements with persons dealing with him which are really necessary for the carrying on of his business are not void under this section.

The exceptional cases which constitutes the valid contracts in restraint of trade are as follow:

1. *Sale of goodwill:* Restrain on a seller of goodwill from carrying on (i) a similar business, (ii) with in specified local limits, (iii) so long as the buyer or his representative deriving title to the goodwill carriers on a like business, Provided (iv) the restraint is reasonable in point of time and place.
2. *Partner's agreements:*
   (i) Partners may enter into an agreement that a partner will not carry on similar business while he is partner.
   (ii) An outgoing retiring partner may agree with other partners that he will not carry on any business similar to that of the firm within a specified time or local limits.
   (iii) Upon or in anticipation of dissolution a partnership firm some or all the partners may agree not to carry on a business similar to that of the firm with a specified period or local limit.

(iv) A partner may upon the sale of goodwill of the firm, make an agreement with the buyer that he will not carry on any similar business within specified time or local limits.

3. *Service agreement:* Agreements of service often contain a clause by which the employees prohibited from working anywhere else during the term of the agreement, such agreement are valid
4. *Trade Combinations:* An agreement among members of trade associations or chambers of commerce etc. to regulate their business is not void under section 27.

Unlawful consideration

Question 17

Mr. Seth an industrialist has been fighting a long drawn litigation with Mr. Raman another industrialist. To support his legal campaign Mr. Seth enlists the services of Mr. X a legal expert stating that an amount of ₹5 lakhs would be paid, if Mr. X does not take up the brief of Mr. Raman. Mr. X agrees, but at the end of the litigation Mr. Seth refuses to pay. Decide whether Mr. X can recover the amount promised by Mr. Seth under the provisions of the Indian Contract Act, 1872.

Answer

The problem as asked in the question is based on one of the essentials of a valid contract. Accordingly, one of the essential elements of a valid contract is that the agreement must not be one which the law declares to be either illegal or void. A void agreement is one without any legal effect. Thus any agreement in restraint of trade, marriage, legal proceedings etc., are void agreements. Thus Mr. X cannot recover the amount of ₹ 5 lakhs promised by Mr. Seth because it is an illegal agreement and cannot be enforced by law.

Question 18

'X' agreed to become an assistant for 5 years to 'Y' who was a Doctor practising at Ludhiana. It was also agreed that during the term of agreement 'X' will not practise on his own account in Ludhiana. At the end of one year, 'X' left the assistantship of 'Y' and began to practise on his own account. Referring to the provisions of the Indian Contract Act, 1872, decide whether 'X' could be restrained from doing so?

Answer

An agreement in restraint of trade/business/profession is void under Section 27 of the Indian Contract Act, 1872. But an agreement of service by which a person binds himself during the term of the agreement not to take service with anyone else directly or indirectly to promote any business in direct competition with that of his employer is not in restraint of trade. Therefore X can be restrained by an injunction from practicing on his own account in Ludhiana.

Agreements expressly declared as void

Question 19

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

An agreement to subscribe to or contribute a plate or prize of the value of ₹ 500 or above to be awarded to the winner of a horse race is

(1) Void

(2) Valid

(3) Illegal

(4) Unenforceable

Answer

Valid: According to the exception stated under Section 30 of the Indian Contract Act, 1872, a subscription, or contribution or agreement to subscribe or contribute, made or entered into for or towards any plate, prize or sum of money, of the value or amount of five hundred rupees or upwards, to be awarded to the winner of any horse race, shall not be deemed to be unlawful.

Question 20

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

X sells the goodwill of his retail store to Y for ₹ 5 lac and promises not to carry on the same business forever and anywhere in India. Is the agreement :

1. Valid

2. Void

3. Voidable

4. Illegal.

Answer

Void : As per Section 27 of the Indian Contract Act, 1872, an agreement in restraint trade is void. However, a buyer can put such a condition on the seller of goodwill not carry on same business. However, the conditions must be reasonable regarding the duration and the place of the business.

Question 21

M promised to pay N for his services at his (M) sole discretion found to be fair and reasonable. However, N dissatisfied with the payment made by M and wanted to sue him. Decide whether N can sue M under the provisions of the Indian Contract Act, 1872?

Answer

N's suit will not be valid because the performance of a promise is contingent upon the mere will and pleasure of the promisor; hence, there is no contract. As per section 29 of the Indian Contract Act, 1872 – agreements, the meaning of which is not certain, or capable of being made certain, are void".

EXERCISE

1. *A student was induced by his teacher to sell his brand new car to the latter at less than the purchase price to secure more marks in the examination. Accordingly the car was sold. However, the father of the student persuaded him to sue his teacher. Can student sue the teacher?*

   [Hint: Yes, the student can sue his teacher on the ground of undue influence.]

2. *A and B enter into a contract believing wrongly that a particular debt is not barred by law of limitation. Is this a valid contract?*

   [Hint: Yes, because there is no mistake of fact but of law only]

3 *.'A' & 'B' are partners in a firm. They agree to defraud a Government department by submitting a tender in the individual name and not in the firm name. Is this a valid agreement ?*

   [Hint: No, it is a void agreement as it is a fraud on the Government department].

4. *An old man with poor eyesight endorsed a bill of exchange thinking it to be a mere guarantee. Is the old man liable under the bill?*

   [Hint: No, because there is a unilateral mistake about a fundamental matter by oldman]

5. *'P' advanced money to 'D' a married woman to enable her to obtain a divorce from her husband. She also promised to marry him after divorce. Is P entitled to recover the amount in case of breach of his promise.*

   [Hint: P was not entitled to recover the amount from D as the agreement was against good morals]

6. *Two persons refer to a ship and refer to it in the contract but each of them had a different ship in mind though of the same name. Whether it will be valid and why?*

   [Hint: No, no identity of mind]

7. *'A' agrees to pay ₹ 100 to 'B' on 'B' stealing the purse of 'C'. 'B' manages to steal the purse of 'C' and 'A' does not fulfill his promise. Whether court can compel 'A' to pay 'B' ₹ 100?*

   [Hints: No, because contract is illegal]

UNIT – 4 : PERFORMANCE OF CONTRACT

By whom a contract may be performed

Question 1

A received certain goods from B promising to pay ₹ 10,000/-. Later on, A expressed his inability to make payment. C, who is known to A, pays ₹, 6000/- to B on behalf of A. However, A was not aware of the payment. Now B is intending to sue A for the amount of ₹ 10000/-. Can B do so? Advise.

Answer

As per section 41 of the Indian Contract Act, 1872, when a promisee accepts performance of the promise from a third person, he cannot afterwards enforce it against the promisor. That is, performance by a stranger, accepted by the promisee, produces the result of discharging the promisor, although the latter has neither authorised nor ratified the act of the third party.

Therefore B can sue A only for ₹ 4000.

Question 2

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

A promises to paint a picture for B by a certain day, at a certain price. A dies before the day. The contract:

(1) can be enforced by A's representative

(2) can be enforced by B

(3) can be enforced either by A's representative or by B

(4) cannot be enforced either by A's representative or by B

Answer

Correct answer is option (4): *The Contract cannot be enforced either by A's representative or by B*. To paint a picture is a personal contract and may be performed only personally. A personal contract cannot be performed by anybody other than the promisee. Hence, if A dies, the contract cannot be enforced.

Liability of Joint Promisor and Promisee

Question 3

X, Y and Z jointly borrowed ₹ 50,000 from A. The whole amount was repaid to A by Y. Decide in the light of the Indian Contract Act, 1872 whether:

(i) Y can recover the contribution from X and Z,

(ii) Legal representatives of X are liable in case of death of X,

(iii) Y can recover the contribution from the assets, in case Z becomes insolvent.

Answer

Section 42 of the Indian Contract Act, 1872 requires that when two or more persons have made a joint promise, then, unless a contrary intention appears from the contract, all such persons jointly must fulfill the promise. In the event of the death of any of them, his representative jointly with the survivors and in case of the death of all promisees, the representatives of all jointly must fulfill the promise.

Section 43 allows the promisee to seek performance from any of the joint promisors. The liability of the joint promisors has thus been made not only joint but "joint and several". Section 43 provides that in the absence of express agreement to the contrary, the promisee may compel any one or more of the joint promisors to perform the whole of the promise.

Section 43 deals with the contribution among joint promisors. The promisors, may compel every joint promisor to contribute equally to the performance of the promise (unless a contrary intention appears from the contract). If any one of the joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares.

As per the provisions of above sections,

(i) Y can recover the contribution from X and Z because XYZ are joint promisors.

(ii) Legal representative of X are liable to pay the contribution to Y. However, a legal representative is liable only to the extent of property of the deceased received by him.

(iii) 'Y' also can recover the contribution from Z's assets.

Question 4

'A', 'B' and 'C' are partners in a firm. They jointly promise to pay ₹1,50,000 to 'P'. C became insolvent and his private assets are sufficient to pay only 1/5 of his share of debts. A is compelled to pay the whole amount to P. Examining the provisions of the Indian Contract Act, 1872, decide the extent to which A can recover the amount from B.

Answer

When two or more persons make a joint promise, the promisee may in the absence of express agreement to the contrary, compel anyone or more of such joint promisors to perform the whole of the promise. In such a situation the performing promisor can enforce contribution from other joint promisors (Section 43 of the Indian Contract Act). If anyone or more joint promisors make default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal share. Hence in the instant case, A is entitled to receive (a) from C's assets - ₹,10,000 (1/5th of ₹ 50,000) and (₹ 50,000 is the amount to be contributed by C being 1/3rd of ₹ 1,50,000), (b) from B - ₹ 70,000 (₹ 50,000 being his own share + ½ (50,000-10,000) i.e. ₹ 20,000 being one half share of total loss of ₹ 40,000 due to C's insolvency). A can recover ₹ 70,000 from B.

Question 5

Ajay, Vijay and Sanjay are partners of software business and jointly promises to pay ₹ 60, 000 to Kartik. Over a period of time Vijay became insolvent, but his assets are sufficient to pay one-fourth of his debts. Sanjay is compelled to pay the whole. Decide whether Sanjay is required to pay whole amount himself to Kartik in discharging joint promise.

Answer

According Section 43 of the Indian Contract Act, 1872 when two or more persons make a joint promise, the promisee may, in absence of express agreement to the contrary, compel any one or more of such joint promisors to perform the whole of the promise. Further, if any one of two or more joint promisors makes default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal shares. Therefore, in this case, Sanjay is entitled to receive 5,000 from Vijay's assets and 27,500 from Ajay.

Time and place for performance of the promise

Question 6

Explain the rules under the Indian Contract Act, 1872 as regards to time and place for the performance of the promise?

Answer

Section 46 to 50 of the Indian Contract Act, 1872 are relevant provisions regarding the time and place for the performance of the promise which are as follows:

(i) *If no time is specified*, the promise must be performed within a reasonable time. The expression 'reasonable' time is to be interpreted having regard to the facts and circumstances of a particular case (Section 46).

(ii) *If a promise is to be performed on a specified date* but the hour is not mentioned, the promisor may perform it at any time during the usual hours of business, on such day. Moreover, the delivery must be made at the usual place of business (Section 47).

(iii) *Where no place is fixed*, it is the duty of the promisor to ask the promisee to fix a reasonable place for the performance of the promise. In all cases the promisor must apply to the promisee; here no distinction is made between an obligation to pay money and obligation to deliver goods or discharge any other obligation [Section 40].

The above rules regarding the time and place for the performance of promise apply, only when the promisor undertakes to perform the promise without an application being made by the promisee.

(iv) *Where the promisor has not undertaken to perform the promise without an application by the promisee*, and the promise is to be performed on a certain day it is the duty of the promisee to apply for performance at a proper place and within the usual hours of business (Section 48).

Generally, the performance of any promise may be made in any manner, or at any time which the promisee prescribes or sanctions.

Supervening impossibility

Question 7

Under what circumstances the doctrine of Supervening Impossibility is not applicable?

Answer

Non-Application of Doctrine of Supervening Impossibility: Events which make the performance of the contract impossible subsequent to formation of the contract known as supervening or subsequent impossibility. The effect of such impossibility is that it makes the contract void and the parties are discharged from further performance of the contract and thereby contract is discharged, (Section 56, Indian Contract Act, 1872). There are certain exceptions. The doctrine of supervening impossibility does not apply in the following cases:

(i) *Performance becoming difficult:* A contract is not discharged merely because its performance turns out to be difficult or burdensome. The parties will not be released from their obligations on account of rise or fall of price, depreciation or appreciation of currency obstacle to the execution of the contract or becoming more expensive or less profitable.

(ii) *Commercial impossibility*: Performance cannot be excused on the ground of commercial impossibility. A contract is not discharged merely because the necessary raw material is available at a very high rate or the expectation of higher profit will not be realized or the performance of contract has become costlier or the necessary transport is available at exorbitant rates or the contract has become costlier in terms of money or labour.

(iii) *Default of third person*: If the contract cannot be performed because of the default of a third person on whose work or conduct the promisor relied, the promisor is not discharged on the ground of frustration.

(iv) *Strikes, lockouts, riots or civil disturbances*: A contract is not discharged automatically on the ground of supervening impossibility due to a strike by the workers or lock-out by the owners or outbreak of riots or outbreak of some civil disturbance coming in the way of performance of the contract. However, the parties to the contract may agree to the contrary by making a clear provision in this regard.

(v) *Partial impossibility:* If a contract is made for the fulfillment of several objects, the failure of one or more of them does not discharge the contract.

(vi) *Self-Induced frustration*: If frustration is imposed by the conduct of the party himself, or by the conduct of those for whom he is responsible, or by party's deliberate or negligent act or choice, the contract is not discharged.

Doctrine of Frustration

Question 8

Akhilesh entered into an agreement with Shekhar to deliver him (Shekhar) 5,000 bags to be manufactured in his factory. The bags could not be manufactured because of strike by the

workers and Akhilesh failed to supply the said bags to Shekhar. Decide whether Akhilesh can be exempted from liability under the provisions of the Indian Contract Act, 1872.

Answer

Delivery of Bags: According to Section 56 (Para 2) of the Indian Contract Act, 1872 when the performance of a contract becomes impossible or unlawful subsequent to its formation, the contract becomes void, this is termed as 'supervening impossibility' (i.e. impossibility which does not exist at the time of making the contract, but which arises subsequently).

But impossibility of performance is, as a rule, not an excuse from performance. It means that when a person has promised to do something, he must perform his promise unless the performance becomes absolutely impossible. Whether a promise becomes absolutely impossible depends upon the facts of each case.

The performance does not become absolutely impossible on account of strikes, lockout and civil disturbances and the contract in such a case is not discharged unless otherwise agreed by the parties to the contract *(Budget V Bennington; Jacobs V Credit Lyonnais).*

In this case Mr. Akhilesh could not deliver the bags as promised because of strike by the workers. This difficulty in performance cannot be considered as impossible of performance attracting Section 56 (Para 2) and hence Mr. Akhilesh is liable to Mr. Shekhar for non-performance of contract.

Contracts which need not be performed

Question 9

M owes money to N under a contract. It is agreed between M, N and O that N shall henceforth accept O as his debtor instead of M. Referring to the provisions of the Indian Contract Act, 1872, state whether N can claim payment from O?

Answer

Yes, a contract need not be performed when the parties to it agree to substitute a new contract for it or to rescind or alter it. (Section 62, Indian Contract Act, 1872). Here, in the given problem, novation has taken place as one of the parties has been replaced with a third party. Therefore, N can claim the money from O.

Discharge of a Contract

Question 10

State in brief, the grounds on basis of which a contract is discharged under the provisions of Indian Contract Act, 1872.

Answer

Discharge of Contract: A contract under the provisions of Indian Contract Act, 1872, may be discharged in any of the following ways:

(1) Discharge by performance: Discharge by performance will take place when there is :

(i) Actual performance (parties fulfilling obligations within time and in the manner prescribed); or

(ii) Attempted performance (promisor offers to perform but promisee refuses to accept it). This is also known as tender.

(2) Discharge by mutual agreement: Discharge also takes place where there is substitution [novation], rescission, alteration and remission. In all these cases old contract need not be performed.

(3) Discharge by impossibility of performance: A situation of impossibility may have existed at the time of entering into the contract or it may have transpired subsequently (also known as supervening impossibility). Situations are destruction of the subject-matter, incapacity, declaration of war etc.

(4) Discharge by lapse of time: Performance of contract has to be done within certain prescribed time. In other words it should be performed before it is barred by law of limitation. In such a case there is no remedy for the promisee. For example where the debt is barred by law of limitation.

(5) Discharge by operation of law: Where the promisor dies or goes insolvent there is a discharge of contract by operation of law.

(6) Discharge by breach of contract: Where there is a default by one party from performing his part of contract on due date then there is breach of contract. Breach of contract can be actual breach or anticipatory breach. Where a person repudiates a contract before the stipulated due date, it is anticipatory breach.

(7) Discharge by remission or satisfaction: A promisee may remit the performance of the promise by the promisor. Here there is a discharge. Similarly the promisee may accept some other satisfaction. Then again there is a discharge on the ground of accord and satisfaction.

(8) Under the provisions of the Indian Contract Act,1872 as contained in Section 67,when a promisee neglects or refuses to afford the promisor reasonable facilities or opportunities for performance, promisor is excused by such neglect or refusal.

Question 11

Explaining the provisions of the Indian Contract Act, 1872, answer the following:

(i) A contracts with B for a fixed price to construct a house for B within a stipulated time. B would supply the necessary material to be used in the construction. C guarantees A's performance of the contract. B does not supply the material as per the agreement. Is C discharged from his liability?

(ii) C, the holder of an over due bill of exchange drawn by A as surety for B, and accepted by B, contracts with X to give time to B. Is A discharged from his liability?

Answer

(i) According to Section 134 of the Indian Contract Act, 1872, the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor. In the given case, B omits to supply the timber. Hence C is discharged from his liability.

(ii) According to Section 136 of the Indian Contract Act, 1872, 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. In the given question the contract to give time to the principal debtor is made by the creditor with X who is a third person. X is not the principal debtor. Hence A is not discharged.

EXERCISE

1 *M and N had a contract. M broke it. N had a right to file a case against M for damages. N wants to assign this right. Decide.*

[Hint: No, N cannot because right to sue for damages is not a contractual right but a personal right given by law]

2 *X agrees to sell 50 tons of some raw material to Y on 20th June,2010.X delivers the goods on 30th of June ,2010.Is Y bound to accept the goods?*

[Hint: No, because, in commercial deals, time is of essence]

3 *X, Y, and Z jointly sells goods to D for ₹, 18,000.After a week, D pays the total amount to Y alone. Is D discharged from liability?*

[Hint: No, The right to demand the performance lies with the joint promisees jointly, unless agreed otherwise.]

4. *'B' the son of 'A' has inherited assets & liabilities from his father after his death. But the liabilities were more than the assets. Whether 'B' will be responsible to pay only to the extent of the assets he has inherited?*

[Hint: Yes]

5. *A,B and 'C' jointly borrowed a sum of money from 'X'. 'A' dies, whether his legal representative 'L' would be liable to repay the loan along with 'B' and 'C'?*

[Hint:Yes]

6. *X,Y & Z jointly borrow from 'P' ₹ 3000/- the liability of borrower is joint & several.*

   (i) Whether 'P' can recover the amount either from 'X' or from 'Y' or from 'Z' or from all of them jointly?

   (ii) Similarly whether the creditor can bring a suit against any one or more of legal heirs of a debtor on his death?

[Hints: (i) Yes ,(ii) No]

7. *A sells 500 quintals of rice to 'B' and 'B' promises to pay the price on delivery. What is the name of promise in this case?*

[Hints :Reciprocal Promise,]

8. *Where there are two debts one ₹ 500/- another ₹ 700/- falling due on the same day and if the debtor pays ₹ 600/-. Whether the appropriation can be made prorata for the two debts?*

[Hint: Yes]

UNIT- 5: BREACH OF CONTRACT

Anticipatory breach of contract

Question 1

(a) What is meant by Anticipatory Breach of Contract?

(b) Mr. Dubious textile enters into a contract with Retail Garments Show Room for supply of 1,000 pieces of Cotton Shirts at ₹ 300 per shirt to be supplied on or before 31st December, 2004. However, on 1st November, 2004 Dubious Textiles informs the Retail Garments Show Room that he is not willing to supply the goods as the price of Cotton shirts in the meantime has gone upto ₹ 350 per shirt. Examine the rights of the Retail Garments Show Room in this regard

Answer

(a) Anticipatory breach of contract: Anticipatory breach of contract occurs when the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived. In such a situation the promisee can claim compensation by way of loss or damage caused to him by the refusal of the promisor. For this, the promisee need not wait till the time stipulated in the contract for fulfillment of the promise by the promisor is over.

(b) In the given problem Dubious Textiles has indicated its unwillingness to supply the cotton shirts on 1st November 2004 itself when it has time upto 31st December 2004 for performance of the contract of supply of goods. It is therefore called anticipatory breach of contract. Thus Retail Garments show room can claim damages from Dubious Textiles immediately after 1st November, 2004, without waiting upto 31st December 2004. The damages will be calculated at the rate of ₹ 50 per shirt i.e. the difference between ₹ 350/- (the price prevailing on 1s1 November) and ₹ 300/- the contracted price.

Question 2

Mr. Ramaswamy of Chennai placed an order with Mr. Shah of Ahmedabad for supply of Urid Dhall on 10.11.2006 at a contracted price of ₹ 40 per kg. The order was for the supply of 10 tonnes within a month's time viz. before 09.12.2006. On 04.12.2006 Mr. Shah wrote a letter to Mr. Ramaswamy stating that the price of Urid Dhall was sky rocketing to ₹ 50 Per. Kg. and he would not be able to supply as per original contract. The price of Urid Dhall rose to ₹ 53 on 09.12.06 Advise Mr. Ramaswamy citing the legal position.

Answer

The stated problem falls under the head 'anticipatory breach of contract' defined in Section 39 of the Indian Contract Act, 1872.

The case law applicable here is *Frost vs. Knight*. As per details in the problem, price as contracted ₹ 40 per kg on 10.11. 2006 rose to ₹ 50 per kg as on 4.12.2006 and finally to ₹ 53 per kg, on 09.12.2006.

The answer to the problem is that

1. Mr. Ramaswamy can repudiate the contract on 04.12.2006 and can claim damages of ₹ 10 per kg viz. ₹ 1,00,000.
2. He could wait till 09.12.2006 and claim ₹ 1,30,000 i.e. ₹ 13 per kg.
3. If the Government, in the interim period i.e. between 04.12.2006 and 09.12. 2006 imposes a ban on the movement of the commodity to arrest rise of prices, the contract becomes void and Mr. Ramaswamy will not be able to recover any damages whatsoever.

Measurement of Damages

Question 3

M Ltd., contracts with Shanti Traders to make and deliver certain machinery to them by 30.6.2004 for ₹ 11.50 lakhs. Due to labour strike, M Ltd. could not manufacture and deliver the machinery to Shanti Traders. Later, Shanti Traders procured the machinery from another manufacturer for ₹ 12.75 lakhs. Shanti Traders was also prevented from performing a contract which it had made with Zenith Traders at the time of their contract with M Ltd. and were compelled to pay compensation for breach of contract. Advise Shanti Traders the amount of compensation which it can claim from M Ltd., referring to the legal provisions of the Indian Contract Act, 1872.

Answer

Section 73 of the Indian Contract Act, 1872 provides for consequences of breach of contract. According to it, when a contract has been broken, the party who suffers by such breach is entitled to receive from the party who has broken the contract, compensation for any loss or damage caused to him thereby which naturally arose in the usual course of things from such breach or which the parties knew when they made the contract, to be likely to result from the breach of it. Such compensation is not given for any remote and indirect loss or damage sustained by reason of the breach. It is further provided in the explanation to the section that in estimating the loss or damage from a breach of contract, the means which existed of remedying the inconvenience caused by the non-performance of the contract must be taken into account.

Applying the above principle of law to the given case, M Ltd is obliged to compensate for the loss of ₹ 1.25 lakhs (i.e. ₹ 12.75 minus ₹ 11.50 = ₹ 1.25 lakhs) which had naturally arisen due to default in performing the contract by the specified date.

Regarding the amount of compensation which Shanti Traders were compelled to make to Zenith Traders, it depends upon the fact whether M Ltd., knew about the contract of Shanti Traders for supply of the contracted machinery to Zenith Traders on the specified date. If so, M Ltd is also obliged to reimburse the compensation which Shanti Traders had to pay to Zenith Traders for breach of contract. Otherwise M Ltd is not liable.

Question 4

A contracted with B to supply him (B) 500 tons of iron-steel @ ₹5,000 per ton, to be delivered at a specified time. Thereafter, A contracts with C for the purchase of 500 tons of iron-steel @ ₹4,800 per ton, and at the same time told 'C' that he did so for the purpose of performing his contract entered into with B. C failed to perform his contract in due course. Consequently, A could not procure any iron-steel and B rescinded the contract. What would be the amount of damages which A could claim from C in the circumstances ? Explain with reference to the provisions of the Indian Contract Act, 1872.

Answer

The problem in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 73. Section 73 provides that when a contract has been broken the party who suffers by such breach is entitled to receive from the party who has broken the contract compensation for any loss or damage caused to him thereby which naturally arose in the usual course of things from such breach or which the parties knew when they made the contract to be likely to result from the breach of it. The leading case on this point is *Hadley v Baxendale.*

In *"Hadley vs. Baxendale"* it was decided that if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated.

In the instant case 'A' had intimated to 'C' that he was procuring iron steel from him for the purpose of performing his contract with 'B'. Thus, C had the knowledge of the special circumstance. Therefore, 'A' is entitled to claim from 'C' ₹ 1,00,000 (difference between the procuring price of iron steel and contracted selling price to 'B') being the amount of profit 'A' would have made by the performance of his contract with 'B'. If A had not told C of B's contract then the amount of damages would have been the difference between the contract price and the market price on the day of default.

Liability for damages

Question 5

State whether the following statement is/ are correct or incorrect:

In case of breach of contract, the Court awards remote damages to the aggrieved party.

Answer

Incorrect

How to calculate the damage

Question6

How the damages can be calculated on the breach of contract?

Answer

In case of a contract for sale of goods, where the buyer breaks the contract, the damages would be the difference between contract price and market price as on the date of breach. Similarly where the seller breaks the contract, the buyer can recover the difference between market price and contract price as on date of breach.

If the seller retains the goods after the contract has been broken by the buyer he cannot recover from the buyer any further loss even if the market falls. Again he is not liable to have the damages reduced if the market rises.

In *Jamal vs. Mulla Dawood (1961) 43.I.A. 6*, the defendant agreed to purchase from the plaintiff, certain shares on December 30, but wrongfully rejected them when tendered on date. The difference between the contract price and market price amounted to ₹ 1,09,218; the plaintiff recovered a part of the loss by selling those shares in a rising market and the actual loss amounted to ₹ 79,882. The plaintiff, however, sued the defendant claiming ₹ 1,09,218 as damages and the Privy Council allowed the claim in full.

Question 7

X agreed to sell to Y 100 bags of price @₹500 per bag, the entire price to be paid at the time of delivery. Before it is delivered, the price of rice per bag goes up by ₹50 per bag, X refuses to deliver unless and until Y agrees to the increased price. Y sues X for damages for the breach of contract. What Y can claim as damages?

Answer

In a Contract of sale of Goods, the damages for the breach of contract is measured by the difference in contract price and market price of the goods on the date of breach. In this problem Y can claim ₹ 50 per bag (₹ 550-500) as ordinary damages.

Question 8

What is the law relating to determination of compensation, on breach of contract, contained in section 73 of the Indian Contract Act, 1872 ?

Answer

Compensation on Breach of Contract: Section 73 of the Indian Contract Act, 1872 provides that when a contract has been broken, the party who suffers by such breach is entitled to receive from the party who has broken the contract, compensation for any loss or damage caused to him thereby which naturally arose in the usual course of things from such breach or which the parties knew when they made the contract, to be likely to result from the breach of it. Such compensation is not given for any remote and indirect loss or damage sustained by reason of the breach. The explanation to the section further provides that in estimating the loss or damage from a breach of contract, the means which existed of remedying the inconvenience caused by the non-performance of the contract must be taken into account.

EXERCISE

1 *A was appointed as a managing director by a company. Later on it was found that appointment was invalid because the director appointed him were not eligible. Can A claim salary for the time he worked?*

[Hint: Yes, he is entitled to remuneration for the services rendered on quantum meruit basis]

2 *X contracted to sell 100 kg of Sugar to Y at ₹ 15 per kg on a certain date. In anticipation X contracted to purchase from Z the same quantity at ₹ 8 per kg. Z does not deliver the sugar to X. X suffers the loss of ₹ 7 per kg. Can he recover this loss from Z?*

[Hint: No. This loss amount to special loss which X and Z had not contemplated in their contract.

3 *A appointed B to accompany him on a tour for three months from 1st july at a certain salary. Before the 1st July, A told B that B was no more required by him. Can B sue A ?*

[Hint: Yes on the basis of the anticipatory breach of contract]

4. *In case of breach of promise to marry the damages are awarded under what type of measurement of damage and what will be taken into account to give damage?*

[Hint: Exemplary damages, would take into account the injury suffered by the person]

5. *When the buyer breaks the contract, the damage would be the difference between ___ price and _____ price.*

When the seller breaches the contract, the buyer can recover the difference between.____ price and _____ price as on the date of breach.

[Hint: Contract, Market & Market, Contract]

6. *How liquidated damages and penalty are imposed?*

[Hint: By compensation and punishment]

UNIT – 6: CONTINGENT AND SPECIAL CONTRACTS

Contingent contract

Question 1

Pick out the correct answer from the following:

(a) In case of void agreements, collateral transactions are:

(1) Also void

(2) Unenforceable

(3) Not affected

(4) Illegal.

(b) A contract of insurance is:

(1) Contingent Contract

(2) Wagering Agreement

(3) Contract of Guarantee

(4) Unilateral Agreement.

Answer

(a) (3) Not affected.

(b) (1) Contingent Contract.

Question 2

Pick-up the correct answer from the following and give reason:

A contingent contract is:

(1) Valid *(2) Void*

(3) Voidable *(4) Illegal.*

Answer

Option (1) is the correct answer : Contingent contract is a contract to do or not to do something, if some event collateral to such contract does or does not happen.

Rules relating to Enforcement

Question 3

What are contingent contracts? Explain the rules for enforcement. How does it differ from wagering agreement?

Answer

Section 31 of the Indian Contract Act,1872 defines contingent contract as the contracts, which are conditional on some future event happening or not happening and are enforceable when the future event or loss occurs.

Rules for enforcement-

- Contingent contract dependent on the happening of some uncertain future event.
- Contingent contract dependent upon not happening of some uncertain future event.
- Contingent contract dependent upon the future act or conduct of a living person.
- Contingent contract dependent upon the happening of specified event within fixed time.
- Contingent contract dependent upon specified event not happening within fixed time.
- Contingent contracts depends upon impossible event.

Contingent contract and wagering agreement

Contingent contract is a contract to do or not to do something if some event, collateral to such contract does or does not happen whereas on other hand a wagering agreement is a promise to give money or money's worth upon the determination or ascertainment of an uncertain event.

Question 4

Enumerate the differences and similarities between 'wagering agreements' and 'contingent contracts'.

Answer

Distinction and similarities between wagering agreement and contingent contract are as follows – [Note that there cannot be any 'wagering contract', as wagering agreement is void and cannot become 'contract'].

Wagering Agreement	Contingent Contract
Differences	
A wagering agreement is a promise to give money or money's worth, depending on a future uncertain event.	A contingent contract is to do or not to do something if some event does or does not happen [section 32].
In a wager, the future event is the only event. It is the sole determining factor of contract in wager.	In contingent contract, the future uncertain event is collateral to the contract.
In a wagering agreement, parties have no pecuniary or financial interest in subject matter	In contingent contract, the party has pecuniary financial interest in the event.

except the winning or losing amount or wager.	
Wagering agreement is a game of chance. Wagering agreement consists of reciprocal promises. It is a set of mutual promises, each of them conditional on the happening or not happening of a future uncertain event.	A contingent event is uncertain but not a game of chance. A contingent contract may or may not contain reciprocal promises.
In a wager, the uncertain event is beyond the power of both parties.	In contingent contract, the event may be within the power of one of the parties.
Wagering agreement is void.	Contingent contract is valid.
Similarities	
Performance of agreement depends on happening or not happening of a future uncertain event.	Performance of agreement depends on happening or not happening of a future uncertain event.

Quasi – Contracts

Question 5

X, a minor was studying M.Com. in a college. On 1st July, 2005 he took a loan of ₹ 10,000 from B for payment of his college fees and to purchase books and agreed to repay by 31st December, 2005. X possesses assets worth ₹ 2 lakhs. On due date X fails to pay back the loan to B. B now wants to recover the loan from X out of his (X's) assets. Referring to the provisions of the Indian Contract Act, 1872 decide whether B would succeed.

Answer

Yes, B can proceed against the assets of X. According to section 68 of the Indian Contract Act, 1872 "If a person, incapable of entering into a contract, or any one whom he is legally bound to support, is supplied by 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." Since the loan given to X is for the necessaries suited to the conditions in life of the minor, his assets can be sued to reimburse B.

Question 6

Y holds agricultural land in Gujarat on a lease granted by X, the owner. The land revenue payable by X 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 termination of Y's lease. Y, in order to prevent the sale and the consequent termination of his own lease, pays the Government, the sum due from X. Referring to the provisions of the Indian Contract Act, 1872 decide whether X is liable to make good to Y, the amount so paid ?

Answer

Yes, X is bound to make good to Y the amount so paid. Section 69 of the Indian Contract Act, 1872, 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. In the given case Y has made the payment of lawful dues of X in which Y had an interest. Therefore, Y is entitled to get the reimbursement from X.

Question 7

Z rent out his house situated at Mumbai to W for a rent of ₹ 10,000 per month. A sum of ₹ 5 lac, the house tax payable by Z to the Municipal Corporation being in arrears, his house is advertised for sale by the corporation. W pays the corporation, the sum due from Z to avoid legal consequences. Referring to the provisions of the Indian Contract Act, 1872 decide whether W is entitled to get the reimbursement of the said amount from Z.

Answer

Section 69 of the Indian Contract Act, 1872 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".

In the given problem W has made the payment of lawful dues of Z in which W had an interest. Therefore, W is entitled to get the reimbursement from Z.

Question 8

The principle that no one shall be allowed to enrich himself at the expense of another is known as:

1. *Quantum Meruit*
2. *Nudum Pactum*
3. *Quasi-contract*
4. *None of these.*

Answer

Correct answer is *(3) i.e. "Quasi Contract"* : In certain situations, a person is obliged to compensate another although the basis of this obligation is neither a contract between the parties nor any tort on the part of the person who is bound to compensate. The basis of the obligation is that no one should have unjust benefit at the cost of the other. It is based on equity. These obligations relate to money and such other benefits, which the party under obligation has benefited from the other.

Question 9

Enumerate the rights of the finder of lost goods.

Answer

Finding is not keeping. The finder must make reasonable efforts to locate the real owner and may also spend reasonable money in taking care of the goods found. However, he earns

certain rights also as against the goods found as well as the owner of those goods. His rights are:

(1) He has a right of lien over the goods for his expenses. But he has no right to sue the owner for any such compensation (Section 168).

(2) He can sue for any specific reward, which the owner has offered for the return of goods (Section 168).

(3) He can even sell the goods under the following circumstances:

   (a) If the owner cannot with reasonable diligence be found;

   (b) If found , he refuses to pay the lawful charges of the finder;

   (c) If the goods are in the danger of perishing or of losing the greater part of their value

   (d) If the lawful charges of the finder, in respect of the goods found, amount to more than two thirds of their value (Section 169).

EXERCISE

1. *M found a purse in a mall. He deposited the purse to the manager of the mall, so that the true owner can claim it back. However , no one claimed the purse. M wants the purse back. Can he succeed?*

   [Hint: Yes, finder's right of possession is superior to all except the true owner.]

2. *P pays the arrears of rent of his nephew to his landlord just to avoid tension . Can he recover this amount from his nephew?*

   [Hint: No, Section 69 applies only when such a payment is made in which the person is interested]

3. *N had to pay property tax to the government. To save N's property from being seized by the government, N's friend O paid the tax to the government in N's presence. Can O recover the money from N?*

   [Hint: Yes, under the section 70 of the Indian Contract Act,1872]

4. *A promises to sell his bike to Z for ₹ 75,000 if he feels like selling it after having a new bike. Is it a contingent contract?*

   [Hint: No, it is a void agreement because it is an uncertain agreement]

5. *A agrees to make a furniture for B for ₹ 1 lac on the term that payment will be made after the completion of the work. Is it a contingent contract?*

   [Hint: No ,because the uncertain event(completion of the work) is not collateral to the contract, but the main part of the consideration in the contract]

6. *'A' agrees to pay 'B' ₹ One lakh if sun rises in the west next morning. Is the contract valid?*

   [Hint: No-Contract is void]

7. *A promises to give money or money's worth if an uncertain event happens or does not happen is…….agreement. A contract to do or not to do something with reference to a collateral event happening or not happening is…….contract.*

   [Hint: Wagering & Contingent]

UNIT – 7: CONTRACT OF INDEMNITY AND GUARANTEE

Contract of Indemnity

Question 1

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

A contracts to save B against the consequences of any proceedings, which C may take against B in respect of a certain sum of 500 rupees. This is a:

(1) Contract of guarantee *(2) Quasi contract*

(3) Contract of indemnity *(4) Void contract.*

Answer

No. (3): *'Contract of Indemnity'* : A Contract of indemnity is a Contract by which one party promises to save or indemnify the other from loss caused to him by the promisor himself or by the conduct of any other person (Section 124, Indian Contract Act, 1872).

Guarantee

Question 2

M advances to N ₹ 5,000 on the guarantee of P. The loan carries interest at ten percent per annum. Subsequently, N becomes financially embarrassed. On N's request, M reduces the interest to six per cent per annum and does not sue N for one year after the loan becomes due. N becomes insolvent. Can M sue P?

Answer

M cannot sue P, because a surety is discharged from liability when, without his consent, the creditor makes any change in the terms of his contract with the principal debtor, no matter whether the variation is beneficial to the surety or does not materially affect the position of the surety (Sec.133, Indian Contract Act, 1872).

Question 3

Choose the correct answer from the following and give reason:

In a Contract of Guarantee there is/are :

(a) One contract *(b) Two contracts*

(c) Three contracts *(d) Four contracts.*

Answer

Answer (c)

Reason: In a Contract of Guarantee there are three contracts arising between the Creditor & Principal debtor, Creditor and Surety and Principal debtor and Surety. However, the contract is primarily between Principal debtor & Creditor whereas the other two contracts are ancillary.

Alternate Answer

[As per the definition given under Section 126 of the Indian Contract Act, 1872, it states that a 'Contract of Guarantee' is a contract to perform the promise, or discharge the liability, of a third person in case of his default.

Therefore, Contract of Guarantee is a single contract primarily between Principal Debtor and the Creditor with Surety standing as collateral only. The liability of Surety will occur when there is default of the Principal Debtor.

So, Contract of Guarantee is a single contract with the three parties.]

Question 4

What are the rights of the indemnity-holder when sued?

Answer

According to the Section 125 of the Indian Contract Act,1872 the indemnity holder i.e., promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor :

(1) all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;

(2) all costs which he may be compelled to pay in any such suit, if in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorised him to bring or defend the suit.

(3) all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorised him to compromise the suit.

Section 125 is by no means exhaustive, which deals only with his rights in the event of his being sued. The indemnity holder has other rights besides those mentioned above. If he has incurred a liability and that liability is absolute he is entitled to call upon his indemnifier to save him from that liability and to pay it off.

Question 5

Define contract of indemnity and contract of guarantee and state the conditions when guarantee is considered invalid?

Answer

Section 124 of the Indian Contract Act,1872 says that "A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or the conduct of any person", is called a "contract of indemnity".

Section 126 of the Indian Contract Act says that "A contract to perform the promise made or discharge liability incurred by a third person in case of his default." is called as "contract of guarantee".

The conditions under which the guarantee is invalid or void are stated in section 142,143 and 144 of the Indian Contract Act are:

(i) Guarantee obtained by means of misrepresentation.

(ii) creditor obtained any guarantee by means of keeping silence as to material circumstances.

(iii) When contract of guarantee is entered into on the condition that the creditor shall not act upon it until another person has joined in it as co-surety and that other party fails to join as such.

Nature of Surety's Liability

Question 6

Point out the circumstances in which a surety is discharged from liability by the conduct of the creditor.

Answer

Discharge of Surety is a person who promises to undertake the responsibility to perform the promise or discharge the liability of third person in case of his default (Section 126). A surety is said to be discharged when his liability come to an end. A surety may be discharge from his liability by the conduct of the creditor in the following cases:

(i) Variance in terms of contract (Section 133): Any variance, made with out the surety's consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as transactions subsequent to the variance.

(ii) Release or discharge of principal debtor (Section 134): The surety is discharged by any contract between the creditor and the principal debtor by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

But in the following cases the surety will not be discharged even through the principal debtor has been released.

(a) If the principal debtor is discharged by operation of law e.g. discharge/insolvency.

(b) If creditor omits to sue the principal debtor within the period of limitation.

(iii) By impairing surety's remedy (Section 139): If the creditor does any act which is inconsistent with the rights of the surety, or omits to do any act which the duty to the surety requires him to do, and the eventual remedy of surety himself against the principal debtor is thereby impaired, the surety is discharged.

(iv) Compounding by creditor with the principal debtor (Section 135): Any contract between the principal debtor and the creditor by which the creditor makes composition with, or

promises to given time to, or not to sue, the principal debtor, discharges the surety, unless the surety assents to such contract.

But under this head the surety is not discharged in the following cases:

(a) 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 (Section 136).

(b) Mere forbearance on the part of the creditor to sue the principal debtor to enforce any other remedy against him does not discharge the surety (Section 137)

(c) Where there are co-sureties, release by the creditor of one of them does not discharge the other; neither does it free the surety so released from his responsibility to the other sureties (Section 138).

(v) By loss of security (Section 141): If the creditor loses or without the consent of the surety, parts with any security given to him at the time of the contract of guarantee, the surety is discharged from liability to the extent of the value of security.

(vi) Guarantee obtained by misrepresentation or concealment: Where a guarantee is obtained by misrepresentation or concealment by the creditor concerning a material part of the transaction, the surety is discharged.

Question 7

Mr. X, is employed as a cashier on a monthly salary of ₹ 2,000 by ABC bank for a period of three years. Y gave surety for X's good conduct. After nine months, the financial position of the bank deteriorates. Then X agrees to accept a lower salary of ₹ 1,500/- per month from Bank. Two months later, it was found that X has misappropriated cash since the time of his appointment. What is the liability of Y?

Answer

If the creditor makes any variance (i.e. change in terms) without the consent of the surety, then surety is discharged as to the transactions subsequent to the change. In the instant case Y is liable as a surety for the loss suffered by the bank due to misappropriation of cash by X during the first nine months but not for misappropriations committed after the reduction in salary. [Section 133, Indian Contract Act, 1872].

Question 8

B owes C a debt guaranteed by A. C does not sue B for a year after the debt has become payable. In the meantime, B becomes insolvent. Is A discharged? Decide with reference to the provisions of the Indian Contract Act, 1872.

Answer

Discharge of surety

The problem is based on the provisions of Section 137 of the Indian Contract Act, 1872 relating to discharge of surety. The section states that mere forbearance on the part of the creditor to sue the principal debtor and/or to enforce any other remedy against him would not, in the absence of any provision in the guarantee to the contrary, discharge the surety. In view of these provisions, A is not discharged from his liability as a surety.

Continuing Guarantee

Question 9

Ravi becomes guarantor for Ashok for the amount which may be given to him by Nalin within six months. The maximum limit of the said amount is ₹ 1 lakh. After two months Ravi withdraws his guarantee. Upto the time of revocation of guarantee, Nalin had given to Ashok ₹ 20,000.

(i) Whether Ravi is discharged from his liabilities to Nalin for any subsequent loan.

(ii) Whether Ravi is liable if Ashok fails to pay the amount of ₹ 20,000 to Nalin?

Answer

Discharge of Surety by Revocation (Problem): As per section 130 of the India Contract Act, 1872 a specific guarantee cannot be revoked by the surety if the liability has already accrued. A continuing guarantee may, at any time, be revoked by the surety, as to future transactions, by notice to the creditor, but the surety remains liable for transactions already entered into.

As per the above provisions, the answer is Yes. Ravi is discharged from all the subsequent loans because it's a case of continuing guarantee. Where as in second case (ii) Ravi is liable for payment of ₹ 20,000 to Nalin because the transaction has already completed.

Question 10

'A' stands surety for 'B' for any amount which 'C' may lend to B from time to time during the next three months subject to a maximum of ₹ 50,000. One month later A revokes the guarantee, when C had lent to B ₹ 5,000. Referring to the provisions of the Indian Contract Act, 1872 decide whether 'A' is discharged from all the liabilities to 'C' for any subsequent loan. What would be your answer in case 'B' makes a default in paying back to 'C' the money already borrowed i.e. ₹ 5,000?

Answer

The problem as asked in the question is based on the provisions of the Indian Contract Act 1872, as contained in Section 130 relating to the revocation of a continuing guarantee as to future transactions which can be done mainly in the following two ways:

1. By Notice: A continuing guarantee may at any time be revoked by the surety as to future transactions, by notice to the creditor.
2. By death of surety: The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions. (Section 131).

   The liability of the surety for previous transactions however remains.

   Thus applying the above provisions in the given case, A is discharged from all the liabilities to C for any subsequent loan.

   Answer in the second case would differ i.e. A is liable to C for ₹ 5,000 on default of B since the loan was taken before the notice of revocation was given to C.

Discharge of a surety

Question 11

Mr. X, is employed as a cashier on a monthly salary of ₹ 2,000 by ABC bank for a period of three years. Y gave surety for X's good conduct. After nine months, the financial position of the bank deteriorates. Then X agrees to accept a lower salary of ₹ 1,500/- per month from Bank. Two months later, it was found that X has misappropriated cash since the time of his appointment. What is the liability of Y?

Answer

If the creditor makes any variance (i.e. change in terms) without the consent of the surety, then surety is discharged as to the transactions subsequent to the change. In the instant case Y is liable as a surety for the loss suffered by the bank due to misappropriation of cash by X during the first nine months but not for misappropriations committed after the reduction in salary. [Section 133, Indian Contract Act, 1872].

Question 12

M advances to N ₹ 5,000 on the guarantee of P. The loan carries interest at ten percent per annum. Subsequently, N becomes financially embarrassed. On N's request, M reduces the interest to six per cent per annum and does not sue N for one year after the loan becomes due. N becomes insolvent. Can M sue P?

Answer

M cannot sue P, because a surety is discharged from liability when, without his consent, the creditor makes any change in the terms of his contract with the principal debtor, no matter whether the variation is beneficial to the surety or does not materially affect the position of the surety (Sec. 133, Indian Contract Act, 1872).

Question 13

A gives to C a continuing guarantee to the extent of ₹ 5000 for the vegetables to be supplied by C to B from time to time on credit. Afterwards, B became embarrassed, and without the

knowledge of A, B and C contract that C shall continue to supply B with vegetables for ready money, and that the payments shall be applied to the then existing debts between B and C. Examining the provision of the Indian Contract Act, 1872, decide whether A is liable on his guarantee given to C.

Answer

The problem as asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 133. The section provides that any variance made without the surety's consent in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.

In the given problem all the above requirements are fulfiled. Therefore, A is not liable on his guarantee for the vegetable supplied after this new arrangements. The reason for such a discharge is that the surety agreed to be liable for a contract which is no more there and he is not liable on the altered contract because it is different from the contract made by him.

Question 14

C, the holder of an over due bill of exchange drawn by A as surety for B, and accepted by B, contracts with X to give time to B. Is A discharged from his liability ?

Answer

According to Section 136 of the Indian Contract Act, 1872, 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. In the given question the contract to give time to the principal debtor is made by the creditor with X who is a third person. X is not the principal debtor. Hence A is not discharged.

Question 15

A contracts with B for a fixed price to construct a house for B within a stipulated time. B would supply the necessary material to be used in the construction. C guarantees A's performance of the contract. B does not supply the material as per the agreement. Is C discharged from his liability.

Answer

According to Section 134 of the Indian Contract Act, 1872, the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released or by any act or omission for the creditor, the legal consequence of which is the discharge of the principal debtor. In the given case the B omits to supply the timber. Hence C is discharged from his liability.

Rights of surety against the principal debtor and creditor

Question 16

What are the rights of a surety against the principal debtor and as against co-sureties?

Answer

Rights of a surety against the Principal Debtor:

1. Right to be subrogated (Section 140)
2. Right to claim indemnity (Section 145)

Right of surety against co-sureties:

When a debt is guaranteed by two or more sureties, they are known as co-sureties. The rights are

1. Liability of co-sureties to contribute equally in the absence of any contract to the contrary (Section 146).
2. Liability for equal limits (Section 147). where the co-sureties have agreed to guarantee different sums, they have to contribute equally subject to maximum amount guaranteed by any one.
3. Right to share security obtained from the creditor.

Contribution as between Co-Sureties

Question 17

What are the principles of law of guarantee with regard to contribution of the same debt between the co-sureties?

Answer

Contribution as between co-sureties: The principle in this regard is laid down in Section 146 of the Indian Contract Act, 1872 which is as follows:

"When two or more persons are co-sureties for the same debt, or duty either jointly, or severally and whether under the same or different contracts and whether with or without the knowledge of each other, the co-sureties in the absence of any contract to the company, 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".

A co-surety is entitled to recover from other sureties the amount that he has paid but the right arises only if the surety has paid an amount beyond his share of the debt to the creditor, for only then does it become certain that there is ultimately a case for contribution at all. A judgement against the surety at the suit of the creditor for the full amount of the guarantee will have the same effect as payment made for these parties and would entitle the surety or his representative to a declaration of the right to contribution on the very same principle by which the rights of company trustees in respect of amount which they are made liable to pay are settled.

Liabilities of two sureties are not affected by mutual agreements between them. This principle has been laid down in Section 132 which runs thus, where two persons, contract with a third

party to undertake a certain liability, and also contract with each other that one of them shall be liable only on the default of the other the third person not being a party to such contract, the liability of each of such two persons to the third person under the first contract is not affected by the existence of the second contract, although such third person may have been aware of its existence.

This position is applicable when the liability is undertaken jointly by two parties in respect of the same debt but not in different debts [*Pogose v. Bank of Bengal (1877)].*

EXERCISE

1. *X contracts to indemnify Y for the loss resulting out of litigation filed against him(Y) by Z. Z obtains a court decree against Y. Before paying to Z, Y sues X to get the promised amount. Will B succeed?*

   [Hint: Yes, the liability of the indemnifier commences as soon as the liability of the indemnifier becomes absolute]

2. *A became surety before X for payment of rent by Y under a lease. Subsequently, without A's consent, Y agreed to pay higher rent to X. What is the position of the A?*

   [Hint: A is discharged in respect to arrears of rent subsequent to such variance]

3. *D, a dealer, supplies certain goods to F in separate lots regularly. Z guarantees payment by F upto ₹ 45,000 for goods supplied from time to time. Can a Guarantee by Z be revoked?*

   [Hints: Yes, Because it is a continuing guarantee.]

4. *A farmer contracted to sell grains to merchant to be grown on his land. S guarantees performance by farmer. Merchants later divert the stream of water necessary for irrigation of Farmer's land. As a result, the crop could not be grown. Is S liable for the guarantee ?*

   [Hint: No, S is not liable for the guarantee as per section 134 of the Indian Contract Act,1872]

5. *A obtains housing loan from LIC Housing and if B promises to repay what is the nature of contract?*

   [Hint: Contract of Guarantee]

6. *If A becomes a surety to C for payment of rent by B under a lease and B and C contract, without the consent of 'A' that 'B' will pay higher rent, then what would be the liability of 'A' as a surety?*

   [Hint: A will be discharged from his liability]

7. *'A' puts 'M' as the cashier under 'B' and agrees to stand as surety provided, 'B' checks the cash every month. B does not check the cash every month. 'M' embezzles the cash. What is the liability of 'A' in this case?*

   [Hint: A was not held to be responsible]

8. *On discharging the debt due by the principal debtor to the creditor what is the remedy available to the surety?*

   [Hint: He can proceed against the principal debtor]

UNIT – 8: BAILMENT AND PLEDGE

What is Bailment?

Question 1

What is Bailment? Explain the rights and duties of Bailor?

Answer

Bailment is defined as an act whereby goods are delivered by the person to another for some purpose on a contract that the goods shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.

Bailor – the person who delivers the goods

Bailee- the person to whom the goods are delivered.

Bailors duties and rights

Duties

(i) Bailor has to disclose all the facts/faults about bailed goods to bailee.

(ii) Under gratuitous bailment, Bailor has to reimburse expenses incurred by Bailee, if any.

(iii) Bailor has to compensate the loss on bailed goods to Bailee, if any.

(iv) Bailor has to accept the goods after purpose is accomplished.

Rights

(i) To enforce bailee's duties such as right to claim damages, compensation, if any.

(ii) To terminate the contract of bailment.

(iii) To demand back goods.

(iv) To claim increase or profit from goods bailed.

Question 2

Examine whether the following constitute a contract of 'Bailment' under the provisions of the Indian Contract Act, 1872:

(i) V parks his car at a parking lot, locks it, and keeps the keys with himself.

(ii) Seizure of goods by customs authorities.

Answer

(i) No. Mere custody of goods does not mean possession. For a bailment to exist the bailor must give possession of the bailed property and the bailee must accept it, Section 148, of the Indian Contract Act, 1872 is not applicable.

(ii) Yes, the possession of the goods is transferred to the custom authorities. Therefore bailment exists and section 148 is applicable.

Question 3

A, the bailor, pledges a cinema projector and other accessories with Cine Association Co-operative Bank Limited, the bailee, for a loan. A requests the bank to allow the pledged goods to remain in his possession and promises to hold the same in trust for the bailee and also further promises to handover the possession of the same to the bank whenever demanded. Examining the provisions of the Indian Contract Act, 1872 decide, whether a valid contract of pledge has been made between A, the bailor and Bank, the bailee?

Answer

Delivery to pawnee under Indian Contract Act, 1872: The problem as asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 149 (delivery to bailee and pledgee). The Section provides that the delivery of the goods to the bailee may be made by actual or constructive delivery or delivery by attornment to the bank. In such a case there is change in the legal character of the possession of goods though not in the actual or physical custody. Though the bailor continues to be in possession of the goods, it is the possession of the bailee.

In the given problem the delivery of the goods is constructive i.e. delivery by attornment to the bailee (pawnee) and the possession of the goods by A, the bailor is construed as possession by bailee/pawnee, the Bank. A constructive pledge comes into existence as soon as the pawnor, without actually delivering the goods, promises to deliver them on demand. The transaction was, therefore, a valid pledge. On this point, the decision given by the Andhra Pradesh High Court in *Bank of Chittur Ltd. vs. Narasimhulu AIR 1966 AP 163* is relevant.

Question 4

A hires a carriage of B and agrees to pay ₹ 500 as hire charges. The carriage is unsafe, though B is unaware of it. A is injured and claims compensation for injuries suffered by him. B refuses to pay. Discuss the liability of B.

Answer

Problem asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 150. The section provides that if the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed. Accordingly, applying the above provisions in the given case B is responsible to compensate A for the injuries sustained even if he was not aware of the defect in the carriage.

Bailee has right to terminate

Question 5

A bails his jewelry with B on the condition to safeguard in bank's safe locker. However, B kept in safe locker at his residents, where he usually keeps his own jewelry. After a month all jewelry was lost in a religious riot. A filed a suit against B for recovery. Referring to provisions of the Indian Contract Act, 1872, state whether A will succeed.

Answer

Referring to the Section 152 of the Indian Contract Act, 1872, B is liable to compensate A for his negligence to keep jewelry at his resident. Here, A and B agreed to keep the jewelry at the Bank's safe locker and not at the latter's residence.

Rights of bailee

Question 6

Sunil delivered his car to Mahesh for repairs. Mahesh completed the work, but did not return the car to Sunil within reasonable time, though Sunil repeatedly reminded Mahesh for the return of the car. In the meantime a big fire occurred in the neighborhood and the car was destroyed. Decide whether Mahesh can be held liable under the provisions of the Indian Contract Act, 1872.

Answer

The problem asked in the question is based on the provisions of section 160 and 161 of the Indian Contract Act, 1872. Accordingly, it is the duty of the bailee to return or deliver the goods bailed according to the bailor's directions, without demand, as soon as the time for which they were bailed has expired, or the purpose for which they were bailed has been accomplished. According to Section 161, if, by the default of the bailee, the goods are not returned, delivered or tendered at the proper time, he is responsible to the bailor for any loss, destruction or deterioration of the goods from that time, notwithstanding the exercise of reasonable care on his part.

Therefore, applying the above provisions in the given case, Mahesh is liable for the loss, although he was not negligent, but because of his failure to deliver the car within a reasonable time *(Shaw & Co. v. Symmons* & Sons).

Question 7

M lends a sum of ₹5,000 to B, on the security of two shares of a Limited Company on 1st April 2007. On 15th June, 2007, the company issued two bonus shares. B returns the loan amount of ₹5,000 with interest but M returns only two shares which were pledged and refuses to give the two bonus shares. Advise B in the light of the provisions of the Indian Contract Act, 1872.

Answer

Bailee's Duties and Liabilities : The problem as asked in the question is based on the provisions of Section 163(4) of the Indian Contract Act, 1872. As per the section, "in the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, any increase or profit which may have accrued from the goods bailed."

Applying the provisions to the given case, the bonus shares are an increase on the shares pledged by B to M. So M is liable to return the shares along with the bonus shares and hence B the bailor, is entitled to them also *(Motilal v Bai Mani).*

Question 8

R gives his umbrella to M during raining season to be used for two days during Examinations. M keeps the umbrella for a week. While going to R's house to return the umbrella ,M accidently slips and the umbrella is badly damaged. Who bear the loss and why?

Answer

M shall have to bear the loss since he failed to return the umbrella within the stipulated time and Section 161 clearly says that where a bailee fails to return the goods within the agreed time, he shall be responsible to the bailor for any loss, destruction or deterioration of the goods from that time notwithstanding the exercise of reasonable care on his part.

Pledge

Question 9

What do you mean by Pledge? What is Pawnor's right to redeem ?

Answer

Pledge : Section 172 of the Indian Contract Act,1872 defines a pledge as the bailment of goods as security for payment of debt or performance of a promise. When goods have been pledged, the bailor is called in this case the pawner and the bailee, the pawnee. In the case of pledge no transfer of any interest in property takes place; but a special right to property is carved out in favour of the pledgee, i.e. he has right to dispose of the property in certain circumstances.

Pawnor's right to redeem: As per the provision laid down under Section 177 of the Indian Contract Act, 1872 if a time is stipulated for the payment of the debt or performance of the promise; for which the pledge is made, and the pawnor makes default, he may redeem the goods pledged at any subsequent time before the goods are sold, but in that case, he must pay, in addition, any expenses occasioned by the default.

The period for a suit against a pawnee to recover the things pledged is 3 years from the date of pawnee's refusal to do so after demand (The Limitation Act 1963 - Schedule, 70).

Question 10

Ravi sent a consignment of goods worth ₹ 60,000 by railway and got railway receipt. He obtained an advance of ₹ 30,000 from the bank and endorsed and delivered the railway receipt in favour of the bank by way of security. The railway failed to deliver the goods at the destination. The bank filed a suit against the railway for ₹ 60,000. Decide in the light of provisions of the Indian Contract Act, 1872, whether the bank would succeed in the said suit?

OR

X sent a consignment of mobile phones worth ₹ 60,000 to Y and obtained a railway receipt therefore. Later,he borrowed a loan of ₹ 40,000 from Star Bank and endorsed the railway receipt in favour of the Bank as security. In transit the consignment of mobile phones was lost.

The Bank files a suit against the railway for a claim of ₹ 60,000, the value of the consignment. The railway contended that the Bank is entitled to recover the amount of loan i.e. ₹ 40,000 only. Examining the provisions of the Indian Contract Act, 1872, decide, whether the contention of the railway is valid.

Answer

Rights of Bailee: As per Sections 178 and 178A of the Indian Contract Act, 1872 the deposit of title deeds with the bank as security against an advance constitutes a pledge. As a pledgee, a banker's rights are not limited to his interest in the goods pledged. In case of injury to the goods or their deprivation by a third party, the pledgee would have all such remedies that the owner of the goods would have against them. In *Morvi Mercantile Bank Ltd. vs. Union of India*, the Supreme Court held that the bank (pledgee) was entitled to recover not only the amount of the advance due to it, but the full value of the consignment. However, the amount over and above his interest is to be held by him in trust for the pledgor. Thus, the bank will succeed in this claim of ₹ 60,000 against Railway.

Question11

Choose the correct answer from following:

The delivery of goods by one person to another for some specific purpose and time is known as:

(a) Mortage

(b) Pledge

(c) Bailment

(d) Charge

Answer

(c) Bailment

Question 12

State the essential elements of a contract of bailment. Distinguish between the 'contract of bailment' and 'contract of pledge'.

Answer

Essential elements of a contract of bailment: Section 148 of the Indian Contract Act, 1872 defines the term 'Bailment'. A 'bailment' is the delivery of goods by one person to another for some purpose upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The essential elements of the contract of the bailment are :-

1. *Delivery of goods – The essence of bailment is delivery of goods by one person to another.*

2. *Bailment is a contract – In bailment, the delivery of goods is upon a contract that when the purpose is accomplished, the goods shall be returned to the bailor.*
3. *Return of goods in specific - The goods are delivered for some purpose and it is agreed that the specific goods shall be returned.*
4. *Ownership of goods – In a bailment, it is only the possession of goods which is transferred and the bailor continues to be the owner of the goods .*
5. *Property must be movable – Bailment is only for movable goods and never for immovable goods or money.*

Difference between contract of bailment and contract of pledge:-

1. *Right of sale – In case of pledge, the pawnee (pledgee) can sell the goods and recover his debt, if pawnor (pledger) does not pay while in bailment the bailee can retain the goods and sue for damages, but he has no authority to sell the goods.*
2. *Purpose – Pledge is specifically for securing a debt, while bailment may be for any purpose e.g. for repairs, safe custody etc.,*
3. *Right to use the goods – In case of pledge, pawnee cannot use the goods pledged but bailee can use the bailed goods if contract so provides.*

EXERCISE

1. *A gives his old jewellery to a jeweler for making a new jewellery. He defaults in paying the service charges to jeweler. Can jeweler exercise lien for this?*

   [Hint: Yes, the jeweler is entitled to exercise particular lien till he is paid]
2. *A takes a mobile by fraud from owner. Before owner avoids the contract, A pledges the mobile with C, who takes it in good faith, Can owner recover the mobile from C?*

   [Hint: Yes, but only after paying the loan taken by A]
3. *M had taken the car from N for use for three days. M keeps it for seven days. Then in spite of his utmost care, the car is damaged. Is M liable for damages to N?*

   [Hint: Yes, under section 161,when bailee fails to return in time, he is liable for any loss to the goods.]
4. *Is depositing of money in a bank is a bailment? And why or why not?*

   [Hint: No-the money cannot be identified]
5. *Is depositing of ornaments in a bank locker bailment?*

   [Hint: No- the ornaments are in possession of owner]
6. *'X' bails his ornament to 'Y' and 'Y' keeps this ornament in his own locker at his house along with his own ornaments and if all the ornament are lost, whether 'Y' is responsible for the loss to 'X'?*

   [Hint: No- he has exercised with ordinary prudence]
7. *In bailment the bailee cannot sell the goods, he can either retain the goods or sue for non-payment of dues. What is the position in the case of pledge?*

   [Hint: He enjoys the right to sell after giving the notice]

UNIT – 9: AGENCY

What is Agency?

Question 1

State the meaning of Agency and its silent features.

Answer

The Indian Contract Act, 1872 does not define the word 'Agency'. However the word 'Agent' is defined "as a person employed to do any act for another or to represent another in dealings with third persons. The third person for whom the act is done or is so represented is called "Principal".

Salient features of agency

Following are the four salient features of agency

(i) *Basis*-The basic essence of 'agency' is that the principal is bound by the acts of the agent and is answerable to third parties.

(ii) *Consideration not necessary*-Unlike other regular contracts, a contract of agency does not need consideration.

(iii) *Capacity to employ an agent*- A person who is competent to contract alone can employ an agent. In other words, a person in order to act as principal must be a major and of sound mind.

(iv) *Capacity to be an agent*-A person in order to be an agent must also be competent to contract. In other words, he must also be a person who has attained majority and is of sound mind.

Question 2

A appoints M, a minor, as his agent to sell his watch for cash at a price not less than ₹ 700. M sells it to D for ₹ 350. Is the sale valid? Explain the legal position of M and D, referring to the provisions of the Indian Contract Act, 1872.

Answer

According to the provisions of Section 184 of the Indian Contract Act, 1872, as between the principal and a third person, any person, even a minor may become an agent. But no person who is not of the age of majority and of sound mind can become an agent, so as to be responsible to his principal. Thus, if a person who is not competent to contract is appointed as an agent, the principal is liable to the third party for the acts of the agent. Thus, in the given case, D gets a good title to the watch . M is not liable to A for his negligence in the performance of his duties.

Modes of Creation of Agency

Question 3

Briefly explain different modes of creation of an agency relationship.

Answer

The law recognises various modes to create the agency, which are as follows:

(i) Agency by actual authority

(ii) Agency by ratification

(iii) Agency by ostensible authority

(iv) Agency by necessity

(vi) Actual authority and apparent authority

Question 4

What is Agency by Ratification?

Answer

Agency by Ratification: A person may act on behalf of another without his knowledge or consent. Later on such another person may accept the act of the former or reject it. If he accepts the act of the former done without his consent, he is said to have ratified that act and it places the parties in exactly the same position in which they would have been, the former had later's authority at the time he made the contract. Likewise, when an agent exceeds the authority bestowed upon him by the principal, the principal may ratify the unauthorised act.

Question 5

State with reason whether the following statement is correct or incorrect

Ratification of agency is valid even if knowledge of the principal is materially defective.

Answer

Incorrect : Section 198 of the Indian Contract Act, 1872 provides that for a valid ratification, the person who ratifies the already performed act must be without defect and have clear knowledge of the facts of the case. If the principal's knowledge is materially defective, the ratification is not valid and hence no agency.

Question 6

State with reason whether the following statement is correct or incorrect.

No consideration is necessary to create an Agency

Answer

Correct: Unlike other regular contract, a Contract of Agency does not need consideration. In other words, the relationship between the Principal and Agent need not be supported by consideration as per Section 185 of the Contract Act, 1872.

Question 7

R is the wife of P. She purchased some sarees on credit from Q. Q demanded the amount from P. P refused. Q filed a suit against P for the said amount. Decide in the light of provisions of the Indian Contract Act, 1872, whether Q would succeed?

Answer

Problem on Agency: Problem as asked in the question is based on the provisions related with the modes of creation of agency relationship under the Indian Contract Act, 1872. Agency may be created by a legal presumption; in a case of cohabitation by a married woman (i.e. wife is considered as an implied agent, of her husband). If wife lives with her husband, there is a legal presumption that a wife has authority to pledge her husband's credit for necessaries. But the legal presumption can be rebutted in the following cases:

(i) Where the goods purchased on credit are not necessaries.

(ii) Where the wife is given sufficient money for purchasing necessaries.

(iii) Where the wife is forbidden from purchasing anything on credit or contracting debts.

(iv) Where the trader has been expressly warned not to give credit to his wife.

If the wife lives apart for no fault on her part, wife has authority to pledge her husband's credit for necessaries. This legal presumption can be rebutted only in cases (iii) and (iv).

Applying the above conditions in the given case 'Q' will succeed. He can recover the said amount from 'P' if sarees purchased by 'R' are necessaries for her.

Extent of agent's authority

Question 8

Ramesh instructed Suresh, a transporter, to send a consignment of apples to Mumbai. After covering half the distance, Suresh found that the apples will perish before reaching Mumbai. He sold the same at half the market price. Ramesh sued Suresh. Will he succeed?

Answer

An agent has the authority in an emergency to do all such acts as a man of ordinary prudence would do for protecting his principal from losses which the principal would have done under similar circumstances.

A typical case is where the 'agent' handling perishable goods like 'apples' can decide the time, date and place of sale, not necessarily as per instructions of the principal, with the intention of protecting the principal from losses. Here the agent acts in an emergency and acts as a man of ordinary prudence. In the given case Suresh had acted in an emergency situation and Ramesh will not succeed against him.

Question 9

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

A without B's authority let outs B's flat to C. Afterwards B accepts rent of the flat from C. It is an agency by :

1. *holding out*
2. *estoppel*
3. *ratification*
4. *necessity*

Answer

An agency by ratification: the acceptance of rent by B amounts to implied ratification by B of A's act of let outing flat to C.

Duties and Obligations of an Agent

Question 10

Mr. Ahuja of Delhi engaged Mr. Singh as his agent to buy a house in West Extension area. Mr. Singh bought a house for ₹ 20 lakhs in the name of a nominee and then purchased it himself for ₹ 24 lakhs. He then sold the same house to Mr. Ahuja for ₹ 26 lakhs. Mr. Ahuja later comes to know the mischief of Mr. Singh and tries to recover the excess amount paid to Mr. Singh. Is he entitled to recover any amount from Mr. Singh? If so, how much? Explain.

Answer

The problem in this case, is based on the provisions of the Indian Contract Act, 1872 as contained in Section 215 read with Section 216. The two sections provide that where an agent without the knowledge of the principal, deals in the business of agency on his own account, the principal may:

(1) repudiate the transaction, if the case shows, either that the agent has dishonestly concealed any material fact from him, or that the dealings of the agent have been disadvantageous to him.

(2) claim from the agent any benefit, which may have resulted to him from the transaction.

Therefore, based on the above provisions, Mr. Ahuja is entitled to recover ₹ 6 lakhs from Mr. Singh being the amount of profit earned by Mr. Singh out of the transaction.

Question 11

P appoints A as his agent to sell his estate. A, on looking over the estate before selling it, finds the existence of a good quality Granite-Mine on the estate, which is unknown to P. A buys the estate himself after informing P that he (A) wishes to buy the estate for himself but conceals the existence of Granite-Mine. P allows A to buy the estate, in ignorance of the existence of Mine. State giving reasons in brief the rights of P, the principal, against A, the agent.

What would be your answer if A had informed P about the existence of Mine before he purchased the estate, but after two months, he sold the estate at a profit of ₹ 1 lac?

Answer

Agent's duty to disclose all material circumstances & his duty not to deal on his own account without principal's consent. (Sections 215 and 216 of the Indian Contract Act, 1872), The problem

is based on Sections 215 & 216 of the Indian Contract Act, 1872. According to Section 215, if an agent deals on his own account in the business of the agency, without obtaining the consent of his principal and without acquainting him with all material circumstances, then the principal may repudiate the transaction. On the other hand, Section 216 provides that, if an agent, without the knowledge of his principal, acts on his own account in the business of the agency, then the principal may claim any benefit which may have accrued to the agent from such a transaction. Hence in the first instance, though P had given his consent to A permitting the latter to act on his own account in the business of agency, P may still repudiate the sale as the existence of the mine, a material circumstance, had not been disclosed to him.

In the second instance, P had knowledge that A was acting on his own account and also that the mine was in existence; hence P cannot repudiate the transaction under Section 215. Also, under Section 216, he cannot claim any benefit from A as he had knowledge that A was acting on his own account in the business of the agency.

Personal liability of the agent

Question 12

Briefly explain the circumstances under which an agent may be held personally liable.

Answer

Personal liability of an agent: The general rule is that only the principal can enforce, and can be held liable on, a contract entered into by the agent except when there is a contract to the contract. However, in the following cases an agent is personally held liable:

(i) When the contract expressly provides for his personal liability.

(ii) When the agent acts for a principal.

(iii) When he acts for an undisclosed principal.

(iv) When he acts for a principal who cannot be sued, e.g., minor.

(v) Where he signs a contract in his own name.

(vi) Where he acts for a principal not in existence e.g., promoter of a company under formation.

(vii) Where he is liable for breach of warranty.

(viii) Where he receives or pays money by mistake or fraud.

(ix) Where the agency is coupled with interest.

Question 13

Choose the correct answer from the following:

An agency in which the agent himself has interest in the subject matter of agency is called:

(a) Agency by estoppel

(b) Agency by holding out

(c) Agency by necessity

(d) Agency coupled with interest

Answer

(d) Agency coupled with interest

Principal's liability for agent's act to third parties

Question 14

Briefly explain when the principal is liable for the acts of an agent and state under what circumstances an agent is personally liable.

Answer

Principal's liabilities for Agents acts

1. When the agent exceeds his authority principal is liable for such acts.
2. Principal is bound by notice given to agent in the course of business.
3. A principal is liable where he has by words or conduct induced a belief in the contracting party that the act of the agent was within the scope of his authority.
4. The principal is liable for misrepresentation or fraud of his agent acting within the scope of his actual or apparent authority during the course of the agency business.

Agent is personally liable

1. When the contract expressly provides for the personal liability of the agent.
2. When the agent signs a negotiable instrument in his own name without making it clear that he is signing as agent.
3. Where the agent acts for a principal, who cannot be sued on account of his being a foreign sovereign, ambassador, etc.,

Irrevocable Agency

Question 15

A, who owes B ₹10,000, appoints B as his agent to sell his landed property at Delhi and after paying himself (B) what is due to him, to hand over the balance to A. Can A revoke his authority delegated to B?

Answer

According to Section 202 of the Indian Contract Act, 1872 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. In the instant case the doctrine of agency coupled with interest applies. Therefore, A cannot revoke the authority delegated to B.

Sub-Agent

Question 16

Comment on the following:

'Principal is not always bound by the acts of a sub-agent '.

Answer

The statement is correct. Normally, a sub-agent is not appointed, since it is a delegation of power by an agent given to him by his principal. The governing principle is, a delegate cannot delegate'. (Latin version of this principle is, *"delegates non potest delegare")*. However, there are certain circumstances where an agent can appoint sub-agent.

In case of proper appointment of a sub-agent, by virtue of Section 192 of the Indian Contract Act, 1872 the principal is bound by and is held responsible for the acts of the sub-agent. Their relationship is treated to be as if the sub-agent is appointed by the principal himself.

However, if a sub-agent is not properly appointed, the principal shall not be bound by the acts of the sub-agent. Under the circumstances the agent appointing the sub-agent shall be bound by these acts and he (the agent) shall be bound to the principal for the acts of the sub-agent.

Question 17

Briefly explain the positions of sub-agent and substituted agent under the law of agency.

Answer

Sub-Agent: Sub agency occurs when an agent appoints another agent. The appointment of sub agent is not lawful, because the agent is a delegate and a delegate cannot further delegate. This is based on the Latin principle "*delegates non potest delegare*".

The appointment of a sub-agent would be valid, if the terms of appointment originally contemplated it. Sometimes customs of trade may provide for appointment of sub agents. In both these cases the sub-agent would be treated as the agent of the principal.

Position of sub-agent vis a vis third parties where the sub-agent is properly appointed:

(a) *Where the sub-agent is property appointed*: The principal is bound by his acts and is therefore responsible to third parties as if he were an agent originally appointed by the principal.

(b) *In the case of appointment without authority:* In this case the principal is not bound by the acts of sub-agent and sub-agent is not bound to the principal. It is the agent who is the principal of sub agent. Where the sub-agent purportedly acts in the name of first principal, the first principal may ratify the act of sub-agent. However if the sub-agent acts in his own name or in the name of the agent who has without authority delegated to the sub-agent the business which is in fact that of the principal, the principal cannot ratify such acts of sub-agent.

Substituted Agent: Substituted agents are not sub-agents. They are agents of the principal. Where the principal appoints an agent and if that agent identifies another person to carry out the acts ordered by principal, than the second person is not to be treated as a sub-agent but only as an agent of the original principal.

For *example*, 'A' directs 'B' his solicitor to sell his property by auction and 'B' appoints 'C' an auctioneer. In this regard, 'C' is an agent of 'A' and not a sub-agent.

While selecting a "substituted agent" the agent is bound to exercise same amount of diligence as a man of ordinary prudence would and if he does so he will not be responsible for acts or negligence of the substituted agent.

For *example*, 'X' consigns goods to 'Y' a merchant for sale. 'Y in due course employs an auctioneer in goods to sell goods of 'X' and also allows him to receive the proceeds of sale. The auctioneer becomes insolvent afterwards without handing over the proceeds. Here 'Y' will not be responsible to 'X' as he has discharged his duties as a man of ordinary prudence and diligence

EXERCISE

1. *A agrees to work as an agent of B without remuneration. Later A refuses to work. Can B hold him guilty of breach of contract?*

   [Hint: No, because agreement was without consideration. However, if A had actually acted, he would have acted as valid agent]

2. *D engaged E, an auctioneer, to sell some property for a commission of ₹ 15,000. E however received secretly ₹ 1,500 also as commission from purchaser. Discuss the rights of D and E.*

   [Hint: D is entitled to recover both the amounts from E].

3. *P without Q's authority, lends Q's money to R. Later Q accepts interest on money from R. Discuss the rights of Q.*

   [Hint: Loan contract is valid. Acceptance of interest by Q amounts to implied ratification.]

4. *A person appointed by the original agent to act in the business of agency, but under the control of original agent, is known as----------*

   [Hint: Sub-agent]

5. *Which of the following agency is irrevocable?*

   (a) agency for fixed period.

   (b) agency for single transaction.

   (c) agency coupled with interest.

   (d) continuing agency.

   [Hint: Option (c)]

2
The Negotiable Instruments Act, 1881

Meaning of negotiable instruments

Question 1

Explain the meaning of negotiable instruments?

Answer

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

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

Definitions

Question 2

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

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

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

Answer

Essential Elements of a Promissory Note:

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

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

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

Question 3

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

Answer

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

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

'Holder in due course': (i) In the case of an instrument payable to bearer means any person who, for consideration became its possessor before the amount of an instrument payable. (ii) In the case of an instrument payable to order, 'holder in due course' means any person who became the payee or endorsee of the instrument before the amount mentioned in it became

payable. (iii) He had come to possess the instrument without having sufficient cause to believe that any defect existed in the title of transferor from whom he derived his title.

The problem is based upon the privileges of a 'holder in due course'. Section 42 of the Negotiable Instrument Act, 1881, states that an acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relieved from liability to any holder in due cause claiming under an endorsement by the same hand as the drawer's signature, and purporting to be made by the drawer. In this problem, P is not a fictitious payee and D, the drawer can recover the amount of the cheque from A's bankers *[North and South Wales Bank B. Macketh (1908) A.C. 137; Town and Country Advance Co. B, Provincial Bank (1917) 2 Ir. R.421].*

Question 4

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

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

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

Answer

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

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

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

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

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

Question 5

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

Answer

Essentials of a valid acceptance of a Bill of Exchange:

The essentials of a valid acceptance are as follows:

1. *Acceptance must be written*: The drawee may use any appropriate word to convey his assent. It may be sufficient acceptance even if just signatures are put without additional words. An oral acceptance is not valid in law. ‘
2. *Acceptance must be signed*: A mere signature would be sufficient for the purpose. Alternatively, the words ‘accepted’ may be written across the face of the bill with a signature underneath; if it is not so signed, it would not be an acceptance.
3. *Acceptance must be on the bill*: The acceptance should be on the face of the bill normally but it is not necessary. An acceptance written on the back of a bill has been held to be sufficient in law. What is essential is that must be written on the bill; else it creates no liability as acceptor on the part of the person who signs it.
4. *Acceptance must be completed by delivery*: Acceptance would not be complete and the drawee would not be bound until the drawee has either actually delivered the accepted bill to the holder or tendered notice of such acceptance to the holder of the bill or some person on his behalf.
5. Where a *bill is drawn in sets,* the acceptance should be put on one part only. Where the drawee signs his acceptance on two or more parts, he may become liable on each of them separately.
6. *Acceptance may be either general or qualified:* An acceptance is said to be general when the drawee assents without qualification order of the drawer. The qualification may relate to an event, amount, place, time etc. (Explanation to Section 86 of the Negotiable Instruments Act, 1881). In the given case, the acceptance is a qualified acceptance since a condition has been attached declaring the payment to be dependent on the happening of an event therein stated.

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

Question 6

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

Answer

Distinction between a Promissory Note and a Bill of Exchange:

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

Sl. No.	Promissory Note	Bill of Exchange
1.	It contains a promise to pay	It contains an order to pay
2.	The liability of the maker of a note is primary and absolute	The liability of the drawer of a bill is secondary and conditional. He would be liable if the drawee, after accepting the bill fails to pay the money due upon it provided notice of dishonor is given to the drawer within the prescribed time.
3.	It is presented for payment without any previous acceptance by maker	If a bill is payable sometime after sight, it is required to be accepted either by the drawee himself or by someone else on his behalf, before it can be presented for payment.
4.	The maker of a promissory note stands in immediate relationship with the payee and is primarily liable to the payee or the holder.	The maker or drawer of an accepted bill stands in immediate relationship with the acceptor and the payee
5.	It cannot be made payable to the maker himself, that is the maker and the payee cannot be the same person	In the case of bill, the drawer and payee or the drawee and the payee may be the same person.
6.	In the case of a promissory note there are only two parties, viz. the maker (debtor) and the payee (creditor).	In the case of a bill of exchange, there are three parties, viz., drawer, drawee and payee, and any two of these three capacities can be filled by one and the same person.
7.	A promissory note cannot be drawn in sets	The bills can be drawn in sets
8.	A promissory note can never be conditional	A bill of exchange too cannot be drawn conditionally, but it can be accepted conditionally with the consent of the holder. It should be noted that neither a promissory note nor a bill of exchange can be made payable to bearer on demand.

Question 7

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

(i) An oral acceptance

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

Answer

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

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

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

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

Question 8

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

Answer

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

In case a cheque is crossed, the banker who pays the cheque drawn by his customer, he can debit the drawer's account so paid even though the amount of cheque does not reach true owner. The protection that can be availed are if the payment has been made in due course in

good faith and without negligence too any person in possession thereof in the circumstances which do not excite any suspicion that is not entitled to receive the payment of the cheque. In other words, the condition of good faith and without negligence would be the criteria applied for judging the conduct of a collecting banker. Even though the banker is protected for having made payment of the cheque to a wrong person, the true owner of the cheque is entitled to recover the amount of the cheque from the person who had no title to the cheque.

Question 9

State whether the following statement is correct or incorrect:

A cheque marked "Not-Negotiable" is not transferable

Answer

Incorrect

Question 10

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

Answer

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

Essentials:

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

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

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

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

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

Distinction between a cheque and a bill of exchange

1. In a cheque the drawee is always a bank, whereas in a bill the drawee may be a 'bank' or any other person.
2. In a cheque days of grace are not allowed, whereas in a bill three days of grace are allowed for payment.
3. Notice of dishonour is not needed in a cheque, whereas notice of dishonour is usually required in case of a bill.

4. A cheque can be drawn to bearer and made payable on demand, whereas a bill cannot be bearer, if it is made payable on demand.
5. Cheque does not require presentment for acceptance. It needs presentment for payment. Bill, sometimes, require presentment for acceptance and it is advisable to present them for acceptance even when it is not essential to do so.
6. Cheque does not require to be stamped in India, whereas bill must be stamped according to the law.
7. A cheque may be crossed, whereas a bill cannot be crossed.
8. A cheque being a revocable mandate, the authority may be revoked by countermanding payment, and is determined by notice of the customer's death or insolvency. This is not so in the case of a bill.
9. The drawer of a bill is discharged from liability, if it is not duly presented for payment but the drawer of a cheque is not discharged by delay of the holder in presenting the cheque for payment unless the drawer has suffered some loss due to delay.

Question 11

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

Answer

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

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

Distinction between Holder and Holder in Due Course:

1. A holder may become the possessor or payee of an instrument even without consideration, whereas a holder in due course is one who acquires possession for consideration.

2. A holder in due course as against a holder must become the possessor payee of the instrument before the amount thereon become payable.
3. A holder in due course as against a holder must have become the payee of the instrument in good faith i.e., without having sufficient cause to believe that any defect existed in the transferor's title.

Question 12

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

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

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

(ii) Whether C is the Fictitious Payee?

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

Answer

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Question 13

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

Answer

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

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

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

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

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

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

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

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

Question 14

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

Answers

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

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

Question 15

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

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

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

Answer

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

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

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

Question 16

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

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

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

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

Answer

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

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

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

Thus:

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

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

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

Question 17

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

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

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

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

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

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

Answer

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

On applying the above provision in the given cases-

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

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

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

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

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

Question 18

Give the answer of the following:

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

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

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

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

Answer

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

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

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

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

Question 19

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

Answer

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

Question 20

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

Answer

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

Question 21

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

Answer

As per Section 44 of the Negotiable Instruments Act, 1881, when the consideration for which a person signed a promissory note, bill of exchange or cheque consisted of money, and was

originally absent in part or has subsequently failed in part, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionally reduced.

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

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

Question 22

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

Answer

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

Question 23

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

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

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

Answer

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

Question 24

J accepted a bill of exchange and gave it to K for the purpose of getting it discounted and handing over the proceeds to J. K having failed to discount it returned the bill to J. J tore the bill in two pieces with the intention of cancelling it and threw the pieces in the street. K picked up the pieces and pasted the two pieces together, in such manner that the bill seemed to have been folded for safe custody, rather than cancelled. K put it into circulation and it ultimately

reached L, who took it in good faith and for value. Is J liable to pay the bill under the provisions of the Negotiable Instruments Act, 1881 ?

Answer

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

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

Classification of instruments

Question 25

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

Answer

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

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

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

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

Sight and time bills etc (Sections 21 to 25)

Question 26

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

Answer

Calculation of maturity of a Bill of Exchange: The maturity of a bill, not payable on demand, at sight, or on presentment, is at maturity on the third day after the day on which it is

expressed to be payable (Section 22, para 2 of Negotiable Instruments Act, 1881). Three days are allowed as days of grace. No days of grace are allowed in the case of bill payable on demand, at sight, or presentment.

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

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

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

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

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

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

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

Question 27

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

Answer

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

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

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

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

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

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

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

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

Question 28

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

Answer

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

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

Negotiation, negotiability, assignability

Question 29

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

Answer

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

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

Types of Indorsements.

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

Question 30

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

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

Answer

The problem stated in the question is based on the provisions of the Negotiable Instruments Act, 1881 as contained in Section 53. The section provides: 'Once a negotiable instrument passes through the hands of a holder in due course, it gets cleansed of its defects provided the holder was himself not a party to the fraud or illegality which affected the instrument in

some stage of its journey. Thus any defect in the title of the transferor will not affect the rights of the holder in due course even if he had knowledge of the prior defect provided he is himself not a party to the fraud. (Section 53).

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

Question 31

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

Answer

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

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

Question 32

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

Answer

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

Different provisions relating to Negotiation

Question 33

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

Answer

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

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

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

Question 34

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

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

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

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

Answer

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

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

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

Question 35

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

Answer

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

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

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

(iii) when the drawee gives a qualified acceptance;

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

(v) when the drawee is incompetent to contract.

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

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

Provided that nothing in this section shall apply unless:

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

(ii) The payee or holder in due course of such cheque had made a demand in writing for the payment of the said amount of money from the drawer within 15 days of the receipt of information by him from the bank regarding the return of the cheque unpaid; and

(iii) The drawer of the cheque had failed to pay the money to the payee or holder in due

course of the cheque within 15 days for the written demand for payment.

Question 36

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

Answer

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

Question 37

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

Answer

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

Question 38

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

Answer

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

Question 39

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

Answer

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

- If a cheque is undated, if it is stale, that is if it has not been presented within reasonable period, which may vary three months to a year after its issue dependent on the circumstances of the case
- If the instrument is inchoate or not free from reasonable doubt
- If the cheque is post-dated and presented for payment before its ostensible date
- If the customer's funds in the banker's hands are not 'properly applicable' to the payment of cheque drawn by the former. Thus, should the funds in the banker's hands be subject to a lien or should the banker be entitled to a set-off in respect of them, the funds cannot be said to be "properly applicable" to the payment of the customer's cheque, and the banker would be justified in refusing payment.

- If the customer has credit with one branch of a bank and he draws a cheque upon another branch of the same bank in which either he has account or his account is overdrawn.
- If the bankers receive notice of customer's insolvency or lunacy
- If the customer countermands the payment of cheque for the banker's duty and authority to pay on a cheque ceases
- If a garnishee or other legal order from the Court attaching or otherwise dealing with the money in the hand of the banker, is served on the banker
- If the authority of the banker to honor a cheque of his customer is undermined by the notice of the latter's death. However, any payment made prior to the receipt of the notice of death is valid.
- If notice in respect of closure of the account is served by either party on the other.
- If it contains material alterations, irregular signature or irregular endorsement.

Question 40

State whether the following statements are correct or incorrect:

The validity period of a cheque is three months.

Answer

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

Question 41

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

Answer

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

Question 42

X, a legal successor of Y, the deceased person, signs a Bill of Exchange in his own name admitted a liability of ₹ 50,000 i.e. the extent to which he inherits the assets from the deceased payable to Z after 3 months from 1st January, 2002. On maturity, when Z presents the bill to X, he (X) refuses to pay for the bill on the ground that since the original liability was that of Y, the deceased, therefore he is not liable to pay for the bill.

Referring to the provisions of the Negotiable Instruments Act, 1881 decide whether Z can succeed in recovering ₹ 50,000 from X. Would your answer be still the same in case X does not state the limit in the bill and the liability is more than the assets he inherits from Y.

Answer

The problem is based on the provisions of the Negotiable Instruments Act, 1881 as contained in Section 29. A legal representative of a deceased person who signs his own name on a negotiable instrument, is personally liable for the entire amount thereon, unless he expressly limits his liability to the extent of the assets received by him as such (Section 29).

Applying the above provisions to the given problem Z is entitled to recover ₹ 50,000/- from X. X cannot refuse to pay the amount since he has inherited the assets of the deceased. He will be liable to the extent of the full amount of the bill even if he inherits the property valued less than the amount of the bill. Thus in the first case he will be liable to full amount of ₹ 50,000/-. In the second case since he has made a limit in the instrument itself before signing on it, his liability will be only to the extent of ₹ 50,000/- and not to the extent of the full amount as given on the instrument though he might have inherited the property of value greater amount than that of the instrument.

Question 43

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

Answer

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

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

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

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

So far as the first condition is concerned clause (a) of the proviso to section 138 does not put any embargo upon the payee to successively present a dishonoured cheque during the period of validity. It is not uncommon for a cheque being presented again and again within its validity period in the expectation that it would be encashed. The question whether dishonour of the cheque on each occasion of its presentation gives rise to a fresh cause of action, the following facts are required to be proved to successfully to prosecute the drawer for an offence under section 138:-

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

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

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

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

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

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

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

[Note: As per the RBI notification, the validity period of cheques has been reduced from 6 months to 3 months w.e.f. 1st April, 2012]

Question 44

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

Answer

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

Question 45

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

Answer

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

Question 46

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

Answer

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

Question 47

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

Answer

"The bank" referred to in clause (a) to the proviso to Section 138 of the Negotiable Instruments Act, 1881, mean the drawee-bank on which the cheque is drawn and not all banks where the cheque is presented for collection including the bank of the payee, in whose favour the cheque is issued. It, however, does not mean that the cheque is always to be presented to the

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

Question 48

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

Answer

The above matter was considered by the Supreme Court in *Oalmia Cement (Bharat) Ltd v.Galaxy Traders and Agencies Ltd., (2001) 5 CLJ 26 SC.* The Court observed that, the payee has to make a demand by giving notice in writing and it is a failure on the part of the drawer to pay the amount within 15 days [30 days as per Negotiable Instrument (Amendment and Miscellaneous Provisions) Act, 2002] of the receipt in writing of the said notice in writing giving is a process of which receipt is the accomplishment. It is therefore clear that 'giving' notice is not the same as 'receipt' of notice.

Question 49

What is the starting point for fifteen (now 30 days) days notice?

Answer

Section 138(b), inter alia, provides that the payee has to make a demand for the payment of money by giving a notice to the drawer of the cheque within 30 days of the receipt of information by him from the bank regarding the return of the cheque as unpaid. Therefore, the 30 days are to be counted from the receipt of information regarding the return of the cheque as unpaid.

Question 50

Whether demand draft is a cheque?

Answer

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

Rights and obligations of parties to an instrument obtained illegally (Sections 45A, 58, 59 and 60).

Question 51

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

Answer

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

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

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

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

Question 52

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

Answer

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

Question 53

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

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

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

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

Answer

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

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

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

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

(c) Crossing of cheque [Section 125]

The important material and non-material alternation are:

Material alteration	Non-material alteration
1. Alteration of date of instrument (e.g. if a bill dated 1st may, 1998) is changed to a	1. Conversion of instrument payable to bearer.

bill dated 1st June, 1998.	
2. Alteration of time of payment (e.g. if a bill payable three months after date is changed to bill payable four months payable after date).	2. Conversion of instrument payable to bearer into order.
3. Alteration of place of payment (e.g., if a bill payable at Delhi is changed to bill payable at Mumbai).	3. Elimination of the words 'or order' from an endorsement.
4. Alteration of amount payable (e.g., if bill for ₹ 1,000 is changed to a bill for ₹ 2000	4. Addition of the words 'or demand' to a note in which no time or payment is expressed.
5. Conversion of blank endorsement into special endorsement.	
6. Addition of a new party to an instrument.	
7. Alteration of one of the clauses of the instrument containing a penal action	

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

Question 54

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

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

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

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

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

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

Answer

(a) Yes.

(b) No.

(c) Yes.

(d) No.

(e) Yes.

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

Question 55

On a Bill of Exchange for ₹ 1 lakh, X's acceptance to the Bill is forged. 'A' takes the Bill from his customer for value and in good faith before the Bill becomes payable. State with reasons whether 'A' can be considered as a 'Holder in due course' and whether he (A) can receive the amount of the Bill from 'X'.

Answer

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

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

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

Question 56

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

Answer

In case of cheques, the paying banker is given statutory protection against the payment of cheques having forged endorsements. And the banker cannot be held liable if it makes

payment in good faith and without any negligence (Section 85, the Negotiable Instruments Act, 1881). But the banker will not be protected where the payment of a cheque is made on which the drawer's signature was forged. The reason for the same is that the banker is protected only in case of forgery of endorser's signature and not in case of forgery of drawer's signature.

Question 57

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

Answer

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

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

Question 58

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

Answer

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

Question 59

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

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

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

Answer

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

(1) the date,

(2) the sum payable,

(3) the time of payment,

(4) the place of payment,

(5) inclusion of place of payment,

(6) the rate of interest.

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

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

Question 60

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

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

Answer

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

Notice of Dishonour

Question 61

Is notice of dishonour necessary in the following cases:

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

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

Answer

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

Noting and Protesting

Question 62

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

Answer

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

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

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

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

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

Acceptance and payment for honour and reference in case of need

Question 63

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

Answer

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

The following conditions are essential for the payment of honour:

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

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

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

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

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

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

Presentment of Instruments

Question 64

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

Answer

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

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

Question 65

A issues a cheque for ₹ 25,000/- in favour of B. A has sufficient amount in his account with the Bank. The cheque was not presented within reasonable time to the Bank for payment and

the Bank, in the meantime, became bankrupt. Decide under the provisions of the Negotiable Instruments Act, 1881, whether B can recover the money from A?

Answer

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

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

Question 66

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

Answer

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

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

EXERCISE

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

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

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

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

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

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

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

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

3

The Payment of Bonus Act, 1965

The Act not to apply to certain classes of employees (Section 32)

Question 1

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

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

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

Answer

(i) As per the provisions contained in Section 32 (v) (c) of the Payment of Bonus Act, 1965, 'J' is not entitled to any bonus as the said Act is not applicable to social welfare organization..

(ii) Similarly the Payment of Bonus Act, 1965 is not applicable to the employees engaged in an industry carried on by a department of the Central Government vide Section 32 (iv) of the Payment of Bonus Act,1965.

Question 2

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

Answer

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

(*i*) Employees employed by the Life Insurance Corporation of India.

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

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

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

(ii) Employees employed by-

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

(*b*) Universities and other educational Institutions;

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

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

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

(*a*) the Industrial Finance Corporation of India;

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

(*c*) the Deposit Insurance Corporation;

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

(*e*) the Unit Trust of India;

(*f*) the Industrial Development Bank of India;

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

(h) the National Housing Bank ;

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

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

Definitions

Question 3

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

Answer

Employee [Section 2(13)]: It means any person other than an apprentice employed on a salary or wage not exceeding ₹ 10,000/- per month in any industry to do any skilled or unskilled, manual, supervisory, managerial, administrative, technical or clerical work for hire or reward, whether the terms of employment be express or implied.

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

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

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

Question 4

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

(i) overtime allowance,

(ii) dearness allowance

(iii) commission on sales

(iv) employer's contribution towards pension fund

(v) value of food.

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

Answer

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

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

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

(iii) Any traveling concession;

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

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

(vi) Any commission payable to the employee.

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

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

Who is entitled to Bonus?

Question 5

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

(i) An apprentice;

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

(iii) A temporary workman;

(iv) A piece-rated worker.

Answer

(i) An Apprentice is not entitled to bonus *[Wheel RIM Co. Vs. Govt. of Tamil Nadu (1971)]*

(ii) An employee dismissed on the ground of misconduct is disqualified for any bonus. *[Pandian Roadways Corporation Ltd. Vs. Presiding Officer (1996)]*

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

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

Question 6

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

Answer

Who is entitled to Bonus: Every employee of an establishment covered under the Act is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than thirty working days in the year on a salary less than ₹ 10,000/- per month. [Section 2(13) read with Section 8].

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

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

An employee in the following cases is not entitled to bonus:

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

Question 7

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

Answer

Entitlement for bonus under the Payment of Bonus Act, 1965: Every employee of an establishment covered under the Act is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than 30 working days in the year on a salary less than ₹ 10,000 per month. *[Section 2(13) read with Section 8]*

If an employee is prevented from working and subsequently reinstated in service, employer's statutory liability for bonus cannot be said to have been lost and the employee concerned shall be entitled to the bonus. *(ONGC v. Sham Kumar Sahegal)*.

Thus based on the above ruling and the provisions of the Act as contained in Section 8, the refusal by the employers to pay bonus to X is not valid and he (X) is entitled to get bonus in the given case for the reasons given above in the provisions, i.e. he has worked for more than

30 days in a year, drawing salary of less than ₹ 10,000 Per mensem land not disqualified for any other reason.

Question 8

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

(i) A University teacher,

(ii) An employee of the 'NABARD',

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

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

(v) An apprentice.

Answer

Every employee of an establishment covered under the Payment of Bonus Act, 1965 is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than thirty working days in the year on a salary less that ₹ 10,000 per month. [Section 2(13) and Section 8]

In the given problem a University teacher and an employee of the NABARD are not entitled for bonus because the employees of Universities and other educational institutions and employees of the Agricultural Refinance Corporation are excluded from the operation of the Act as per Section 32 of the Payment of Bonus Act, 1965.

A reinstated employee without wages for the period of dismissal is also not entitled for bonus because only a dismissed employee reinstated with back wages is entitled to bonus. *[Gammon India Ltd. Vs. Niranjan Das (1984)].* In this case the employee has been reinstated without wages.

A retrenched employee who worked for 45 days in a year on a salary of ₹ 4,000 per month is entitled for bonus as he has worked for qualifying days i.e. 30 days also his salary is within the prescribed limit (₹ 10,000 per month) in the Act.

An apprentice is not entitled to bonus *[Wheel & RIM Co. vs. Government of Tamil Nadu [1971].*

Question 9

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

(i) An employee employed through contractors on building operations

(ii) A retrenched employee

(iii) A dismissed employee reinstated with back wages.

Answer

Entitlement to Bonus

(i) An employee employed through contractors on building operations is entitled to bonus as according to the Payment of Bonus (Amendment) Act, 2007, an employee employed through contractors on building operations had been removed from the purview of the Section 32 of the Payment of Bonus Act,1965.

(ii) Retrenched Employee: He is eligible to get bonus provided he has worked for minimum qualifying period *(East Asiatic Co. (P) Ltd. Vs Industrial Tribunal)*

(iii) Employee includes a person who is no longer in service (Explanation under Section 21). A dismissed employee reinstated with back wages is entitled to bonus *(Gammon India Ltd Vs Niranjan Das)*

Question 10

Examine with reference to Payment of Bonus Act,1965 if an employee drawing a salary of ₹ 5,000 and who joined duty on January 20th, 2008 and who availed maternity leave for premature delivery from February 8th, 2008 till April 4, 2008, is eligible for bonus for the year 2007-08.

Answer

According to Section 2(13) every employee of an establishment covered under this Act is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than thirty working days in the year on a salary of less than ₹ 10, 000 per month. Under Section 14, the days when an employee has been on maternity leave with salary or wages during the accounting year will be included in calculating the total working days for the purpose of payment of bonus. In the instance, the salary is falling within the limit. Also, her maternity leave period will be treated as working days. Therefore, she is eligible for bonus for the year 2007-08.

Question 11

Examine the entitlement of the following persons to receive bonus under the Payment of Bonus Act, 1965 : (1) a probationer; (2) an apprentice, (3) an employee who had been laid –off for 20 days and had attended work for only 22 days in an entire accounting year; (4) an employee who is found guilty of misconduct causing financial loss to the employer.

Answer

(1) A probationer is an employee and as such is entitled to bonus per Section 8 of the Payment of Bonus Act *[Bank of Madura Ltd. vs. Employee's Union, 1970]*.

(2) An apprentice is not entitled to bonus per Section 8 of the Payment of Bonus Act. *[Wheel & RIM Co. vs. Government of T.N. (1971) 2 LLJ 299 40 FJR 18]*

(3) According to Section 14, when an employee had been laid off under an agreement, those days on which he has been laid-off shall be deemed to be working days for the employee

and it shall be counted while calculating the total days on which he has been on work for the purpose of payment of bonus. In the instance, the employee had been laid off for 20 days and had attended work for 22 days in the entire accounting year equaling to 42 total working days. An employee is entitled to bonus when he has worked in the establishment for not less than thirty working days in the year (Section 13). So, in this case, the employee is entitled to get bonus.

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

Question 12

An employee working in an establishment commits fraud during the accounting year 2004-2005, but continues to work during the subsequent accounting years 2005-2006 and 2006-2007, and has a clean record during the subsequent years. On the basis of the fraud committed in 2004-2005, the employee is dismissed from service at the end of the accounting year 2006-2007. In this case, does he lose the bonus for the accounting year of misconduct i.e. 2004-2005 or for all 3 accounting years ending with 2006-2007? Discuss in the light of the provisions of the Payment of Bonus Act, 1965.

Answer

According to Section 9 of the Payment of Bonus Act, 1965, one of the grounds for disqualification for any bonus is fraud. An employee who is dismissed from service on the ground of misconduct as mentioned in section 9, is disqualified for any bonus and not merely for the bonus of the accounting year in which he is dismissed. Based on these provision, in the given case, the employee lose the bonus for all 3 three accounting years [*Pandian Roadways Corporation Ltd Vs Presiding officer(1996)2 CLR 1175(Mad)].*

Question 13

Mr. 'E' joined as supervisor on monthly salary of ₹ 3,400 on 1. 02. 2007 and resigned from his job on 28. 02. 2007. The company declared a bonus of 20% to all eligible employees and paid it on time. Mr. 'E' knowing the facts made a claim to HRD, which in turn rejected the claim. Examine the validity in the light of the provisions of the Payment of Bonus Act, 1965.

Answer

As per provision of Section 2(13) of The Payment of Bonus Act, 1965 an employee means only person on a salary or wage not exceeding ten thousand rupees per month.

Further, Section 8 provides that an employee to be entitled for bonus in the accounting year should have worked in the establishment for not less than thirty working days in that year.

Thus, in view of the above Mr. 'E' is not entitled for Bonus, as he has not worked for 30 days in the accounting year.

Question 14

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

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

Answer

In accordance with the provisions of Section 2(13) of the Payment of Bonus Act, 1965 any person other than an apprentice employed on a salary or wage not exceeding ₹ 10,000 (by notification dated 15th Nov. 2007) per month in any industry to do any skilled or unskilled, manual, supervisory, managerial, administrative, technical or clerical work for hire or reward whether the terms of employment be express or implied is eligible for bonus. Further, in accordance with the provisions of Section 8 of the Payment of Bonus Act, 1965 every employee of an establishment covered under the Act is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than thirty working days in the year on a salary less than ₹ 10,000 per month.

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

(a) As regards the employees who resigned : The employees who have resigned are not entitled to bonus because they have given their services only for 28 days in an accounting year although they are drawing salary less than ₹ 10,000 per mensem.

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

As regards part time employees: Even a part time employee is also entitled to bonus on the basis of total number of days worked by him in an accounting year. The Payment of Bonus Act, 1965 does not prohibit such employees as they fulfil all the requirements stated above [*Automobile Karmachari Sangh vs. Industrial Tribunal (1971*)].

Question 15

During the financial year 2010-2011 Mr. Ram was a temporary employee in Ayurved Products Limited and drawing a salary of ₹ 6000/- per month . On the basis of charge of violent

behavior within the premises of the company, he was prevented from working in the company for 60 days pending inquiry. Since there was no adverse conclusion against him, he was reinstated in the service with back salary. He worked for the remaining ten months in that financial year and thereafter resigned from the service. Afterwards, when bonus was paid to others employees, the company refused to pay bonus to Mr. Ram. Decide, whether Mr. Ram will be entitled to bonus under the provisions of the Payments of Bonus Act, 1965?

Answer

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

(a) fraud; or

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

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

If an employee is guilty of riotous and disorderly behavior he is disqualified for bonus but if such employee because of riotous act, is being prevented from working in the company, pending enquiry and later on he is reinstated as there is no adverse findings, with back wages, will be entitled for bonus *[Gammon India Ltd. Vs. Niranjan Das (1984)].*

In the given case Mr. Ram has worked as a temporary employee for 10 months continuously, so he is qualified and entitled to bonus. Here, a temporary workman is also entitled to bonus on the basis of total number of days which he has completed. After completion of the required period of services for the entitlement to bonus if a workman resigns, he will be entitled to bonus.

Therefore, refusal of company is not valid and Mr. Ram will be entitled to the bonus from every angle according to Section 9 of the Payment of Bonus Act, 1965.

Establishment to include departments, undertakings and branches (Section 3)

Question 16

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

Answer

Where an establishment consists of different departments or undertakings or has branches whether situated at the same place or in different places, all such departments or undertakings or branches are to be treated as parts of the same establishments for the purpose of bonus under Section 3 of the Payment of Bonus Act, 1965.

But it has been provided that if, for any accounting year, a separate balance sheet and profit and loss account are prepared and maintained in respect of any such departments etc., then such department, undertaking or branch shall be treated as separate establishments for the purpose of calculation of bonus for that year, unless such department, etc., were immediately

prior to the commencement of that accounting year, treated as part of the establishment for the purpose of computation of bonus. If these two conditions are fulfilled it is possible to provide for the payment of bonus unit-wise instead of establishment wise.

The First Schedule

Question 17

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

Answer

Calculation of gross profit in case of banking company as per the first schedule of the Payment of Bonus Act, 1965;

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

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

The Third Schedule

Question 18

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

Answer

Deduction allowed under Third Schedule under the Payment of Bonus Act, 1965: According to Section 6 of Payment of Bonus Act, 1965 the available surplus in respect of any accounting year shall be the gross profits for that year after deducting therefrom the sums referred to the section. The third Schedule of the Act states the prior charges to be deducted from gross profits in respect of a company other than a banking company (a non-banking company) as follows:

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

Where the employer is a foreign company within the meaning of section 591 of the Companies Act, 1956, the total amount to be deducted under this item shall be 8.5% of the aggregate of the value of the net fixed assets and the current assets of the company in India after deducting the amount of its current liabilities (other than any amount shown as payable by the company to its Head Office whether towards any advance made by the Head Office or otherwise or any interest paid by the company to its Head Office) in India.

Question 19

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

Answer

Any direct tax payable by the employer for any accounting year shall, subject to the following provisions, be calculated at the rates applicable to the income of the employer for the year.

In calculating the above mentioned tax, no account shall be taken on the following matters, namely:

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

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

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

Payment of Minimum Bonus

Question 20

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

Answer

Problem on Payment of Bonus: Section 10 of the Payment of Bonus Act, 1965 provides that subject to the other provisions of this Act, every employer shall be bound to pay to every employee in respect of the accounting year commencing on any day in the year1979 and in respect of any subsequent year, a minimum bonus which shall be 8.33 % of the salary or wage earned by the employee during the accounting year or ₹ 100 (₹ 60 in case of employees below 15 years of age), whichever is higher. The minimum bonus is payable whether or not employer has any allocable surplus in the accounting year.

Therefore based on the above provision (Section 10) the question asked in the problem can be answered as under:

Yes, applying the provisions as contained in Section 10 the employees shall succeed and they are entitled to be paid minimum bonus at rate 8.33% of the salary or wage earned during the accounting year or ₹ 100 (₹ 60 in case of employees below 15 Years of age), whichever is higher.

Question 21

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

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

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

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

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

Answer

Payment of bonus: In accordance with the provisions of Section 10 of the Payment of Bonus Act, 1965, every employer shall be bound to pay to every employee in respect of any accounting year, a minimum bonus which shall be 8.33 percent of the salary or wage earned by the employee during the accounting year or one hundred rupees, whichever is higher, whether or not the employer has any allocable surplus in the accounting year. Where an employee has not completed 15 years of age at the beginning of the accounting year, the minimum bonus payable is 8.33% or ₹ 60 whichever is higher. Even in the case of loss, minimum bonus has to be paid.

Further, in accordance with the provisions of Section 11(1) the maximum bonus payable to the employee is 20% of the salary or wage earned in any accounting year. Section 17 of the Act is related to the adjustment of customary or interim bonus. Bonus should be paid only in cash by the employer.

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

(a) As regards minimum and maximum bonus: The workmen of the Skypark Wooden Toys Ltd. are entitled to get 8.33% of the salary or wage earned during that particular accounting year. The maximum bonus payable is 20% of the salary or wage earned during that particular accounting year. Even if the employer suffers losses during that accounting year the company is bound to pay minimum bonus as prescribed by Section 10. (Related case is *Jalan Trading Co. vs. D.M Aney AIR 1979 SC 233*).

(b) As regards adjustment of Puja Bonus:

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

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

Question 22

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

Answer

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

There are two stages in Section 36:

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

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

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

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

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

Question 23

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

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

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

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

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

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

Answer

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

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

iii. The statement is false as under Section 2(1), the accounting year in relation to a corporation does not mean the year commencing on 1st of April.

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

v. The statement is true as per Section 17.

Question 24

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

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

Answer

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

Question 25

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

Answer

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

But if the employee has not completed 15 years of age at the beginning of the accounting year he will be entitled to a minimum bonus which shall be 8.33% of the salary or wage during the accounting year or ₹ 60, whichever is higher.

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

Payment of Maximum Bonus (Section 11)

Question 26

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

Answer

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

Calculation of Bonus with respect to certain employees (Section 12)

Question 27

A workshop is employing 50 workmen. A shop-supervisor is drawing monthly wages of ₹ 9,000. HRD paid annual bonus to all employees except the supervisor. The Supervisor contends that he is also entitled to bonus. Referring to the provisions of the Payment of Bonus Act, 1965 decide whether the HRD's action is correct.

Answer

Problem: Quantum of Bonus (The Payment of Bonus Act, 1965)

The HRD view is not correct. The limit for payment of bonus originally was ₹ 3500 p.m. being the wages as defined in the Payment of Bonus Act, 1965. But this upper limit has been revised to ₹ 10,000 p.m. by way of notification dated 15th November 2007, and therefore the contention of supervisor is correct.

Procedure for calculation of working days and proportionate reduction in Bonus

Question 28

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

Answer

Section 14 of the Payment of Bonus Act, 1965 provides computation of number of working days for the purposes of Section 13. Section 13 in turn prescribes a scale whereby bonus can be proportionately reduced in certain cases. Under Section 14, following days shall be deemed to be the working days of an employee and shall be counted while calculating the total working days on which he has been on work for the purpose of bonus:

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

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

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

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

Question 29

Examine with reference to Payment of Bonus Act if an employee drawing a salary of ₹ 5,000 and who joined duty on January 20th, 2008 and who availed maternity leave for premature delivery from February 8th, 2008 till April 4, 2008, is eligible for bonus for the year 2007-08.

Answer

According to Section 2(13) every employee of an establishment covered under the Act is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than thirty working days in the year on a salary of less than ₹ 10, 000 per month. Under Section 14, the days when an employee has been on maternity leave with salary or wages during the accounting year will be included in calculating the total working days for the purpose of payment of bonus. In the instance case, the salary is falling within the limit. Also, her maternity leave period will be treated as working days. Therefore, she is eligible for bonus for the year 2007-08.

Special provisions with respect to certain establishments (Section 16)

Question 30

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

Answer

Section 16 of the Payment of Bonus Act, 1965 deals with the special provisions regarding newly set up establishment. Accordingly, where an establishment is newly set up, the employees of such an establishment shall be entitled to be paid bonus in accordance with the provisions of sub-sections (1A), (1B) and (1C). Newly set up establishment does not mean that there is change in its location, management, name or ownership.

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

provisions of Section 15 [Sub-section (1A)]. It may be noted that an employer shall not be deemed to have derived profit in accounting year unless:

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

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

But in the sixth and seventh accounting year, the provisions of Section 15 shall apply subject to the following modifications, namely:

(i) for the sixth accounting year, set on or set off, as the case may be, shall be made in the manner illustrated in the Fourth Schedule, taking into account the excess or deficiency, if any, as the case may be, of the allocable surplus set on or set off in respect of the 5th and 6th accounting years; (ii) for the seventh accounting year, the same principle is to be followed but the excess or deficiency of the allocable surplus set on or set off in respect of the 5th, 6th, and 7th accounting year has to be taken into account [sub-section (1B)]; (iii) From the eighth accounting year following the accounting year in which the employer sells the goods produced or manufactured by him or renders services, as the case may be, from such establishment, the provisions of Section 15, shall apply in relation to such establishment as they apply in relation to any other establishment [Sub-section (1C)].

Question 31

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

Answer

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

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

In the second case, A will get relief from the Court because the losses are related to the accounting year 2005-06. As per the provision, the employers are entitled to deduct the losses incurred due to misconduct of the employee in the same accounting year. In this problem bonus payable year and accounting year are different.

Question 32

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

Answer

Presumptions about the accuracy of balance sheet and profit and loss account of a company: Dispute between an employer and his employees regarding bonus payable under the Payment of Bonus Act, 1965 shall be deemed to be an industrial dispute within the meaning of the Industrial Disputes Act, 1947 or any corresponding law relating to investigation and settlement of industrial disputes in force in a state and the provisions of that Act or as the case may be such law shall, save and otherwise expressly provided, apply accordingly (Section 22).

Proceeding may be lying before any arbitrator or tribunal under the Industrial Disputes Act or under any corresponding law relating to investigation and settlement of industrial disputes in force in the state (herein referred to as the 'said authority') to which any dispute of the nature specified in Section 22 has been referred. During the course of such proceeding the balance sheet and the profit and loss account of an employer, being a corporation or a company other than a banking company may be produced. If these statements of accounts are audited by the Comptroller and Auditor General of India or by auditors qualified under Section 226(1) of the Companies Act, then as specifically provided in Section 23 of the Payment of Bonus Act, the said authority may presume that those are accurate. In view of this presumption corporation or company need not prove the accuracy of such statements by affidavit or any other mode.

But there are certain limitations. If the said authority is satisfied that those statements are not accurate, it may take such steps as it thinks necessary to find out the accuracy thereof.

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

Question 33

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

Or

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

Answer

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

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

Question 34

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

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

Answer

The provisions of the Payment of Bonus Act, 1965 do not ordinarily apply to an establishment in public sectors, but Section 20 of the Payment of Bonus Act,1956 provides that , in any accounting year, an establishment in public sector may sell any goods produced or manufactured by it or it may render any services in competition with an establishment in private sector. And if the income from such sale or service or both is not less than 20% of the gross income of establishment in public sector, then the provisions of the Payment of Bonus Act, 1956 shall apply in relation to establishment in private Sector.

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

Question 35

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

(a) Time Limit for Payment of Bonus.

(b) Recovery of Bonus due from an employer.

OR

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

Answer

(a) Time Limit for payment of bonus (Section 19): The employer is bound to pay his employee bonus within one month from the date on which the award becomes enforceable or the settlement comes into operation, if a dispute regarding payment of bonus is pending before any authority under Section 22.

In other cases, however, the payment of the bonus is to be made within a period of 8 months from closing of the accounting year. But this period of 8 months may be extended upto a maximum of 2 years by the Appropriate Government or by any authority specified by the Appropriate Government. This extension is to be granted on the application of the employer and only for sufficient reasons.

(b) Recovery of the bonus due from an employer (Section 21): It may so happen that an amount to bonus is due to an employee from his employer under a settlement or an award or agreement and it is not paid. In such a case, the employee is to make an application for the recovery of the amount to the Appropriate Government. This application can be made even by his assignee or heirs when the employee is dead. The application is to be made within one year from the date on which the money (Bonus) becomes due but it may be entertained even after the expiry of the said period of one year, if the Appropriate Government is satisfied that the applicant had sufficient cause for not making the application within the said period.

On the receipt of the aforesaid application for the recovery of the bonus amount, the appropriate Government or such authority as it may specify in this connection is to be satisfied that the money is so due. On being thus satisfied, it must issue a certificate for that amount to the Collector. Thereupon, Collector shall proceed to recover the same in the same manner as an arrear of land revenue.

Question 36

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

Answer

As per Section 21 of the Payment of Bonus Act, 1965 it may so happen that an amount of bonus is due to an employee from his employer under a settlement or an award or agreement and it is not paid. In such a case, the employee is to make an application for the recovery of the amount to the Appropriate Government. Even his assignee or heirs can make this

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

In the given problem, the Universal Limited's action is not valid. Y is entitled for payment of bonus as per above provision. Y should apply for the payment of bonus to the Appropriate Government within one year from the date on which bonus becomes due. On the receipt of the aforesaid application for the recovery of the bonus amount, the Appropriate Government or such authority as it may specify in this connection is to be satisfied that the money is so due. On being thus satisfied, it must issue a certificate for that amount to the Collector. There upon, Collector shall proceed to recover the same in the same manner as an arrear of land revenue.

Question 37

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

Answer

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

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

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

(ii) At any reasonable time and with assistance, if any, as he thinks fit, enter any establishment or any promises connected there with and require any one found in charge thereof to produce before him for examination any account books, register and other documents relating to the employment of persons or the payment of salary or wage or bonus in the establishment;

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

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

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

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

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

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

Question 38

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

Answer

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

Offences by Companies (Section 29): If any person committing an offence under this Act is a company, then every person who, at the time the offence was committed was in charge of and responsible to the company for the conduct of its business, and also the company would be deemed to be guilty of the offence and liable to be proceeded against and punished accordingly.

Special Provision with respect to bonus linked with production or productivity (Section 31A)

Question 39

On 1st January 2002, Aryan Textiles Ltd. agreed with the employees for payment of an annual bonus linked with production or productivity instead of bonus based on profits subject to the limit of 30% of their salary wages during the relevant accounting year. It was also agreed by the employees that they will not claim minimum bonus stated under Section 10 of the Payment of Bonus Act, 1965. As per the agreement the employees of Aryan Textiles Ltd claimed annual bonus linked with production or productivity in the relevant accounting year. On refusal of the company the employees of the company moved to the court for relief.

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

Answer

Problem relating to bonus linked with production or productivity (Section 31A): As per Section 31 (A) of the Payment of Bonus Act, 1965, there may be an agreement or settlement

by the employees with their employer for payment of an annual bonus linked with production or productivity in lieu of bonus based on profits, as is payable under the Act. Accordingly, when such an agreement has been entered into the employees are entitled to receive bonus as per terms of the agreement/settlement, subject to the following restriction imposed by Section 31A;

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

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

In the given case Aryan Textile Ltd. agreed with the employees for payment of an annual bonus linked with production or productivity instead of based on profits subject to the limit of 30% of their salary/ wages during the relevant accounting year. According to Section 31A the maximum bonus under this provision can be given which should not exceed 20% of the salary/wages earned by the employee during the relevant accounting year. Hence, the maximum bonus may be paid upto 20% of the salary/wages. If the company agrees to pay more than 20% then it will be against the provisions of the Payment of Bonus Act, 1965.

The employees of Aryan Textiles also agreed not to claim minimum bonus stated in Section 10 of the Payment of Bonus Act, 1965 such an agreement shall be null and void as it purports to deprive the employees of their right of receiving minimum bonus. Hence, the relief may be given by the court, as regards to the payment of bonus to the employees, based on the production or productivity, if it is agreed, subject to a maximum of 20%. The employees will also be entitled legally to claim bonus which is minimum prescribed under Section 10 of the Act, even though they have relinquished such right as per the agreement.

Question 40

The management of Shakthi Mills Ltd. entered into an agreement with their employees to pay them bonus based on production in lieu of Bonus based on profits, from the accounting year 2007. The employees further agreed to forego their right to receive minimum bonus and instead accept 25% of their salary/wage as bonus based on productivity. Is such an agreement valid? Examine in the light of the provisions of the Payment of Bonus Act, 1965.

Answer

Payment of bonus linked with productivity: No, such an agreement is null and void. The problem is based on Section 31A of the Payment of Bonus Act, 1965 which allows an agreement between employers and employees for payment of bonus linked with productivity. But such payment is subject to two restrictions:

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

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

Accordingly, in the given problem, the agreement to forego the right of receiving minimum bonus is null and void. The employees shall not be entitled to receive the excess over 20% of salary/wages in case of bonus payable linked with productivity.

Power of exemption (Section 36)

Question 41

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

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

Answer

An employer who is unable to comply with the provisions of the Payment of Bonus Act, due to paucity of funds or for other reasons, can make an application to the Appropriate Government for exemption fully or partly from the provisions of the Payment of Bonus Act,1965 under Section 36. If the Appropriate Government having regard to the financial position and other relevant circumstances of any establishment or class of establishments, is of the opinion that it will not be in public interest to apply all or any of the provisions of the Act thereto, it may, by notification in official Gazette, exempt for such period as may be specified therein and subject to such conditions as it may think fit to impose, such establishment or class of establishments from all or any of the provisions of the Act. Such relevant considerations for granting exemptions are industrial peace, law and order situation, effect on production of consumer goods, difficulties of management, etc.

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

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

EXERCISE

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

   (i) Defense canteen

   (ii) Institutions engaged in Social or welfare activities

   (iii) Delhi Development authority

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

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

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

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

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

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

   (a) 5000/- per month.

   (b) 3,500/- per month.

   (c) 2,500/- per month.

   (d) None of the above.

   [Hint: Option (b) as per section 12 of the Payment of Bonus Act,1965]

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

   (a) True.

   (b) False.

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

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

   (a) True.

   (b) False.

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

4

The Employees' Provident Funds and Miscellaneous Provisions Act, 1952

Introduction

Definitions (Section 2)

Question 1

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

"Basic wages include the cash value of food concessions"

Answer

This statement is false because the expression basic wages does not include the cash value of food concessions. Basic wages means 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.

Question 2

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

Answer

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

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

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

Question 3

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

(i) Piece rate wages

(ii) Productivity bonus

(iii) Additional dearness allowance

(iv) Value of Puja gift.

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

OR

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

Answer

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

(i) the cash value of any food concessions;

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

(iii) any presents made by the employer.

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

Question 4

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

Answer

Employees' Provident Funds & Miscellaneous Provisions Act, 1952 applies to every factory employing 20 or more persons engaged in an industry specified in Schedule I [Section 1(3)]. Hence, the definition of 'factory' is important. 'Factory' means any premises, including the

precincts thereof, in any part of which a manufacturing process is being carried on or is ordinarily so carried on, whether with the aid of power or without the aid of power [Section 2(g)]. As per Section 2(ic), 'manufacture' or 'manufacturing process' means any process for making, altering, repairing, ornamenting, finishing, packing, oiling, washing, cleaning, breaking up, demolishing or otherwise treating or adapting any article or substance with a view to its use, sale, transport, delivery or disposal. Thus, this definition is very wide. It includes workshop for repairing and servicing of cars. [*Lawly Sen v. RPFC (1959) 1 LabLJ 272 & AIR 1959 Pat 271].*

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

Industries as per Schedule I: The industries to which the Act applies are specified in Schedule I to the EPF & Miscellaneous Provisions Act. As per Section 4, the Central Government can add any industry to the schedule by issuing a notification. Under these powers, various industries have been added from time to time. The schedule covers almost all types of industry, including cement, cigarettes, iron and steel, textiles, chemicals, food products, aerated water, paper and paper products, electrical, mechanical and general engineering products, beedi, automobile repairing and servicing, medical and pharmaceutical preparations, brick making etc. Practically, all organized industries are covered under the Act. [However, tea factories in Assam have been exempted vide para 1(3)(a) of EPF Scheme,1952].

Employees' Provident Fund Scheme (Section 5)

Question 5

Write a note on the composition and functions of Central Board of Trustees under the EPF & MP Act, 1952.

Answer

Central Board of Trustees:

Under Section 5A of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, the Central Board of Trustees consists of the following persons as members:

(a) Chairman and Vice-Chairman appointed by the Central Government.

(b) Central Provident Fund Commissioner as ex-officio member.

(c) Not more than 5 officials of Central Government.

(d) Not more than 15 persons representing the State Government.

(e) 10 persons representing employees in the establishments to which the Scheme applies, appointed by the Central Government.

(f) 10 persons representing employers of the establishments to which the Scheme applies, appointed by the Central Government.

The functions of the Board are as follows:

The fund of the Employees' Provident Funds Scheme (EPF) under Section 5, the Employees Pension Scheme under Section 6A and the Employees' Deposit Linked Insurance Scheme (EDLI) under Section 6C is vested in the Central Board of Trustees. The fund is administered by them as provided in the Scheme. The Central Board will perform other functions as may be required under any provisions of the PF Scheme, the pension Scheme and the Insurance Scheme [Section 5A].

Question 6

An Executive Committee is to be constituted to assist the Central Board under the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. State the composition of such Executive Committee.

Answer

The Central Government may by notification in the Official Gazette, constitute with effect from such date as may be specified therein, an Executive Committee to assist the Central Board in the performance of its functions under Section 5AA of the Employees' Provident Funds and Miscellaneous Provision Act, 1952.

The Executive Committee shall consist of the following persons as members, namely:

a) a Chairperson, the secretary to the Government of India from the Ministry of Labour and Employment appointed by the Central Government.;

(b) two persons Additional secretary to the Government of India and the Financial Advisor from the Ministry of Labour and Employment appointed by the Central Government.

(c) three persons representating the Governments of the States(presently are the representative of the Government of the Assam, Rajasthan and of the Tamil Nadu) appointed by the Central Government.

(d) three persons representing the employers of the establishments to which the scheme applies appointed by the Central Government.

(e) three persons representing the employees in the establishments to which the scheme applies appointed by the Central Government..

(f) the Central Provident Fund Commissioner of Employees' Provident Fund Oganisation

[Note : The Reconstitution of Executive Committee is as per the Notifications 1045(E) dated 13th May, 2011 by the Ministry of Labour and Employment]

Question 7

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

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

Answer

This statement is false because the Chairman of the Executive Committee is appointed by the Central Government and not the Central Board.

Question 8

State the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 regulating the quantum of contribution to be made by the employer and employee to the provident fund. Is it possible for an employee to increase the amount of his contribution to the provident fund more than the minimum contribution as statutorily prescribed?

Answer

Contribution to Provident Fund under the EPF and Miscellaneous Provisions Act, 1952: Section 6 of the EPF and MP Act, 1952 regulates contribution to Provident Fund Scheme established under the Act. The employer's contribution shall be 10% of the basic wages, dearness allowance and retaining allowance, if any. The employee's contribution shall be equal to the contribution payable by the employer in respect of him.

Dearness allowance includes cash value of any food concession allowed to the employees. Retaining allowance means the sum paid for retaining the service, when the factory is not working. The Central Government may by notification make the employer's contribution equal to 12% for certain establishments class of establishments.

The above rule will prevail irrespective of whether the employer employs the person directly or through a contractor.

An employee can at his will voluntarily contribute, beyond 10%. But the employer shall not be under an obligation to pay any contribution over and above his contribution payable under section 6 of the said Act.

Question 9

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

Answer

Section 6 of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 provides that an employee can at his will contribute beyond 10% if the scheme makes provision therefore subject to the condition that the employer shall not be under an obligation to pay any contribution over and above his contribution payable under this section.

Employees' deposit-linked Insurance Scheme

Question 10

Write a note on Employees Deposit-Linked Insurance Scheme.

Answer

The purpose of the Employees' Deposit Linked Insurance Scheme is to provide life insurance benefits to employees who are already covered under PF. Section 6C(1) empowers Central Government to frame a scheme for the purpose of providing life insurance benefits to employees of any establishment or class of establishments to which PF Act is applicable.

Under the scheme a Deposit Linked Insurance Fund is set up. Employer is required to pay contribution which cannot be more than 1% of 'pay' of employee .[Section 6C(2)]. Employer is also required to pay administration charges for the Insurance Scheme [Section 6C(4)(a)]. The Insurance Fund will vest in Central Board of Trustees and will be administered by Central Board as per Insurance Scheme [Section 6C(5)]. The Insurance Scheme can provide for all matters specified in Schedule IV. The Scheme can have provisions which can take effect prospectively or retrospectively [Section 6C(7)].

Schedule IV of the Act provides that Insurance Scheme can provide for (a) Employees to whom it will apply (b) Manner in which accounts will be kept and investment of moneys made as per pattern determined by Central Government (c) Procedures like forms, registers, records and returns (d) Nomination to receive insurance amount (e) Scale of insurance benefits and conditions for grant of benefit (i) Mode of payment of amount due to members of family of employees (j) Any other matter necessary for proper administration and implementation of Scheme.

Accordingly, Employees' Deposit Linked Insurance Scheme has been prepared, which has been made effective w.e.f. 1st August, 1976.

The employee does not contribute any amount to the Scheme. The salary limit for coverage of employees is same as that of Employees Provident Fund Scheme.

Question 11

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

Answer

Amendments in the Employees' Deposit Linked Insurance Scheme: As per the Notification No.G.S.R.523 (E),dated 18th June,2010 and Notification No. G.S.R. 9(E),dated 8th January ,2011 amendments made in Employees' Deposit Linked Insurance Scheme, 1976 by the Employees' Deposit Linked Insurance (Amendment) Scheme,2010 and Employees' Deposit Linked Insurance (Amendment) Scheme, 2011 by the Ministry of Labour and Employment.

Employees' Deposit Linked Insurance (Amendment) Scheme, 2010

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

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

Employees' Deposit Linked Insurance (Amendment) Scheme, 2011

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

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

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

Question 12

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

Answer

The Provident Fund claims complete in all respects submitted along with the requisite documents shall be settled and the benefit amount paid to the beneficiaries within 30 days from the date of its receipt by the Commissioner. If there is any deficiency in the claim, the same shall be recorded in writing and communicated to the applicant within 30 days from the date of receipt of such application. In case the Commissioner fails without sufficient cause to settle a claim complete in all respects within 30 days, the Commissioner shall be liable for the delay beyond the said period and penal interest at the rate of 12% per annum may be charged on the benefit amount and the same may be deducted from the salary of the Commissioner.

Other provisions

Question 13

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

Or

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

Answer

Determination of moneys due from employers (Section 7A) : Section 7A of the Act gives power to the authorities mentioned therein *i.e.,* Central PF Commissioner, Additional Central PF Commissioner, Deputy PF Commissioner or any Regional PF Commissioner Assistant PF Commissioner to determine the amount due from an employer under the provisions of the Act and the Schemes. This involves decisions on various points of quasi-judicial nature, *viz.*

(*i*) amount due as contribution.

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

(*iii*) the administrative charges.

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

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

The authorities have been given power to conduct such enquiry as may be deemed necessary and for this they have been granted powers as are vested in a Court. An order must not be made unless the employer concerned is given a reasonable opportunity of representing his case (Sub-section 3).

Where the employer, employee or any other person required to attend the inquiry under Subsection (1) fails to attend such inquiry without assigning any valid reason or fails to produce any document or to file any report or return when called upon to do so, the officer conducting the inquiry may decide the applicability of the Act or determine the amount due

from any employer, as the case may be, on the basis of the evidence adduced during such inquiry and other documents available on record.

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

No such order shall be set aside merely on the ground that there has been an irregularity in the service of show cause notice if the officer is satisfied that the employer had notice of the date of hearing and had sufficient time to appear before the officer. However, where an appeal has been preferred under this Act against an order passed *ex parte* and such appeal has been disposed of otherwise than on the ground that appellant has withdrawn the appeal, no application shall lie under this Sub-section for setting aside the *ex parte* order [Section 7A(4)].

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

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

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

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

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

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

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

Question 14

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

Answer

Any person aggrieved by order under Section 7A(1) can make application for review of the order in following cases – (a) if new and important evidence is discovered which could not be produced earlier as it was not within his knowledge even after due diligence (b) there is some mistake or error apparent on the records or (c) any other sufficient reason. No application for review can be made if appeal was filed.

The officer can himself review the order on his own motion. [Section 7B(1)]. The officer can either reject the application for review if there are not sufficient grounds for review, or he can grant the review. [Section 7B(4)]. Appeal cannot be filed against order rejecting the application for review. However, if fresh order is passed after the review, appeal can be filed against such order [Section 7B(5)].Application for review should be made within such form and manner and in time as may be specified in the Scheme.

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

Question 15

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

Answer

An appeal against the order of officer made u/s 1(3), 1(4), 3, 7A, 7B, 7C or 14 B can be made to Employees' Provident Funds Appellate Tribunal. [Section 7-I].

The Tribunal is headed by a Presiding Officer who is or has been qualified to be judge of a High Court or a District Judge. [Section 7D]. The Tribunal has been set up at New Delhi w.e.f. 1-7-1997, to hear appeals. The Tribunal has all India jurisdiction. [Notification SO 491(E) dated 30-6-1997]. The presiding officer holds office for five years or until he attains the age of 62 years, whichever is earlier [Section 7E]. He can resign from his office by giving three months' notice. He can be removed after following prescribed procedure [Section 7F]. Staff of Tribunal will be supplied by Central Government [Section 7H].

The Tribunal, during proceedings, will give opportunity of hearing to parties. It will then pass order (a) confirming, modifying or annulling the order appealed against, or (b) remand the matter back to the authority for fresh directions, with such directions as the Tribunal may deem fit [Section 7L(1)]. The Tribunal has powers to rectify its order, if it is apparent from the records. Such rectification can be made within five years from date of the order. If such rectification has effect of increasing the liability of the employer, notice has to be given to the

employer and opportunity of hearing will be given before passing order [Section 7L(2)]. An order passed by the Tribunal is final and no appeal can be filed in any Court of law against the order [section 7L(4)].

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

Question 16

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

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

Answer

This statement is false as the Employees' Provident Funds Appellate Tribunal shall consist of one judge.

Question 17

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

Answer

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

Question 18

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

Answer

Section 7 F of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 provides that the Presiding Officer of a Employees' Provident Funds Appellate Tribunal may by notice in writing under his hand addressed to the Central Government, resign his office provided that the Presiding Officer shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor enters upon his office or until the expiry of his term of office, whichever is the earliest.

Hence, R's action is invalid as per above provisions. He should obtain permission from the Central Government to do so.

Question 19

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

Answer

The Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or annulling the orders appealed against or may refer the case back to the authority which passed such order with such directions as the Tribunal may think fit, for a fresh adjudication or order as the case may be, after taking additional evidence, if necessary.

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

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

A Tribunal shall send a copy of every order passed under this section to the parties to the appeal.

Any order made by a Tribunal finally disposing of an appeal shall not be questioned in any court of law.

Question 20

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

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

Answer

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

Question 21

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

claim of S is tenable under the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

Answer

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

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

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

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

Question 22

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

Answer

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

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

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

(c) appointing a receiver for the management of the movable or immovable properties of the establishment or, as the case may be, the employer (Section 8B);

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

The authorised officer may issue a certificate under section 8B(1) notwithstanding that proceedings for recovery of the arrears by any other mode have been taken [Section 8B(2)].

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

Question 23

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

Or

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

Answer

Protection of the amount standing to the credit of an employee in provident fund against attachment: As per Section 10 of the Employees' Provident Funds and Miscellaneous Provisions Act,1952, the amount standing to the credit of any member in the fund or of any exempted employee in a provident fund shall not in any way be capable of being assigned or charged and shall not be liable to attachment under any decree or order of any court in respect of any debt or liability incurred by the member or exempted employee, and neither the official assignee appointed under the Presidency Town Insolvency Act,1909, nor any receiver appointed under the Provincial Insolvency Act,1920, shall be entitled to or have any claim on, any such amount. This protection also applies to provident fund, pension and insurance amount receivable by employee under the scheme.

The amount standing to the credit of the person at the time of his death is payable to his nominees under the scheme or the rules vest in nominees. And the amount shall be free from any debt or other liability incurred by the deceased or the nominee before the death of the member or of the exempted employee and shall also not be liable to attachment under any decree or order of any Court. (Section 10, EPF & MP Act, 1952).

Question 24

A company which is covered by the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 was adjudged insolvent and an order for winding up was made. State, in this connection, whether the Provident Fund is attachable and whether the payment of Provident Fund contribution be considered as priority over other Debts of the Company.

Or

Discuss under the Employees' Provident Funds and Miscellaneous Act, 1952 as to whether the Provident fund contribution is a preferential payment in case of the employer being declared insolvent.

Answer

Protection against attachment: According to section 10 of the Employee's Provident Fund and Miscellaneous Provisions Act, 1952, the amount standing to the credit of any member or of any exempted employee in the Provident Fund shall not in anyway be capable of, being assigned or charged and shall not be liable to attachments under any decrees order of any court in respect of any debt or liability, incurred by the member or the exempted employee. Neither the official assignee appointed under the Presidency town Insolvency Act, 1909 nor any Receiver appointed under the Provincial Insolvency Act 1920 shall be entitled to have any claim on any such amount. Such amount shall also not be liable to attachment under any degree or order of any court.

Priority of Payment of Contribution over other debts(Section 11): If the employer is adjudged an insolvent or if the employer is a company and an order for winding thereof has been made, the amount due from the employer whether in respect of the employee's contribution or the employer's contribution must be included among the debts which are to be paid in priority to all other debts under Section 49 of the Presidency-Towns Insolvency Act, Section 61 of the Provincial Insolvency Act, Section 530 of the Companies Act, 1956, in the distribution of the property of the insolvent or the assets of the company. In other words, this payment will be a preferential payment provided the liability therefor has accrued before this order of adjudication or winding up is made.

Question 25

An Inspector appointed under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 makes an inspection at 10 p.m. (five hours after factory timings) and seeks to take copies of the "Shareholders' Register". How far under the Act is his action reasonable?

Answer

Under Section 13(2) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, an Inspector can inspect and make copies of, or take extract from any book, register or other document maintained in relation to the establishment and, where he has reason to believe that any offence under this Act has been committed by an employer, seize with such assistance as he may think fit, such book, register or other document or portions thereof as he may consider relevant in respect of that offence.

In the present case the Inspector had sought to take copies of the "Shareholders' Register" which is irrelevant document for the purpose of EPF and MP Act, 1952. Moreover, he has visited the office after the working hours (10.00 pm) which is not reasonable.

Question 26

What are cognizable offences under the Act?

Answer

Cognizable offence (Section 14AB): The offences relating to default in payment of contribution by the employer is a cognizable offence. A cognizable offence is one where the police can arrest a person without warrant.

Cognizance and trial of offence (Section 14AC): The complaints regard to offences under the Act, the scheme or the Pension Scheme or Insurance Scheme and their cognizance.

The essential conditions of cognizance of offences are:

(a) There must be a report in writing of the facts constituting such offence.

(b) This report must be made with the previous sanction of the :

  (i) Central Provident Fund Commissioner; or

  (ii) Such officer as may be authorised by the Central Government.

(c) The report must be made by an Inspector appointed under Section 13.

These conditions being co-existent, no Court inferior to that of a Presidency Magistrate or a Magistrate of the first class shall try any offence under this Act, or the Scheme or the Pension Scheme or the Insurance Scheme.

Question 27

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

"Default in payment of contribution by employer is a cognizable offence".

Answer

This statement is true because according to Section 14AB of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, offences relating to default in payment of contribution by the employer is a cognizable offence. A cognizable offence is one where the police can arrest a person without warrant.

Question 28

An employee leaves the establishments in which he was employed and gets employment in another establishment wherein he has been employed. Explain the procedure laid down in the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 in this relation.

Or

Describe in brief the mode of transfer of balance to the credit of Provident Fund Account of an employee leaving one organisation and joining another organisation, to the new employer under the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

Or

An employee working in an establishment covered by the E.P.F. and M.P. Act, leaves his employment and takes up employment in another establishment. State in this connection:

(i) How shall the amount accumulated to his P.F. Account be transferred?

(ii) What steps shall be taken if the establishment in which he has joined is not covered by the Act?

(iii) What would be your answer if the establishment in which he was previously working is not covered by the Act?

Answer

Transfer of accumulated amount to the credit of Employees' Provident Funds on change of employment: Section 17-A of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 provides for the transfer of accounts of an employee in case of his leaving the employment and taking up employment and to deal with the case of an establishment to which the Act applies and also to which it does not apply. The option to get the amount transferred is that of the employee. Where an employee of an establishment to which the Act applies leaves his employment and obtains re-employment in another establishment to which the Act does not apply, the amount of accumulations to the credit of such employees in the Fund or, as the case may be, in the provident Fund in the establishment left by him 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. The transfer has to be made with in such time as may be specified by the Central Govt. in this behalf. [Sub-Section (I)].

Conversely, when an employee of an establishment to which the Act does not apply leaves his employment and obtains re-employment in another establishment to which this Act applies, the amount of accumulations to the credit of such employee in the provident fund of the establishment left by him, if the employee so desires and the rules in relation to such provident fund permit, may be transferred to the credit of his account in the fund or as the case may be, in the provident fund of the establishment in which he is employed [Sub-Section (2)].

Question 29

Is the amount standing to the credit of a member of the Provident Fund attachable in the execution of decree or order of the Court? Examine the law, on this point, laid down in the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

Answer

Attachment of Provident Fund: According to Section 10 of E.P.F. & M.P. Act, 1952 the amount standing to the credit of any member in the fund or of any exempted employee in a provident fund shall not in any way be capable of being assigned or charged and shall not be liable to attachment under any decree or order of any court in respect of any debt or liability incurred by the member or the exempted employee, and neither the official assignee appointed under the Presidency Towns Insolvency Act nor any receiver appointed under the Provincial Insolvency Act shall be entitled to or have any claim on, any such amount.

The amounts standing to the credit of aforesaid categories of persons at the time of their death and payable to their nominees under the scheme or the rules vest in nominees, and the amount shall be free from any debt or other liability incurred by the deceased or the nominee before the death of the member or of the exempted employee and shall also not be liable to attachment under any decree or order of any court.

Question 30

Explain the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 authorising certain employers to maintain a Provident Fund Account.

Answer

Section 16-A of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 empowers the Central Government to authorize to certain employers to maintain a P.F. Account. This section states, the Central Government may, on an application made to it in this behalf by the employer and the majority of employees in relation to an establishment employing one hundred or more persons, authorize the employer by an order in writing, to maintain a provident fund account in relation to the establishment subject to such terms and conditions, as may be specified in the scheme.

No authorization shall, however, be made under this sub-section, if the employer of such establishment had committed any default in the payment of provident fund contribution or had committed any other offence under this Act during the three years immediately preceding the date of such authorization.

Where an establishment is authorised to maintain a provident fund account as aforesaid, the employer in relation to such establishment shall maintain such account, submit such return, deposit the contribution in such manner, provide for such facilities for inspection, pay such administrative charges, and abide by such other terms and conditions, as may be specified in the scheme.

Any authorization made under this Section may be cancelled by the Central Government by order in writing if the employer fails to comply with any of the terms and conditions of the authorization or where he commits any offence under any provisions of this Act.

Before cancellation the authorization, the Central Government shall give the employer a reasonable opportunity of being heard.

Question 31

State the establishments, which were exempted from the operation of EPF & MP Act, 1952?

Answer

The EPF & MP Act, 1952 does not apply to:

(a) Any establishment registered under the Co-operative Societies Act, 1912, employing less than 50 persons and working without the aid of power; or

(b) To any other establishment belonging to or under the control of the Central Government or a State Government and whose employees are entitled to the benefit of contributory provident fund or old age pension in accordance with any scheme or rule framed by the Central Government or the State Government governing such benefits; or

(c) To any other establishment set up under any Central, Provincial or State Act and whose employees are entitled to the benefits of contributory provident fund or old age pension in accordance with any scheme or rule framed under that Act governing such benefits; or

(d) Any other establishment newly set up until the expiry of 3 years from the date on which the establishment is, or has been set up.

Question 32

Manorama Group of Industries sold its textile unit to Giant Group of Industries. Manorama Group contributed 25% of total contribution in Pension Scheme, which was due before sale under the provisions of Employees' Provident Funds and Miscellaneous Provisions Act, 1952. The transferee company (Giant Group of Industries) refused to hear the remaining 75% contribution in the Pension Scheme. Decide, in the light of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, who will be liable to pay for the remaining contribution in case of transfer of establishment and upto what extent?

Answer

The problem as asked in the question is based on the provisions of section 17(B) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. Accordingly where an employer in relation to an establishment, transfers that establishment in whole or in part by sale, gift, lease or licence or in any other manner whatsoever, the employer and the person to whom the establishment is so transferred shall be jointly or severally liable to pay the contribution and other sums due from the employer under the provisions of this Act of the Scheme or Pension Scheme, as the case may be, in respect of the period upto the date of such transfer. It is provided that the liability of the transferee shall be limited to the value of the assets obtained by him by such transfer.

It would be thus evident from the aforesaid provisions that 17-B deals with the liability of transferor and transferee in regard to the money due under (a) the Act or (b) the Scheme (c) and Pension Scheme. In the case of the transfer of the establishment brought in by sale, gift, lease etc. The liability of the transferor and transferee is joint and several, but it is limited to the period upto the date of transfer.

Therefore applying the above provisions in the given case the transferor Manorama Group of Industries, the transferor has paid only 25% of the total liability as contribution in Pension Scheme before sale of the establishment. With regards to remaining 75% liability both the transferor and transferee companies are jointly and severally liable to contribute. In case, the transferor refuses to contribute, the transferee will be liable,

The liability is limited upto the date of transfer and upto remaining amount. Further, the liability of the transferee i.e. Giant Group of Industries, is limited to the extent of assets obtained by it from the transfer of the establishment.'

Question 33

Explain the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 regarding the following:

(i) rate of interest on amount due from the employer under the Act.

(ii) maximum limit of interest rate

(iii) the period for which the employer is liable to pay the said interest.

Answer

Rate, limit and period of payment of interest: As per Section 7Q of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952

(i) the employer shall be liable to pay simple interest at the rate of 12 per cent per annum or at such higher rate as may be specified in the Scheme on any amount due from him under this Act.

(ii) although limit of interest rate is not given in the Act, but it is clearly given the higher rate of interest specified in the Scheme cannot exceed the lending rate of interest of any scheduled bank.

The period for which the employer is liable to pay the interest is from the date on which the amount has become so due till the date of its actual payment.

EXCERCISE

1. *Kumar & Sons company sold its manufacturing unit to X & Co. Kumar & Sons contributed 30 % of total contribution in pension scheme which was due before the sale under the EPF& MP Act,1952. X & Co. refused to bear remaining 70% of the contribution in the pension scheme. Decide who will be liable to pay the remaining contribution?*

   [Hint: Both the parties are liable jointly and severally for the remaining contribution as per the Section 17 B of the EPF&MP Act,1952]

2. *State whether the following statement is correct/incorrect.*

   (i) The maximum contribution that an employee can make to his provident fund account is 10%.

   (ii) The amount of the provident fund of an employee is not attachable even after it is has been received by the employee.

   [Hint: (i) Incorrect as per the provision given under Section 6 of the EPF&MP Act,1952]

   (ii) Incorrect as per section 10 of the EPF&MP Act,1952]

3. *Generally the Employees' Provident funds and Miscellaneous Provisions Act, 1952 applies to entities employing more than*

   (a) 10 persons.

   (b) 20 persons.

   (c) 100 persons.

(d) 1000 persons.

[Hint: Option (b) as per section1(3)(a) of the Employees' Provident Funds and Miscellaneous Act,1952]

4. *The Central Government may apply the provisions of this act even if it employs less than required persons.*

(a) True.

(b) False.

[Hint: Option (a) as per section 1(3)(b) of the Employees' Provident Funds and Miscellaneous Act,1952]

5. *The liability for employer to contribute under the Employees' Provident Funds etc. Act, 1952 is 10% of the employees' emoluments.*

(a) True.

(b) False.

[Hint: True, according to section 6 of the Employees' Provident Funds and Miscellaneous Act,1952]

6. *The maximum contribution that an employee can make to his provident fund account is 10%.*

(a) True.

(b) False.

[Hint: False ,because according to section 6 of the Employees' Provident Funds and Miscellaneous Act,1952 the maximum contribution can be 12%]

5
The Payment of Gratuity Act, 1972

An Introduction

Question 1

State whether the following statements are true or false and give reasons therefor with reference to the Payment of Gratuity Act, 1972.

i. *The Payment of Gratuity Act, 1972 is largely based on Kerala Industrial Employees Payment of Gratuity Act, 1972.*

ii. *A retrenched employee is also eligible for gratuity.*

iii. *Where an employee's resignation has not been accepted, then that employee is not eligible to claim gratuity.*

iv. *Where the negligence of employee causes loss to the employer, then the gratuity shall be wholly forfeited.*

v. *An appeal against the Controlling Authority's order must generally be made within 60 days.*

Answer

i. This statement is false because the Payment of Gratuity Act, 1972 is largely based on West Bengal Employees' Payment of Compulsory Gratuity Act, 1971.

ii. This statement is true because in the case of *State of Punjab Vs. Labour Court* (1986), it was held that a retrenched employee is also eligible for gratuity.

iii. This statement is false as it was held in *Mettur Spinning Mills Vs. Deputy Commissioner of Labour*, (1983) II LLJ 188, that non acceptance of the resignation is no hurdle in the way of an employee to claim gratuity.

iv. This statement is false because when loss is caused by the negligence of employee, there gratuity shall be forfeited to the extent of the damage or loss so caused.

v. This statement is true as an appeal against the Controlling Authority's order must generally be made within 60 days (Section 7 of the Payment of Gratuity Act, 1972).

Important definitions

Question 2

S is employed in Golden ice-cream factory, a seasonal establishment. The factory was in operation for four months only during the financial year 2009-10. S was not in continuous service during this period. However, he has worked only for sixty days. Referring to the provisions of the Payment of Gratuity Act, 1972 decide whether S is entitled to gratuity payable under the Act. Would your answer be the same in case S works for 100 days?

Answer

Section 2 A of the Payment of Gratuity Act, 1972 provides that where an employee, employed in a seasonal establishment, is not in continuous service within the meaning of clause (1), for any period of one year or six months, he shall be deemed to be in continuous service under the employer for such period if he has actually worked for not less than seventy-five percent of the number of days on which the establishment was in operation during such period.

In the given problem, as per above provision, S has worked only for sixty days that are less than 75% of number of days therefore, he shall not be eligible for getting any gratuity in first case.

In the second case, since the S has worked for 100 days that are more than 75% of no. of days therefore, he is entitled for gratuity.

Question 3

K is an employee of RST Limited, a software company which works five days, in a week. K was not in continuous service during the financial year 2009-10. However, she worked only for 150 days because she was on maternity leave with full pay for 50 days. Referring to the provisions of the Payment of Gratuity Act, 1972 decide, whether K is entitled to gratuity payable under the Act? Would your answer remain the same in case RST Limited works six days in a week?

Answer

As per Section 2 A of the Payment of Gratuity Act, 1972 an employee shall be said to be in continuous service for a period if he has, for that period, been in uninterrupted service, including service which may be interrupted on account of sickness, accident, leave, lay-off, strike or a lockout or cessation of work not due to any fault of an employee.

Where any employee (not being an employee employed in a seasonal establishment) is not in continuous service for any period of one year he shall be deemed to be in continuous service under the employer for the said period of one year, if the employee during the period of twelve calendar months preceding the date with reference to which calculation is to be made, has actually worked under the employer for not less than (i) one hundred and ninety days, in the case of any employee employed below the ground in a mine or in an establishment which works for less than six days in a week, and (ii) two hundred and forty days, in any other case.

For the purposes of calculating the number of days on which an employee has actually worked under an employer shall include the days on which in the case of a female, she has been on maternity leave, so, however, that the total period of such maternity leave does not exceed twelve weeks.

Thus, as per the above provisions-

In the first case, K is entitled for gratuity because she was in continuous service (150+50 days) more then 190 days in 2009-10.

In second case, she (K) is not entitled for gratuity because RST Limited works for 6 days in a week and she worked only for 200 days less then prescribed limits (240 days).

Payability of Gratuity [Section 4 (1)]

Question 4

E was an employee of Tea Estate Ltd. The whole of the undertaking of Tea Estate Ltd. was taken over by a new company - Asia Tea Estate Ltd. The services of E remained continuous in new company. After serving for one year E met with an accident and became permanently disabled. E applied to the new company for the payment of gratuity. The company refused to pay gratuity on the ground that E has served only for a year in the company.

Examine the validity of the refusal of the company in the light of the provisions of the Payment of Gratuity Act, 1972.

Answer

According to Section 4 (1) of the Payment of Gratuity Act, 1972, gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous 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 condition of the completion of five years of continuous service is not essential in case of the termination of the employment of any employee due to death or disablement for the purpose of this section. Disablement 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.

The given problem fulfils all the above requirements as stated. Therefore, E is entitled to recover gratuity after becoming permanently disabled, and continuous service of five years is not required in this case. Hence, the company cannot refuse to pay gratuity on the ground that he has served only for a year.

Question 5

Mr. X was an employee of Mutual Developers Limited. He retired from the company after completing 30 years of continuous service. He applied to the company for the payment of gratuity within the prescribed time. The company refused to pay the gratuity and contended

that due to stringent financial condition the company is unable to pay the gratuity. Mr. X applied to the Appropriate Authority for the recovery of the amount of gratuity.

Examine the validity of the contention of the company and also state the provisions of law to recover the gratuity under the Payment of Gratuity Act, 1972.

Answer

(i) Gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years on his superannuation or on his retirement or resignation or on his death or disablement due to accident or disease under Section 4(1) of the Payment of Gratuity Act,1972. Further, as soon as gratuity becomes payable, the employer shall whether the application for the payment of gratuity has been given or not by the employee, determine the amount of gratuity and give notice in writing to the person to whom the gratuity is payable under intimation to the controlling officer [Section 7(2)].

The employer shall arrange to pay the amount of gratuity within 30 days for the date of its becoming due/payable to the person to whom it is payable [Section 7(3)], along with simple interest if it is not paid within the period specified except where the delay in the payment is due to the fault of the employee and the employer has obtained permission thereon from the Controlling Authority[Section 7(3A)].

(ii) If the gratuity payable under the Act is not paid by the employer within the prescribed time to the person entitled thereto, the Controlling Authority shall issue a certificate for the amount to the Collector to recover the same along with compound interest at such rate as prescribed by the Central Government from the date of expiry of the prescribed time as land revenue arrears, to enable the person entitled to get the amount, after receiving the application from the aggrieved person (Section 8).

Before issuing the certificate for such recovery the Controlling Authority shall give the employer a reasonable opportunity of showing cause against the issue of such certificate. The amount of interest payable under the Section shall not exceed the amount of gratuity payable under this Act in no case (Section 8).

In the given case the facts are commensurate with provisions of law as stated above under Sections 7 and 8 of the Payment of Gratuity Act, 1972. Therefore, Mr. X is entitled to recover gratuity as he has completed the service of 30 years. The company cannot take the plea of stringent financial conditions for not paying the gratuity to Mr. X. On the refusal by the company, Mr. X can apply to the appropriate authority and the company will be liable to pay the gratuity along with interest as decided by such authority.

Question 6

Explain as to when is the gratuity payable to an employee of an establishment, under the provisions of the Payment of Gratuity Act, 1972.

Answer

According to section 4 (1) of the Payment of Gratuity Act, 1972, gratuity shall be payable to an 'employee' on the termination of his employment after he has rendered continuous services for not less than 5 years:

On his superannuation, or

On his retirement or resignation, or

On his death or disablement due to accident or disease.

The condition of the completion of five years of continuous service is not essential in case of the termination of the employment of any employee due to death or disablement.

Generally, gratuity is payable to the employee himself. However, in case of death of the employee, it shall be paid to his nominee or if no nomination has been made, to his legal heirs.

The payability of gratuity to the employee is his right as well as the obligation of the employer. By the change of ownership, the relationship of employer and employees subsists and the new employer cannot escape from the liability of payment of gratuity to the employees. (Pattathurila K. Damodharan Vs M. Kassim Kanju, 1993).

An employee resigning from service is also entitled to gratuity (Texmaco Ltd. V/s Sri Ram Dhan, 1992) and non acceptance of the resignation is no hurdle in the way of an employee to claim gratuity (Mettur Spinning Mills V/s Deputy Commissioner of Labour, 1983).

Calculation of gratuity amount payable [*Section 4(2)*]

Question 7

Explain the manner in which the gratuity payable to employees in a seasonal as well as other establishments is calculated under the Payment of Gratuity Act, 1972. State also the maximum amount of gratuity payable under the Act.

Answer

Computation of gratuity amount: Section 4 of the Payment of Gratuity Act, 1972 stipulates the manner in which the amount of gratuity payable to an employee will be calculated.

In the case of establishments other than seasonal establishments, the employer shall pay the gratuity to an employee at the rate of 15 days wages based on the rate of wages last drawn by the employee concerned for every completed year of service or part thereof in excess of 6 months. In the case of piece rated employees, daily wages, shall be computed on the average of the total wages received by him for a period of 3 months immediately preceding the termination of his employment and for this purpose the wages paid for any overtime work shall not be taken into account.

In the case of a monthly rated employee 15 days wages shall be calculated by dividing the monthly rate of wages last drawn, by 26 and by multiplying the quotient by 15.

In the case of seasonal establishment the employees can be classified into 2 groups.

(i) Those who work throughout the year and

(ii) Those who work only during the season.

The former are entitled to get the gratuity at the rate of 15 days wages for every completed year of service or part thereof in excess of 6 months. The latter are entitled to receive gratuity at the rate of 7 days for each season.

The amount of gratuity payable shall not exceed ₹ Ten lakhs.

[As per the Payment of Gratuity (Amendment) Act, 2010,the ceiling amount ₹ 3,50,000 has been increased to 10,00,000]

Question 8

Examining the provisions of the Payment of Gratuity Act, 1972, state whether gratuity is payable to an employee for the periods when he does not actually work in the organization. Explain the manner in which gratuity is calculated for regular employees.

Answer

Periods for which Gratuity Payable: Manner of Calculation (The Payment of Gratuity Act, 1972).

Yes, the periods for which gratuity is payable to an employee even if he does not actually work in the organization are the following:

1. Lay off under the Industrial Disputes Act, 1947.
2. Leave with full wages.
3. Maternity leave for female employees.
4. Absence due to temporary disablement caused during employment.

Manner in which gratuity is calculated: Quantum of gratuity payable is 15 days' wages on the last drawn wages for every completed year of service subject to a maximum of 15 months' wages.

Question 9

When an employee becomes disabled due to any accident or disease and is unable to do the same work and re-employed on the reduced wages, how the gratuity of such employee shall be, computed under the provisions of the Payment of Gratuity Act, 1972?

Answer

Computation of Gratuity of a disabled employee: According to Section 4 (4) of the Payment of Gratuity Act, 1972, when an employee becomes disabled due to any

accident or disease and is not in a position to do the same work and re-employed on reduced wages on some other job, the gratuity will be calculated in two parts :-

- *For the period preceding the disablement: on the basis of wages last drawn by the employee at the time of his disablement.*
- *For the period subsequent to the disablement: On the basis of the reduced wages as drawn by him at the time of the termination of services.*

In the case of Bharat Commerce and Industries Vs. Ram Prasad, it was decided that if for the purposes of computation of quantum of the amount of gratuity the terms of agreement or settlement are better than the Act, the employee is entitled for that benefit but the maximum statutory ceiling limit as providing under Sub-Section 3 of Section 4 of the Act cannot be reduced by mutual settlement or agreement.

Forfeiture of Gratuity

Question 10

Explain the provisions of the Payment of Gratuity Act, 1972 relating to 'forfeiture of the amount of Gratuity' payable to an employee.

Answer

Forfeiture of gratuity: Section 4(6) of the Payment of Gratuity Act, 1972 deals with cases in which gratuity payable to an employee may be forfeited.

According to it, the gratuity of an employee whose service 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 –

(i) his riotous or disorderly conduct or any other act of violence on his part, or

(ii) any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment.

Question 11

National Steels Limited decided to forfeit the amount of gratuity of its employees A,B and C on account of disorderly conduct and other acts which caused loss to the property belonging to the company. A, B and C committed the following acts:

(i) A refused to surrender the occupied land belonging to the company.

(ii) B committed theft under law involving offence of moral turpitude.

(iii) C after superannuation continued to occupy the quarter of the company for six months.

Against the decision of the company, A, B and C applied to the appropriate authorities for relief. The company contented that the right to gratuity is not a statutory right and the forfeiture of the amount of gratuity was within the law.

Examine the contention of the company and the decision taken by the company to forfeit the amount of gratuity in the light of the Payment of Gratuity Act, 1972.

Answer

Forfeiture of Gratuity: In accordance with the provisions of Section 4(6) of the Payment of Gratuity Act, 1972, if the services of any employee have been terminated for any act, willful omission, or negligence causing any damage or loss to or destruction of, property belonging to the employer, the gratuity shall be forfeited to the extent of the damage or loss so caused; and if the services of such an employee have been terminated for any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment, the gratuity payable to the employee may be wholly or partially forfeited.

(1) The problem asked in the question is based on the above provisions and the provisions of Section 4(1) of the Payment of Gratuity Act, 1972. Accordingly, gratuity shall be paid to the employee when he completes five years of continuous service on his superannuation, or on his retirement or resignation, or on his death or disablement due to accident or disease. The condition of the completion of five years' continuous service is not essential in case of the termination of the employment of any employee due to death or disablement. Looking to the provisions of Section 4(1), it is clear that withholding of gratuity is not permissible under any circumstances, except under those circumstances covered by Section 4(6). In *K. C. Mathew vs. Plantation Corporation of Kerala Ltd. 2001 LLR (2) (Ker)*, it was held that withholding of gratuity is not permissible except under those circumstances enumerated in Section 4(6) and that the right to gratuity is a statutory right and none can be deprived of it except as provided by the law. Therefore, the contention of National Steels Ltd. is wrong, to that extent.

(2) The correctness of the decision taken by National Steels Ltd. regarding forfeiture of the gratuity amount of its employees A, B and C may be tested in the light of Section 4(6) of the Payment of Gratuity Act,1972 as referred above.

    (i) Accordingly, the refusal of an employee to surrender the occupied land belonging to the company is not sufficient ground to withhold gratuity under Section 4(6) of the Payment of Gratuity Act, 1972 *[Travancore Plywood Industries Ltd. vs. Regional Joint Labour Commissioner [1966] II LLJ 85 Ker]* Hence, A's gratuity cannot be withheld.

    (ii) The offence of theft committed by B, under law involves moral turpitude and his gratuity stands wholly forfeited in view of Section 4(6) of the Act [relevant case is *Bharat Gold Mines Ltd vs. Regional Labour Commissioner, 1987, 70 FJR 11 (Karnataka)]*.

    (iii) If the employer has to be paid any amount regarding any type of charge by the employee and if he has not paid for the same during the course of his service, then

the employer can adjust the amount from the gratuity of the employee. In the instant case, C after superannuation continued to occupy the quarter of the company for six months. Therefore the company is entitled to charge the rent from him and after adjusting other dues the remaining amount of gratuity may be paid [relevant case is *Wazir Chand vs. Union of India 2001, LLR172 (SC)].*

Question 12

An employee who is governed by the Payment of Gratuity Act, 1972 committed a theft in the course of his employment. And consequently his services was terminated. State in this connection, whether the gratuity payable to him shall be wholly or partly forfeited.

Answer

Reduction and forfeiture of Gratuity: Under Section 4 of the Payment of Gratuity Act, 1972, in the case of damage, loss or destruction of property of employer, due to the willful omission or negligence of the employee, the amount of gratuity to the extent of loss or damage shall stand forfeited. The gratuity payable to an employee may be wholly or partially forfeited, where the services of an employee are terminated on the ground of: (i) riotous or disorderly conduct or act of violence; or (ii) committing an offence involving moral turpitude in the course of his employment. Theft is an offence involving moral turpitude and consequently, if the services of an employee had been terminated for committing theft in the course of his employment, the gratuity payable to him under the provisions of the Act shall be wholly forfeited in view of Section 4(60)(b)(ii). *[Bharat Gold Mines Ltd. Vs Regional Labour Commissioner (Central), (1987) 70 FJR 11 (Kern.)]*]

Nominations for Gratuity [Section 6]

Question 13

What are the procedures for nominations under the Payment of Gratuity Act, 1972 in establishments for which the Central Government is the appropriate government.

Answer

In case of employees in establishment where Central Government is 'Appropriate Government', nomination shall be made in form 'F' in duplicate. Nomination shall be given to employer or sent by registered post. Employee should get proper receipt or acknowledgement from employer [Rule 6(1) of Payment of Gratuity Rules]. Employer should fill details in the form and return one copy to the employee.

Nomination shall be normally submitted within 30 days after completion of service of one year. However, it can be submitted later also.

An employee who did not have family but acquired family later should submit nomination form in duplicate in form G within 90 days after acquiring family.

Notice of change in nomination shall be filed in form H.

Disputes

Question 14

Examine how disputes are resolved under the Payment of Gratuity Act, 1972.

Answer

If there is any dispute regarding the amount of gratuity payable to an employee or admissibility of any claim of or in relation to, an employee for payment of gratuity or the person entitled to receive the gratuity, the employer shall deposit, such amount as he admits to be payable by him as gratuity, to the controlling authority and for these (one or all) other person raising dispute may make an application to the controlling authority for deciding the dispute.

The controlling authority shall, after due inquiry and after giving the reasonable opportunity of being heard to the parties to the dispute, determine the matter or matters in dispute. After such inquiry if any amount is found to be payable to the employee, the controlling authority shall direct the employer to pay such amount or the difference of amount so determined and the amount already deposited by the employer to the controlling authority. The controlling authority shall pay the amount deposited by the employer including the excess amount, if any, to the person entitled thereto.

As soon as the employer made the said deposit, the controlling authority shall pay the amount to the applicant where he is the employee or where the applicant is not the employee, to the nominee or as the case may be, the guardian of such nominee or legal heir of the employee, if he is satisfied that there is no dispute as to the right of the applicant to receive the amount of gratuity. For the purpose of conducting inquiry, the controlling authority shall have the same powers as are vested in a court, while trying a suit, under the Code of Civil Procedure, 1908. The proceeding made by him will be the 'judicial proceedings' within the meaning of Sections 93 & 228 for the purposes of Section 196, Indian Penal Code the controlling authority will avail all the powers like enforcing the attendance, production of documents, receiving evidences on affidavits and issuing commission for the examination of witnesses. [Section 7(4)]

Recovery

Question 15

What is the law relating to recovery of amount of gratuity under the payment of Gratuity Act, 1972 in case the said amount is not paid by the employer?

Answer

Law relating to recovery of gratuity under the Payment of Gratuity Act, 1972: As per the provision given under the Act, if the gratuity payable under the Act is not paid by the employer within the prescribed time, to the person entitled thereto, there the Controlling Authority shall issue a certificate for the amount to the Collector to recover the same along with the compound interest at such rate as prescribed by the Central Government from the date of

expiry of the prescribed time as land revenue arrears to enable the person entitled to get the amount after receiving the application from the aggrieved person [Section 8].

Before issuing the certificate for such recovery the Controlling Authority shall give the employer a reasonable opportunity of showing cause against the issue of such certificate.

The amount of interest payable under this Section shall not exceed the amount of gratuity payable under this Act in no case.[Section 8]

Question 16

Discuss the rules relating to penalties under the Payment of Gratuity Act, 1972.

Answer

Rules relating to penalties under the Payment of Gratuity Act are as follows:

Making false statement or false representation – Whosoever makes or causes to made false statement or false representation for purpose of avoiding payment to be made under Payment of Gratuity Act or enables another person to avoid such payment, shall be punishable with imprisonment upto six months and fine upto ₹ 10,000 or with both [Section 9(1) of Payment of Gratuity Act].

Contravening provisions of Gratuity Act or rules – An employer who contravenes provisions of Payment of Gratuity Act or Rules made thereunder shall be punishable for a term which will not be less than three months but can extend upto one year. In addition, a minimum fine of ₹ 10,000 (maximum ₹ 20,000) will be imposed [Section 9(2) of Payment of Gratuity Act].

Offence relating to non-payment of gratuity – If the contravention relates to non-payment of any gratuity payable under Payment of Gratuity Act, the term of imprisonment shall be minimum six months and maximum two years. The Court can impose a lesser term of imprisonment, if the Court is of the opinion that a lesser term of imprisonment would meet the ends of justice [proviso to Section 9(2) of Payment of Gratuity Act]. In addition, a minimum fine of ₹ 10,000 (maximum ₹ 20,000) will be imposed.

Employer can charge another person as the actual offender – Though the 'employer' is liable under Payment of Gratuity Act, he can charge another person as actual offender. After commission of offence is proved, the employer has to prove that he used due diligence in execution of the Act and the other person committed the offence without the knowledge, consent or connivance of the employer. If actual offender cannot be brought before the Court within three months, the employer will be convicted of the offence [Section 10 of Payment of Gratuity Act].

Cognizance of offence – Cognizance of offence can be taken only on complaint made by authority appointed by 'Appropriate Government'. Complaint can also be filed by 'controlling authority' if employer did not pay gratuity within six months from prescribed time [Section 11(1) of Payment of Gratuity Act]. Metropolitan Magistrate or Judicial Magistrate of First Class can

try the offences punishable under Payment of Gratuity Act [Section 11(2) of Payment of Gratuity Act].

EXERCISE

1. *Mark the correct answer*

   For calculation of gratuity under the Payment of Gratuity Act, 1972 the number of days in a month is to be taken as

   (a) Actual number of days on employment

   (b) 26 days

   (c) 15 days

   (d) 30 days

   [Hint: Option (b) is the correct answer as per Section 4(2) of the Payment of Gratuity Act,1972]

2. *Mr. X was the owner of a factory to which the Payment of Gratuity Act, 1972 was applicable. Mr. X had appointed Ms. D as the Labour Officer for the Factory and given his specific instructions for deducting the employees' contribution as provided by the law. But Ms. D had manipulated the records and cheated the employees by making excessive deductions and pocketing the excess. The Inspector identified the irregularities and sent notice to Mr. X. Does he have a defense?*

   [Hint: Yes, as per Section 7(B) of the Payment of Gratuity Act,1972]

3. *Forfeiture of Gratuity is possible under certain circumstances.*

   (a) True.

   (b) False.

   [Hint: True as per Section 4(6) of the Payment of Gratuity Act, 1972]

4. *The ceiling on the Gratuity amount is rupees----------*

   [Hint: 10 Lakhs as per the amendment in Section 4(3) under the Payment of Gratuity (Amendment) Act,2010]

5. *Gratuity can be attached in execution of any degree or order of any civil, revenue or criminal court*

   (a) True.

   (b) False.

   [Hint: False, as per Section 13 of the Payment of Gratuity Act, 1972]

6
The Companies Act, 1956

UNIT 1: PRELIMINARY

Company and Lifting of the "Corporate Veil"

Question 1

What is a company?

Answer

Section 3(1) of the Companies Act, 1956 defines a 'company'. Company means a company formed and registered under this Act or an existing company. The most striking feature in the company form of organisation is that it acquires a unique character of being a separate legal entity. In other words when a company is registered, it is clothed with a legal personality. It comes to have almost the same rights and powers as a human being. Its existence is distinct and separate from that of its members. Members may die or change, but the company goes on till it is wound up on the grounds specified by the Act. In other words, it means that it has perpetual succession. A company can own property, have banking account, raise loans, incur liabilities and enter into contracts. Even members can contract with company, acquire right against it or incur liability to it. For the debts of the company, only its creditors can sue it and not its members. Also contrast to other forms of organization, the members of the company usually has a limited liability. As the company is an artificial person, it can act only through some human agency, viz., and directors. They are at the helm of affairs of the company and act as its agency, but they are not the agents of the members of the company. A company has a common seal to authenticate its formal acts.

Question 2

'A company is a person separate from its members'. Explain.

Examine the circumstances under which the Courts may disregard the Company's Corporate Personality.

Or

What do you understand by "separate legal entity of the company?" State the circumstances where under the separate legal entity of the company can be ignored and liability can be imposed on the persons regulating the affairs of the company?

Or

Under what circumstances the law disregards the principle that a company is a separate legal entity distinct from its members?

Or

Briefly state the circumstances to lift the status of corporate legal entity of company under the Companies Act, 1956?

Or

Explain clearly the meaning of Lifting the Corporate Veil, as applicable in case of companies incorporated under the Companies Act, 1956. Under what circumstances the veil of a company can be lifted by the court?

Answer

A company in the eyes of law is regarded as an entity separate from its members. It has an independent corporate existence. Any of its members can enter into contracts with the company in the same manner as any other individual can and he cannot be held liable for the acts of the company even if he holds virtually the entire share capital. The company's money and property belong to the company, and not to the shareholders. *(Salomon v. Salomon & Co. Ltd.)*.

Further, from the juristic point of view, a company is a legal person distinct from its members *(Salomon v. Salomon & Co.)*. It has its own corporate personality. This principle may be referred to as 'the veil of incorporation'. The Courts in general consider themselves bound by this principle. The effect of this principle is that there is a fictional veil between the company and its members. That is, the company has a corporate personality which is distinct from its members. This principle must be used for legitimate business purposes only. Where the legal entity of a corporate body is misused for fraudulent and dishonest purposes, the individuals concerned will not be allowed to take shelter behind the corporate personality.

The human ingenuity, however, started using this veil of corporate personality blatantly as a cloak for fraud or improper conduct. Thus it became necessary for the Courts to break through or lift the corporate veil or crack the shell of corporate personality or disregard the corporate personality of the company. Thus while by fiction of law a corporation is a distinct entity, yet, in reality it is an association of persons who are in fact the beneficial owners of all the corporate property *(Gallaghar v. Germania Brewing Co.).*

The circumstances or the cases in which the Courts have disregarded the corporate personality of the company are:

1. *Protection of revenue:* (To prevent evasion of taxation) The Courts may ignore the corporate entity of a company where it is used for tax evasion. *(Juggilal v. Commissioner of Income Tax, B.F. Guzdar v. Commissioner of Income Tax Bombay)*.
2. *Prevention of fraud or improper conduct:* The legal personality of a company may also be disregarded in the interest of justice where the machinery of incorporation has been used for some fraudulent purpose like defrauding creditors or defeating or circumventing law. Professor Gower has rightly observed in this regard that the veil of a corporate body will be lifted where the 'corporate personality is being blatantly used as a cloak for fraud or improper conduct'. Thus where a company was incorporated as a device to conceal the identity of the perpetrator of the fraud, the Court disregarded the corporate personality *(Jones v. Lipman) (Gilford Motor Co. v. Home).*
3. *Determination of character of a company whether it is enemy:* A company may assume an enemy character when persons in de facto control of its affairs are residents in an enemy country. In such a case, the Court may examine the character of persons in real control of the company and declare the company to be an enemy company. (*Daimler Co. Ltd. v. Continental Tyre & Rubber Co. Ltd).*
4. *Where the company is a sham:* The Courts also lift the veil or disregard the corporate personality of a company where a company is a mere cloak or sham (hoax). *(Gilford Motor Co. Ltd. v. Home).*
5. *Company avoiding legal obligation:* Where the use of an incorporated company is being made to avoid legal obligations, the Court may disregard the legal personality of the company and proceed on the assumption as if no company existed.
6. *Company acting as agent or trustee of the shareholders:* Where a company is acting as agent for its shareholders, the shareholders will be liable for the acts of the company *(F.G. Films Ltd., In re.)*
7. *Avoidance of welfare legislation*: Where the courts find that there is avoidance of welfare legislation, it will be free to lift the corporate veil. (*Workmen of Associated Rubber Industry Ltd. v. Associated Rubber Industry Ltd.*).
8. *Protecting public policy:* The Courts invariably lift the corporate veil or a disregard the corporate personality of a company to protect the public policy and prevent transactions contrary to public policy. *(Connors v. Connors Ltd.).*
9. *In quasi-criminal cases:* The courts pierce the corporate veil in quasi-criminal cases in order to look behind the legal person and punish the real persons who have violated the law.

Question 3

Some of the creditors of M/s Get Rich Quick Ltd. have complained that the company was formed by the promoters only to defraud the creditors and circumvent the compliance of legal provisions of the Companies Act, 1956. In this context they seek your advice as to the

meaning of corporate veil and when the promoters can be made personally liable for the debts of the company.

Answer

Corporate Veil: After incorporation, the company in the eyes of law is a different person altogether from the shareholders who have formed the company. The company has its own existence and as a result the shareholders cannot be held liable for the acts of the company even though the shareholders control the entire share capital of the company. This is popularly known as Corporate Veil and in certain circumstances the courts are empowered to lift or pierce the corporate veil by ignoring the company and directly examine the promoters and others who have managed the affairs of the company after its incorporation. Thus, when the corporate veil is lifted by the courts, (i.e., the courts have disregarded the company as an entity), the promoters can be made personally liable for the debts of the company. In the following circumstances, corporate veil can be lifted by the courts and promoters can be held personally liable for the debts of the company.

(i) Trading with enemy country.

(ii) Evasion of taxes.

(iii) Forming a subsidiary company to act as its agent.

(iv) The benefit of limited liability is destroyed by reducing the number of members below 7 in the case of public company and 2 in the case of private company for more than six months.

(v) Under law relating to exchange control.

(vi) Device of incorporation is adopted to defraud creditors or to avoid legal obligations.

Question 4

ABC Pvt. Ltd., is a Private Company having five members only. All the members of the company were going by car to Mumbai in relation to some business. An accident took place and all of them died. Answer with reasons, under the Companies Act, 1956 whether existence of the company has also come to the end?

Answer

Death of all members of a Private Limited Company, Under the Companies Act, 1956: A joint stock company is a stable form of business organization. Its life does not depend upon the death, insolvency or retirement of any or all shareholder(s) or director(s). The provision for transferability or transmission of the shares helps to preserve the perpetual existence of a company. Law creates it and law alone can dissolve it. Members may come and go but the company can go on forever. So in such case, the ABC Pvt. Ltd. does not cease to exist. By way of transmission of shares, shares are transmitted to their legal representatives. The company ceases to exist only on the winding up of the company. Therefore, even with the death of all members (i.e. 5), ABC (Pvt) Ltd. does not cease to exist.

Question 5

F, an assessee, was a wealthy man earning huge income by way of dividend and interest. He formed three Private Companies and agreed with each to hold a bloc of investment as an agent for them. The dividend and interest income received by the companies was handed back to F as a pretended loan. This way, F divided his income into three parts in a bid to reduce his tax liability.

Decide, for what purpose the three companies were established? Whether the legal personality of all the three companies may be disregarded.

Answer

The House of Lords in *Salomon Vs Salomon & Co. Ltd.* laid down that a company is a person distinct and separate from its members, and therefore, has an independent separate legal existence from its members who have constituted the company. But under certain circumstances the corporate veil may be lifted by the courts. It means looking behind the corporate façade and disregarding the corporate entity. Where a company is incorporated and formed by certain persons only for the purpose of evading taxes, by taking shelter of the corporate nature, the courts have discretion to disregard the corporate entity in the matter of tax evasion.

(1) The problem asked in the question is based upon the aforesaid facts. The three companies were formed by the assessee purely and simply as a means of avoiding tax and the companies were nothing more than the assessee himself. Therefore the whole idea of Mr. F was simply to split his income into three parts with a view to evade tax.

(2) The legal personality of the three private companies may be disregarded because the companies were formed only to avoid tax liability and the company was nothing more than the assessee himself. It did no business, but was created simply as a legal entity to ostensibly receive the dividend and interest and to handover them over to the assesse as pretended loans. The same was upheld in *Re Sir Dinshaw Maneckji Petit* AIR 1927 Bom.371 and *Juggilal vs. Commissioner of Income Tax* AIR (1969) SC (932).

Question 6

Explain clearly the concept of "perpetual-succession "and "common-seal" in relation to a company incorporated under the Companies Act, 1956.

Answer

Perpetual Succession and Common Seal: A company is a juristic person with a perpetual succession. It never dies nor does its life depends upon the life of its members. It is not in any manner affected by insolvency, mental disorder or retirement of any of its members. It is created by a process of law and can be put to an end only by the process of law. Members may come and go but the company can go on forever (until dissolved). It continues to exist even if all its human members are dead.

Since a company had independent existence and since all acts of the company are done in the name of the company, it enjoys a "Seal" known as common seal. Common seal is equivalent to signature of the company and is affixed on all documents issued by the company. Common seal of the company is kept in safe custody by a responsible officer of the company.

Question 7

State whether the following statement is correct or incorrect:

A company is a legal person but not a citizen.

Answer

Correct

Classes of Companies under the Act

Question 8

What is meant by a Guarantee Company? State the similarities and dissimilarities between a Guarantee Company and a Company having Share Capital.

Answer

Meaning of Guarantee Company*:* Where it is proposed to register a company with limited liability, the choice is to limit liability by shares or by guarantee. Section 12(2)(b) of the Companies Act, 1956 defines it as a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up. Thus, the liability of the member of a guarantee company is limited by a stipulated amount mentioned in the memorandum. The members cannot be called upon to contribute more than the stipulated amount for which they have guaranteed in the memorandum of association of that company. The articles of association of such company shall state the number of members with which the company is to be registered.

Similarities and dis-similarities between the Guarantee Company and the Company having share capital: The common features between a "guarantee company" and the "company having share capital" are legal personality and limited liability. In case of the later company, the members' liability is limited by the amount remaining unpaid on the shares, which each member holds. Both of them have to state this fact in their memorandum that the members' liability is limited.

However, the dissimilarities between a 'guarantee company' and 'company having share capital' is that in the former case the members may be called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions; but in latter case, they may be called upon to do so at any time, either during the company's life or during its winding up.

Further to note, the Supreme Court in *Narendra Kumar Agarwal vs. Saroj Maloo (1995) 6* SC C 114 has laid down that the right of a guarantee company to refuse to accept the transfer by a member of his interest in the company is on a different footing than that of a company limited by shares. The membership of a guarantee company may carry privileges much different from those of ordinary shareholders.

It is also clear from the definition of the guarantee company that it does not raise its initial working funds from its members. Therefore, such a company may be useful only where no working funds are needed or where these funds can be had from other sources like endowment, fees, charges, donations etc.

Question 9

Can a non-profit organization be registered as a company under the Companies Act? If so, what procedure does it have to adopt?

Answer

Registration of a non-profit organisation as a company: An association of persons set up for promoting commerce, arts, science, religion, charity or any other useful, object and intends to apply its profits or other income in promotion of its objects can be registered as a Company under the Companies Act. However, it has to prohibit payment of any dividend to its members.

Procedure: The association has to apply to the Central Government for issuing a licence. Through this licence the Central Government shall direct the Registrar to register the association as a company with limited liability without the addition of words 'limited' or 'private limited' to its name. Therefore, the association may be registered accordingly.

The association has to fulfill the conditions needed for registration as a company, i.e. it must have its name, its Memorandum of Association, its Articles of Association or Rules/Bye-laws and signatures or its founder members with two witnesses. On registration (subject to the provisos of Section 25) it will have the same privileges and obligations as a limited company has. This licence is revocable by the Central Government, and on revocation the Registrar shall put the words 'Limited' or 'Private Limited' against the company's name in the Register. But before such revocation, the Central Government must give it a written notice of its intention to revoke the licence and opportunity to be heard in the matter.

Question 10

Mr. V, alongwith six other persons desires to float a company for charitable purposes, as permissible under Section 25 of the Companies Act, 1956. He seeks your advise about the procedure to be followed to give effect to the above proposal. Advise him.

Answer

Company for charitable purposes (Section 25 of the Companies Act, 1956): According to Section 25 of the Companies Act, 1956 the procedure to be followed to give effect to the said proposal is as follows:

1. Mr. V, must mobilise six other persons who are majors and sound mind to sign MOA and AOA which may be of its own or as in Table "C" or "D" of the Companies Act.
2. The company may be a Limited Company with share capital or a company limited by guarantee.
3. In no case the profits of the company can be distributed in the forms of dividends on bonus shares.
4. All the profits of the company should be used only for welfare purposes and company's progress. These factors must be incorporated in AOA.
5. Out of the three names chosen by the promoters for the name of the company one should be used. If it is not available the proposals repeated by filing form no. 1A.
6. After getting the name from the ROC, the draft MOA and AOA must be got approved by Regional Director who has been delegated the powers by the Central Government.
7. Three copies of a approved MOA and AOA alongwith the registration and filing fee, documents like form 1, 18, 32 and consent etc. must be submitted.
8. A power of attorney in favour of Practicing CA/CS/CMA or an advocate for presentation before ROC to make corrections and collect incorporation certificate must also be filed on non judicial stamp paper.
9. The company becomes operative on incorporation.

Question 11

State whether the following statement is correct or incorrect:

'A private limited company must have a minimum of two directors, while a public limited company must have atleast three directors,

Answer

Correct

Question 12

Under what circumstances a company becomes subsidiary of another company under the provisions of the Companies Act, 1956?

Answer

Holding and Subsidiary Companies are relative terms. A company is a holding company of another only if the other is its subsidiary. Any of the circumstances illustrated below must exist to constitute the relationship of holding and subsidiary companies:

(a) When one company controls the composition of Board of Directors of the other companies.

(b) When a company is an existing company in respect of which the holders of preference shares issued before the commencement of this Act have the same voting rights in all

respects as the holders of equity shares, exercises or controls more than half of the total voting power of such company.

Where a company other than above mentioned company above holds more than half in nominal value of the equity share capital of the other company. [Section 4(1)(b)].

(c) Where a company is subsidiary of another company which is subsidiary of still another company.

Question 13

With reference to the provisions of the Companies Act, 1956 explain the circumstances under which a subsidiary company can become a member of its holding company- Examine the position of the following with regard to membership in a company:

(i) An Insolvent

(ii) Partnership Firm.

Answer

In accordance with the provisions of Section 42 of the Companies Act, 1956, a subsidiary company cannot become a member in its holding company and any allotment or transfer of shares in a company to its subsidiary is void. The section however does not apply where:

(a) the subsidiary company is a legal representative of a deceased member of the holding company, or

(b) the subsidiary company is a trustee and the holding company or a subsidiary thereof is not beneficially interested under the trust, or

(c) entered into by the holding company in the ordinary course of business which includes the lending of money.

Position of the following with regard to membership in a company:

(i) Partnership Firm: A partnership may firm hold shares in a company in the individual names of partners as joint shareholders. As an un incorporated association, a firm is not a person and as such it cannot be entered as a member in the register of members. *(Ganesh Das Ram Gopal v. R.G. Cotton Mills Ltd.)* Section 25 of the Companies Act however, permits a firm to be a member of a company licensed under Section 25.

(ii) An Insolvent: An insolvent may be a member of a company. So long as his name appears in the register of members, he is a member and is entitled to vote even though his shares vest in the Official Assignee or Receiver. *(Morgan v. Gray)* allotment or transfer of shares is by way of security for the purpose of a transaction.

Question 14

The paid-up Share Capital of AVS Private Limited is ₹1 crore, consisting of 8 lacs Equity Shares of ₹10 each, fully paid-up and 2 lacs Cumulative Preference Shares of ₹10 each, fully

paid-up. XYZ Private Limited and BCL Private Limited are holding 3 lacs Equity Shares and 1,50,000 Equity Shares respectively in AVS Private Limited.

XYZ Private Limited and BCL Private Limited are the subsidiaries of TSR Private Limited.

With reference to the provisions of the Companies Act, 1956, examines whether AVS Private Limited is a subsidiary of TSR Private Limited? Would your answer be different if TSR Private Limited has 8 out of total 10 directors on the Board of Directors of AVS Private Limited?

Answer

Holding, subsidiary relationship: For the purpose of determining whether a company is subsidiary of another company, only equity shares issued by the first mentioned company are to be taken into account [Section 4 (1) (b) (ii), of Companies Act, 1956]. Again, shares held by a subsidiary company shall be treated as held by its holding company [Section 4 (3) (b) (ii)]. If a company by itself or along with its subsidiaries holds more than half in nominal value of the equity shares capital of another company, it will be considered as the holding company of the other company [Section 4(3) (b) (ii) of companies Act, 1956]

In this case, the equity share capital of AVS Pvt. Ltd. is ₹80,00,000 consisting of 8,00,000 equity shares of ₹ 10 each fully paid up XYZ and BCL Pvt. Ltd. are holding 4,50,000 (3,00,000+1,50,000) equity shares in AVS Pvt Ltd., TSR Pvt, Ltd will be treated as holding company as it is holding more than half in nominal value of the equity share capital of AVS Pvt Ltd.

If TSR Pvt. Ltd. controls the composition of the Board of Directors of AVS Pvt. Ltd; it will also be treated as holding company by virtue of Section 4 (1) (a). Hence the answer will not be different.

Question 15

Which of the institutions are regarded as "Public Financial Institutions" under the Companies Act, 1956?

Answer

Public Financial Institutions: By virtue of Section 4A of the Companies Act, 1956 the following institutions are to be regarded as public financial institutions:

(i) The Industrial Credit and Investment Corporation of India Ltd.

(ii) The Industrial Finance Corporation of India

(iii) The Life Insurance Corporation of India

(iv) The Industrial Development Bank of India

(v) The Unit Trust of India

(vi) The Infrastructure Development Finance Company Ltd.

(vii) The Securitisation Co., or The Reconstruction Co. which has been registered under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

The Central Government is empowered under Section 4A(2) to add any other institution to the above list. This addition has to be made through a notification, in the Official Gazette. Secondly, the institution for being added to the existing list, (i) must have been established or constituted by or under any Central Act; or (ii) at least 51% of the paid-up share capital of such new institution is held or controlled by the Central Government. In exercise of this power, the Central Government has notified more than 30 institutions as Public Financial Institutions.

[Note :- The Ministry of Corporate Affairs (MCA) vide General Circular No. 34/2011 dated 2nd June, 2011 has framed the following criteria for declaring any Financial Institution as PFI under Section 4A of the Companies Act, 1956:

(a) A Company or Corporation should be established under a Special Act or the Companies Act being Central Act

(b) Main business of the Company should be Industrial / Infrastructural Financing

(c) The company must be in existence for at least 3 years and their financial statement should show that their income from Industrial / Infrastructural financing exceeds 50% of their income

(d) The net worth of the company should be ₹ One thousand crore

(e) The company is registered as Infrastructure Finance Company (IFC) with RBI or as an Housing Finance Company (HFC) with National Housing Bank

(f) In the case of CPSUs/SPSUs, no restriction shall apply with respect to financing specific sector(s) and net worth

Any financial institution applying for declaration as PFI shall fulfill the aforesaid criteria.]

Miscellaneous Provisions (Sections 43-45)

Question 16

A public limited company has only seven shareholders, all the shares being fully paid–up. All the shares of one such shareholder are sold by the court in an auction and purchased by another shareholder. The company continues to carry on business thereafter. Discuss the liabilities of the shareholders of the company under the Companies Act, 1956.

Answer

Consequences of membership falling below legal minimum: The problem in the question relates to reduction of membership below the statutory minimum. Section 12 of the Companies Act, 1956 requires a public company to have a minimum of seven members. If at any time the membership of a public company falls below seven and it continues its business for more than six months, then according to Section 45 of the Act every such member who was aware of this

fact would be personally and severally liable for all debts contracted by the company during the period and may be severally sued for all debts contracted after six months.

Accordingly, in the given problem, the remaining six members shall incur personal liability for the debts contracted by the company,

(i) If they continued to carry on the business of the company with that reduced membership beyond the six month period.

(ii) Only those members who knew of this fact of reduced membership shall be liable.

(iii) The liability shall extend only to the debts contracted after six months from the date of auction of that member's shares.

Question 17

UMC, Limited has only 7 shareholders having fully paid-up shares. On 30th April, 2009, all the shares of X (a shareholder of the company) are sold to Y (another shareholder of the company) in an auction by the order of the court. Z, (a shareholder of the company) was in USA for a business trip from January and thus he was not aware of the developments. The company continues to carry on its business thereafter. In December, 2009, the company borrowed a sum of ₹5 lac from the Unique Bank. Later, the company was wound up and the Assets of the company were not sufficient for the payment of its Liabilities. The Bank filed a suit against Y and Z for recovery of the said loan from them. Decide the Liabilities of Y and Z under the provisions of Companies Act, 1956. Would your answer be the same, if the said loan was taken in the month of March, 2009?

Answer

The problem relates to reduction of membership below the statutory minimum. Section 12 of the Companies Act, 1956 requires a public company to have a minimum of seven members. It at any time the membership of a public company falls below seven and it continues its business for more than six months, then according to Section 45 of the Act every such member who was aware of this fact would be personally and severally liable for all debts contracted by the company during the period and may be severally sued for all debts contacted after six months.

Accordingly in the given problem:

(i) Y is personally liable for the payment of loan to the Unique Bank because the members of the UMC Limited continued to carry on the business of the company with that reduced membership beyond the six months period and Y knows this fact.

(ii) Z is not responsible for any debt because he is not aware about the reduced membership.

(iii) If the said loan was taken in March 2009, only the company is responsible for the payment of the loan. No members shall be personally liable for the repayment.

Question 18

What will be the consequence in case a Private Company incorporated under the provisions of the Companies Act,1956 defaults in complying with conditions constituting Private Company in terms of Section 3 (1) (iii) of the Companies Act, 1956.

Answer

Consequence in case of private company acting in contravention of Section 3(1) (iii) of the Companies Act 1956: A private company which has been constituted under Section 3(1) (iii) has the following characteristics:

- minimum 2 members
- maximum 50, excluding employees and ex-employees who had become members when they were employees
- minimum 2 directors
- with restrictions on transferability of shares
- restrained from inviting public for share capital and from issuing prospectus
- with minimum paid up capital of ₹ 1 lakh
- prohibited from accepting deposits from persons other than its members, directors and their relatives.

Some other procedural concessions are also given under the Companies Act, 1956.

In accordance with the provisions of Section 43 of the Companies Act, 1956, if contravention is made against complying with the provisions contained in Section 3 (1) (iii), the company shall lose all the privileges and exemptions conferred on it by the Act, and the provisions of the Act shall apply to it as if it were not a private company. But the Company Law Board may relieve the company from such a consequence if it is satisfied that the failure in compliance with the said requirement was not deliberate but was accidental or inadvertent or that on other grounds it is just and equitable to grant relief.

Conversion of Public Company into a Private Company

Question 19

Define a Private Company. Explain the procedure for conversion of a Public Company into a Private Company.

Answer

Definition of a Private Company: According to Section 3(1) (iii) of the Companies Act, 1956 a 'private company' means a company which has a minimum paid-up capital of one lakh rupees or such higher paid-up capital as may be prescribed and by its articles:

(a) restricts the right to transfer its shares if any.

(b) limits the number of its members to 50 not including its employee members (present or past) [Joint holders of shares are treated as a single member].

(c) prohibits any invitation to the public to subscribe for any shares, or debentures of the company.

(d) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relations.

Procedure for conversion of a Public Company into a Private Company: A private limited company, if it desires to convert itself into a public company will have to follow the under-mentioned procedure:

(1) It should take the necessary decision in its board meeting and fix up the time, place and agenda for convening a general meeting to alter the articles of association and consequently the name by a special resolution as well as to alter by special resolution the "object clause" of the memorandum subject to the confirmation of the Company Law Board (Now Central Government) under Section 17 and by ordinary resolution the share capital clause under Section 94 if the alteration of share capital is involved in the process.

(2) The company has to see that any change in the articles confirms to the provisions of the Companies Act [Section 31(1)] also to see that such change does not increase the liability of any member who had become the member before the alteration.

(3) It must issue notices for the general meeting in order to pass there at the special resolutions together with the explanatory statements for the alteration of the articles and the memorandum.

(4) It will have to convene the general meeting in order to pass there at the special resolution (i) for the purpose of the alteration of the memorandum and article of association; and (ii) also for the purpose of deleting those articles which are required to be included in the articles of a private company only [Section 3(i)(iii)]. Such other articles which do not apply to a public company should be deleted and those which apply should be inserted. Consequent upon the above changes, it will have to delete the word "private" from its name [Section 21].

(5) It shall file with the Registrar the said special resolution together with the explanatory statement within 30 days of their passing [Section 192].

(6) The company has to apply to the Registrar for the issue of a fresh certificate of incorporation for the changed name, on issue of such certificate shall be name of the converted company be final and complete [Section 23].

Question 20

State whether the following statement is correct or incorrect:

If the Central Government permits, a public company can be converted into a private company.

Answer

Correct

Procedure for Conversion of a Private Company into a Public Company

Question 21

What is the procedure laid down in the provisions of the Companies Act, 1956 for converting a private company into a public company?

Or

Board of Directors of a private company decided to convert it into a public company. State the steps to be taken for such conversion in order to comply with the requirements under the Companies Act, 1956.

Answer

Conversion of Private Company into a Public Company

Procedure for conversion of a private company into a public company is as follows:

(i) Take necessary decision in its Board Meeting and fix up time, place and Agenda for convening Annual General Meeting.

(ii) Amend Memorandum to change its name by removing the word 'Private' by a special resolution. Approval of Central Government is not necessary for change of name.

(iii) Must pass a special resolution deleting from its articles the requirements of a private company under Section 3(1)(iii). Such other articles which do not apply to a public company should be deleted and those which apply should be inserted. A copy of the special resolution must be filed with the Registrar of Companies within 30 days. It becomes a public company on the date of alteration [Section 44(1)(a)].

(iv) Increase the number of shareholders to at least 7 and number of directors to at least 3.

(v) Within 30 days from the passing of the Special Resolution, a prospectus or a statement in lieu of prospectus in the prescribed form must be filed with the Registrar [Section 44(1)].

(vi) The aforesaid prospectus or the statement in lieu of prospectus must be in conformity with Part I and II of Schedule II or with Part I and II of Schedule IV respectively. The prospectus or statement in lieu of prospectus must be true and not misleading [Section 44(2) and (3)].

(vii) The company has to apply to the Registrar for the issue of a fresh Certificate of Incorporation, for the changed name, namely, the existing name with the word 'private' deleted.

Question 22

Sparkle Infotech Ltd. was registered as a Public Company. There are 76 members in the Company as stated below:

(i)	*Directors and their relatives*	*36*
(ii)	*Employees*	*12*
(iii)	*Ex-employes (shares were allotted when they were employees)*	*8*
(iv)	*7 couples holding shares jointly in the names of husband and wife (7X2)*	*14*
(v)	*Others*	*6*
	Total number of members	*76*

The Board of Directors of the Company proposes to convert it into a Private Company. Advise the Board of Directors about the steps to be taken for conversion into a Private Company including reduction in the number of members, if necessary, as per the Companies Act, 1956.

Answer

A private company as per Section 3 (1)(iii) cannot have more than 50 members, but for counting these 50 members, employee members and ex-employee members (provided they acquired the shares while in employment) are to be excluded. Besides, joint members are to be counted as a single member. Accordingly, the total number of members are actually 36 +7+6+=49 only. No reduction in membership is therefore called for.

The procedure for converting a public company will require:

(i) Passing of a Special Resolution authorizing the conversion and altering the articles so as to contain the matters specified in Section 3(1)(iii).

(ii) Changing the name of the company by omitting the "Private". As per Section 21, it does not require special resolution to be passed.

(iii) Obtaining the approval of the Registrar of Companies as required by Section 31.

(iv) Filing of printed copy of the articles with registrar as altered within one month of the receipt of the approval [Section 31 (2A)].

Privileges and Exemptions

Question 23

Define Private Company. Briefly explain the privileges and exemptions for a private company as provided under the Companies Act, 1956.

Answer

A private company means a company which has a minimum paid-up capital of one lakh rupees or such higher paid-up capital as may be prescribed, and by its articles –

(a) restricts the right to transfer its shares, if any;

(b) limits the number of its members to fifty;

(c) prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company;

(d) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

It enjoys some privileges and exemptions, which a public company is deprived of. These are as follows:

1. Two or more persons may form a private company [Section 12(1)].
2. It need not hold a Statutory Meeting or file a statutory report [Section 165].
3. The consent of directors to act as such, and to take up qualification shares need not be filed with the Registrar [Section 266].
4. There is no restriction on the amount of overall managerial remuneration that it may pay [Section 198].
5. The directorship of a private company is not includible in the maximum number of directorships that a person may hold [Section 310].
6. The consent of the Central Government for advancing loans to directors is not required [Section 295].
7. There are no restrictions on the powers of the Board of Directors [Section 293]
8. The Central Government is not empowered to prevent a change in the Board of Directors of a company, which is likely to affect management prejudicially [Section 409].
9. It can advance loans for the purchase of its own shares [Section 77(2)].

Question 24

Whether a limited company can become partner in a partnership firm?

Answer

One of the important features of a company is an artificial juristic person. Being a juristic person, company is capable of entering into contract in its own name. According to Section 4 of the Partnership Act, 1932, partnership is a contractual relationship between persons; therefore, there should not be any objection to a company in becoming partner. Further, the limited liability element of a limited company is also do not restrict a company in becoming a partner in an unlimited liability of a partnership firm, because, it is limited liability of members of a limited company and not the company itself. However, the Ministry of Corporate Affairs is in the opinion that, a company may become a partner if the Memorandum of Association specifically allows it.

When Companies must be Registered?

Question 25

The United Traders Association was constituted by two joint Hindu Families consisting of 21 major and 5 minor members. The Association was carrying on the business of trading as retailers with the object for acquisition of gains. The Association was not registered as a company under the Companies Act, 1956 or any other law.

State whether United Traders Association is having any legal status? Will there be any change in the status of this Association if the members of the United Traders Association subsequently were reduced to 15?

Answer

Section 11 of the Companies Act, 1956 provides that no company, association or partnership consisting of more than 10 persons for the purpose of carrying on the business of banking and more than 20 persons for the purpose of carrying on any other business can be formed unless it is registered under the Companies Act or is formed in pursuance of some other Indian Law. Thus if such an association violates the provisions of Section 11 it is an "Illegal Association" although none of the objects for which it may have been formed is illegal.

This Section does not apply to a joint Hindu family but where the business is being carried on by two or more joint Hindu families the provisions of Section 11 shall be applicable. For computing the number of members for this purpose, minor members of such families shall be excluded.

Hence, the United Traders Association constituted by two joint Hindu Families is an Illegal Association according to the provisions of Section 11 as stated above.

Further, such Association of more than 20 persons, if unregistered is invalid at its inception and cannot be validated by subsequent reduction in the number of members to below 20 (*Madan Lal vs. Janki Prasad 4 All 319*).

Mode of Registration/Incorporation of Companies

Question 26

Explain in brief the mode of incorporation of a company.

Answer

Mode of registration/incorporation of company: In the case of a public company with or without limited liability any 7 or more persons can form a company by subscribing their names to memorandum and otherwise complying with the requirements of the Companies Act, 1956. In exactly the same way, 2 or more persons can form a private company [Section 12]. Persons who form the company, who conceive the idea of forming the company are known as promoters. They take all necessary steps for its registration.

(a) Lawful purpose: The essence of validly incorporated company is that it must consist of a particular number of persons and be an association for a lawful purpose. Unless the purpose appears to be unlawful *ex facie* or is transparently illegal or prohibited by way of statute, it cannot be regarded as an unlawful purpose.

(b) Applying for the name: The promoters of the company should decide upon at least three suitable names in order of preference to afford flexibility to the Registrar to decide the availability of the name.

(c) Documents to be filed: After getting the name approved, the certain documents along with the application and prescribed fees, are to be filed with the Registrar.

(d) Subscribing their names: Subscribing name means signing the names. Section 15 stipulates that the Memorandum should be signed by each subscriber who should add his address, description and occupation in the presence of one witness.

(e) Commencement of business

(f) Statement in Lieu of Prospectus: If a public company does not issue a prospectus inviting the public to purchase its share because, the directors think they can sell the shares even without the issue of the prospectus, it can do so.

(g) Certificate of incorporation: Upon the registration of the documents mentioned earlier under the head "Documents to be filed for registration of the company" and the payment of the necessary fees, the Registrar of Companies issues a certificate that the company is incorporated, and in the case of a limited company that it is limited.

Question 27

Which documents are required to be filed with the Registrar of Companies at the time of registration of a company under the provisions of the Companies Act, 1956?

Answer

Filing of document with the Registrar of Companies:

After getting the name approved, the following documents along with the application and prescribed fee, are to be filed with the Registrar:-

(1) Memorandum of Association [Section 33(1)(a)]

(2) Articles of Association, if any [Section 33(1)(b)]

(3) The agreement, if any, which the company proposed to enter into with any individual for appointment as its Managing or Whole Time Director or Manager, [Section 33(1)(c)]

(4) A declaration that the requirements of the Act and the rules framed there under have been complied with. This declaration is required to be signed by an advocate of the Supreme Court or High Court or an attorney or a pleader having the right to appear before High Court or a Company Secretary or a Chartered Accountant in whole time

practice in India who is engaged in the formation of a company, or by person named in the Articles as a Director, Manager or Secretary of the company [Section 33(2)].

(5) In the case of a public company having share capital, where the Articles name a person as director/directors, the list of the directors and their written consent in prescribed form to act as directors and take up qualification shares.(Section 266).

(6) Apart from the above, the company must give a notice regarding the situation of its registered office under Section 146 within 30 days of registration.

Question 28

What is the meaning of "Certificate of Incorporation" under the provisions of the Companies Act, 1956?

OR

State the conditions which are applicable for the purpose of commencement of business by a public company under the Companies Act, 1956.

Answer

Certificate of Incorporation: Upon the registration of the documents required for registration of a proposed company and filed by such company along with the necessary fee, the Registrar of Companies issues a certificate that the company is incorporated and in the case of a limited company, that it is limited (Section 34 of the Companies Act, 1956).

Section 35 provides that the certificate of incorporation given by the Registrar shall be conclusive evidence that all the requirements of this Act have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is a company authorized to be registered and duly registered under this Act. A certificate of incorporation is conclusive as to all administrative acts relating to incorporation and as to from the date of incorporation *(Jubilee Cotton Mills vs. Lewis)*

Commencement of Business: A private company can commence its business as soon as it gets Certificate of Incorporation. But a company having a share capital which has issued a prospectus inviting the public to subscribe for its shares cannot commence any business or exercise borrowing power unless:

(a) The minimum number of shares which have to be paid for in cash has been subscribed and allotted.

(b) Every director has paid, in respect of share for which he is bound to pay an amount equal to what is payable on shares offered to the public on application and allotment.

(c) No money is or may become liable to be paid to application of any shares or debentures offered for public subscription by reason of any failure to apply for or to obtain permission for the shares or debentures to be dealt in any recognised stock exchange; and

(d) A statutory declaration by the secretary or one of the directors that the aforesaid requirements have been complied with is filed with the Registrar.

If, however, a company having a share capital has not issued a prospectus inviting the public to subscribe for its shares, it cannot commence any business or exercise borrowing powers unless it has issued a statement in lieu of prospectus and the conditions contained in paragraph (b) and (d) aforesaid have been complied with.

The Registrar of Companies shall examine them and if satisfied, shall issue to the company a certificate to commence business.

Question 29

What are the effects of registration of a company?

Answer

Section 34(2) of the Companies Act, 1956 which provides for the effect of incorporation states that: From the date of incorporation mentioned in the certificate of incorporation, such of the subscribers to the Memorandum and other persons, as may from time to time be members of the company, shall be a body corporate by the name contained in the memorandum, capable forthwith of exercising all the functions of an incorporated company and having perpetual succession and a common seal, but with such liability on the part of the members to contribute to the assets of the company in the event of its being wound up as is mentioned in the Companies Act.

Accordingly, when a company is registered and a certificate of incorporation is issued by the Registrar, three important consequences follow:

(i) The company becomes a distinct legal entity. Its life commences from the date mentioned in the certificate of incorporation.

(ii) It acquires a perpetual succession. The members may come and go, but it does on forever, unless it is wound up.

(iii) Its property is not the property of the shareholders. The shareholders have a right to share in the profits of the company when realised and divided. Likewise any liability of the company is not the liability of the individual shareholders.

Question 30

A Company was incorporated on 6th October, 2003. The certificate of incorporation of the company was issued by the Registrar on 15th October, 2003. The company on 10th October, 2003 entered into a contract, which created its contractual liability. The company denies from the said liability on the ground that company is not bound by the contract entered into prior to issuing of certificate of incorporation. Decide, under the provisions of the Companies Act, 1956, whether the company can be exempted from the said contractual liability.

Answer

Certificate of Incorporation and the binding effect: Upon the registration of the documents as required under the Companies Act, 1956 for incorporation of a company, and on payment of the necessary fees, the Registrar of Companies issues a Certificate that the company is incorporated (Section 34).

Section 35 provides that a certificate of incorporation issued by the Registrar is conclusive as to all administrative acts relating to the incorporation and as to the date of incorporation. The facts as given in the problem are similar to those in case of *Jubilee Cotton Mills v. Lewis (1924) A.C. 1958* where it was held that an allotment of shares made on the date after incorporation could not be declared void on the ground that it was made before the company was incorporated when the certificate of incorporation was issued at a later date.

Applying the above principles the contention of the company in this case cannot be tenable. It is immaterial that the certificate of incorporation was issued at a later date. Since the company came into existence on the date of incorporation stated on the certificate, it is quite legal for the company to enter into contracts. To conclude the contracts entered into by the company before the issue of certificate of incorporation shall be binding upon the company. The date of issue of certificate is immaterial.

Question 31

The promoters of your company incorporated on 10th September, 2009 has entered into a contract with A on 7th August, 2009 for supply of goods. After incorporation, your company does not want to proceed with the contract. As a Company advisor, advise the management of the company, referring to the provisions of the Companies Act, 1956.

Answer

Pre-incorporation contracts in general are void ab initio, and hence not binding on the company. However, under Section 19(e) of the Specific Relief Act, 1963, the party to the contract can enforce the contract against the company, if

(i) the company had adopted the same after incorporation; and

(ii) the contract is warranted by the terms of incorporation.

Thus, unless the company adopts the contract, the other party cannot enforce the same against the Company. However, promoters can be held personally liable.

Question 32

Though six out of seven signatures to the Memorandum of Association of a company were forged, the company was registered and the Certificate of Incorporation was issued. Can the registration of the company be challenged subsequently on the ground of forged signatures?

Or

The Memorandum of Association of a company was signed by two adult members and by a guardian of the other five minor members, the guardian signing separately for each minor member. The Registrar registered the company and issued under his hand a Certificate of Incorporation. The plaintiff contended that (a) conditions of registration were not duly complied with, and (b) that there were no seven subscribers to the Memorandum. Will the Court uphold his contention?

Answer

No. Registration cannot be challenged. Section 35 of the Companies Act 1956 declares that certificate of incorporation given by the Registrar in respect of any company shall be conclusive evidence that all the requirements of the Act have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is company authorized to be registered and duly registered under the Act. *(Peel's Case)*

Question 33

Mr. Ram Lal and his friend desire to incorporate a Public Company and approach you for help. Advise.

Answer

1. A name must got allotted out of a choice of three.
2. Seven members (minimum) must be ready to sign as subscribers to the MOA and AOA.
3. MOA and AOA with necessary objects and clauses should be prepared on stamp paper according to State Stamp Act.
4. Consent must be given in Form No. 32 for becoming a Director. List of directors must also be filed.
5. Form No. 18 showing address of the registered office is also another document.
6. Form No. I – Declaration by a Professional or Director is also necessary on the requisite stamp paper.
7. The name available letter should be filed in Original.
8. A power of attorney on non-judicial stamp paper for making corrections and receiving Incorporation Certificate is necessary.
9. Fees for registration of a company depending upon the authorised capital must also be paid.

After satisfaction of the above requirements, the ROC issues a certificate staling that the public company has been incorporated.

Question 34

The Articles of a Public Company clearly stated that Mr. A will be the solicitor of the company. The company in its general meeting of the shareholders resolved unanimously to appoint B in

place of A as the solicitor of the company by altering the articles of association. Examine, whether the company can do so? State the reasons clearly.

Answer

According to Section 36(1) of the Companies Act,1956, the memorandum and articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member and combined covenants on its and his part to observe all the provisions of the memorandum and articles. Section 36 creates an obligation binding on the company in its dealings with the members but the word "members" in this Section means members in their capacity as members, that is, excluding any relationship which does not flow from the membership itself. Therefore even a member cannot enforce the provisions of articles for his benefit in some other capacity than that of a member.

Section 31 also provides that the company may by special resolution alter its articles. In the given problem the company has changed its articles by passing resolution unanimously and therefore the company can change its articles. The provision of memorandum and articles will bind the members but in the capacity of a member only and even a member may be treated as an outsider. Therefore a member cannot enforce the provisions of articles for his benefit in some other capacity than that of a member. In the given case, A will not succeed and the company is empowered to appoint B as a solicitor of the company and may change the articles accordingly. The problem is based upon the decision held in *Eley vs. Positive Govt. Security Life Assurance Co. (1876).*

Question 35

Distinguish between "pre-incorporation contracts" and "provisional contracts" under the Companies Act, 1956.

Answer

Pre-incorporation vs. Provisional Contracts: Following are the points of distinction between Pre-incorporation contracts and Provisional-contracts:

(i) Pre-incorporation contracts are those contracts, which are entered into, by the persons proposing to float a company for prospective company before it has come into existence. Contracts which are entered into by a company after obtaining the Certificate of Incorporation but before getting the certificate to commence business are known as provisional contracts.

(ii) The company which is not in existence, is not bound by the pre-incorporation contracts unless the company adopts the same after incorporation. There can be no ratification in case of pre-incorporation contracts. Provisional contracts on the other hand shall be binding upon the company from the date on which the company is entitled to commence business.

(iii) Contracts entered into by a company after its incorporation and before it is entitled to commence business are provisional only and are not binding on the company until the trading certificate is issued [Sec. 149(4) of the Companies Act, 1956]. The expressional "provisional" denotes that the contract should be read subject to an implied term that it shall not be binding until the company becomes entitled to commence business. Consequently, should the company go into liquidation without commencing business, such contracts cannot be enforced at all.

Memorandum of Association

Question 36

Explain fully the doctrine of Ultravires and state its implications.

Or

Briefly explain the doctrine of "ultravires" under the Companies Act, 1956. What are the consequences of ultravires acts of the company?

Answer

The objects or the acts which a Company is empowered to do are specified in the Memorandum of Association of the company and the company cannot cross the boundary drawn by the Memorandum of Association. The company is empowered to do only such acts which are:

(a) within the framework of the Memorandum *i.e.* stated in clear terms in the Memorandum of Association of the company, or

(b) which are reasonably and fairly incidental to the attainment of its objects, or

(c) which are otherwise authorised by the Companies Act.

If the company does any acts which are not covered under the three categories, such acts shall be beyond the power of the company and shall be declared *ultravires* the Memorandum of the Company. The term *ultravires* means *beyond powers.* These ultra vires acts may be categorized under the following three heads:

(i) *Acts ultra vires* the directors, i.e. acts beyond the powers of the Directors of the company. Such are not altogether void and inoperative. They can be ratified by the shareholders in a general meeting.

(ii) *Acts ultra vires* the Articles of Association of the company, i.e. the acts which are beyond the powers of the company given to it by its Articles of Association. These acts are also not altogether void and inoperative. They can also be ratified by the company, by altering the articles through a Special Resolution.

(iii) Acts *ultra vires* the Memorandum of Association of the company, i.e. acts which are beyond the powers of the company given to it by its Memorandum of Association. As a matter of fact such acts are beyond the legal powers of the company and therefore,

known as *"ultra vires" the company .* These Acts are wholly void and inoperative; they cannot be ratified since they are beyond the legal powers, of the company. The company, therefore, is not bound by such acts at all. Most important thing is, that such acts cannot be ratified even by the whole body of the shareholders of the company.

The decisions given in the following leading cases, have proved the point in question, that ultra vires acts of the company are void and inoperative wholly. The cases are:

(1) Ashbury Railway Carriage and Iron Co. Ltd. V. Riche (I875)

(2) Re German Date Coffee Co. (1882)

(3) Egyptian Salt Co. v. Port said Salt Association (1931)

Implications of ultra vires Acts:

Their implications can be stated as under:

(1) *Injunction against the Company:* Any member of the company can obtain injunction from the court i.e. an order from the court to restrain the company from proceeding with the *ultra vires* acts.

(2) *Personal liability of the Directors:* The directors of the company are personally liable to the company for the *ultra vires* acts. It is the duty of the directors to see that the company's capital is used for the legitimate objects of the company and not otherwise. However, if the person receiving the money knows that he is receiving payment for an *ultra vires* act, then he is bound to return the money back to the director.

(3) *Personal liability of the directors to third parties:* Directors action is treated to be an action of an agent who acts beyond his authority and, therefore, the directors for *ultra vires* act(s) shall be held personally liable towards the third party for any loss suffered by such third parties.

(4) *Ultra vires contracts are void:* This is because of the fact, that the Company is not empowered to enter into such contracts, as well such contracts cannot become inter vires by subsequent ratification even by the shareholders of the company.

A contract of a company which is ultra vires the company is void ab initio and of no legal effect. Neither the company nor other contracting party can enforce the ultra vires contract. The company may, however, alter the objects clause for the future, but such alteration will not validate the past ultravires acts done.

Question 37

X, a chemical manufacturing company distributed 20 lacs (₹ Twenty Lacs) to scientific institutions for furtherance of scientific education and research. Referring to the provisions of the Companies Act, 1956 decide whether the said distribution of money was "Ultra vires" the company?

Answer

Distribution of Rupees Twenty Lacs by a company engaged in Chemical manufacturing is not 'Ultravires' the company since it was conducive to the continued growth of the company as chemical manufacturers *(Evans v. Brunnner, Mood & Co. Ltd. 1921).*

Question 38

Explain the doctrine of "Ultra-vires". What are the legal effects of ultra-vires transactions under the Companies Act, 1956?

Answer

Doctrine of Ultravires, the Companies Act, 1956

A company has the power to do all such things as are:

1. Authorised to be done by the Companies Act, 1956;
2. Essential to the attainment of its objects specified in the Memorandum.
3. Reasonably and fairly incident to its objects.

   Everything else is ultra vires the company. The term 'ultra vires' means that the doing of the act is beyond the legal power and authority of the company. If an act is ultra vires the company, no legal relationship or effect ensues there from. Such an act is absolutely void and even the whole body of shareholders cannot ratify it and make it binding on the company. The leading case on the point is *Ashbury Rly. Carriage & Iron Co. Ltd. Vs. Riche* where it was held that a company being a corporate person should not be fined or punished for its own acts or an act of its agent, if it is beyond its powers and privileges. Main features of the doctrine of ultra vires are:

   1. when an act is performed or a transaction is carried out which, though legal itself, is not authorized by the objects clause in the memorandum or by statute, it is said to be ultra vires the company.
   2. if an act is ultra vires the company, it cannot be ratified even by the whole body of shareholders.
   3. if an act is ultra vires the directors, but intra vires the company, it can be ratified by the whole body of shareholders.
   4. if an act is ultra vires the Articles, it can be ratified by altering the Articles by a special resolution at a general meeting.

   Effect of ultra vires transaction and borrowing: An ultra vires transaction being void does not vest the transferee with any right; nor does it divest the transferor. It means the transferor does not lose any right and the transferee does not get any right.

Alteration of the Memorandum

Question 39

The Directors of a company registered and incorporated in the name "Mars Textile India Ltd." desire to change the name of the company entitled "National Textiles and Industries Ltd." Advise as to what procedure is required to be followed under the Companies Act, 1956?

Answer

Change in the name of company: In the first instance, Mars Textile India Ltd., should ascertain from the Registrar of Companies whether the proposed name viz. National Textiles and Industries Ltd. is available or not. For this purpose, the company should file the prescribed Form No.1A with the Registrar along with the necessary fees. The Registrar after examination will inform whether the new name is available or not for registration.

In case the name is available, the company has to pass a special resolution approving the change of name to National Textiles and Industries Ltd.

Thereafter the approval of the Central Government should be obtained as provided in Section 21 of the Companies Act, 1956. The power of Central Government in this regard has been delegated to the Registrar of Companies. Thus, the company has to file an application along with the prescribed filing fee for change of name. The change of name shall be complete and effective only on the issue of a fresh certificate of incorporation by the Registrar. The Registrar shall enter the new name in the Register in place of the former name. The change of name shall not affect any rights or obligations of the company and it shall not render defective any legal proceedings by or against it.

Question 40

India Cosmetics Limited was a registered company under the Companies Act, 1956. Later on, another company, India Cosmetics and Accessories Limited was formed and registered. There being similarity in the names of both the Companies, India Cosmetics Limited lodged a complaint against India Cosmetics and Accessories Limited, with the Registrar of Companies, stating that there is sufficient similarity between these two names which may mislead or defraud the public. India Cosmetics and Accessories Limited is intending to alter its name.

Advise India Cosmetics and Accessories Limited to alter the name of the Company according to the provisions of the Companies Act, 1956.

Or

M/s India Computers Ltd. was registered as a Public Company on 1st July, 2005 in the State of Maharashtra. Another company by name M/s All India Computers Ltd. was registered in Delhi on 15th July, 2005. The promoters of India Computers Ltd. have failed to persuade the management of All India Computers Ltd. to change the company's name, as it closely resembles with the name of the first registered company.

Advise the Management of India Computers Ltd. about the remedies available to them under the provisions of the Companies Act, 1956.

Answer

Similarity in the names of Companies: In accordance with Section 22(1) of the Companies Act, 1956, 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 has been previously registered or resembles a registered trademark, whether under this Act or any previous company law, the first mentioned company, may by ordinary resolution and with the previous approval of the Central Government, signified in writing, change its name or new name.

The problem asked in the question is based upon the provision of Section 22(1) of the Companies Act, 1956. The new company registered under the name India Cosmetics Accessories Ltd. is identical in name with the existing India Cosmetics Limited. According to the aforesaid provisions of Section 22(1) the newly setup company should change its name. In such a case, the company can, on its own, change the name by obtaining previous approval of Central Government (now power delegated to Regional Director) and then by passing an ordinary resolution [Section 22(1)(a)] within 12 months of the registration. Such a change should be made within 3 months of the date of the direction of the Central Government being received or such longer period as the Central Government may deem fit to allow. The application for changing the name is required to be made to the Registrar of companies in Form 1A with a fee of ₹500.

Where the name of a company has been changed the Registrar shall issue fresh certificate of incorporation with the changed name. Such change of name shall not affect any of the company's rights or obligations or affect any legal proceedings by or against it. Any legal proceedings which might have been continued or commenced by or against the company by its former name, may be continued by its name under Section 23 of the Companies Act, 1956.

Question 41

Explain the procedure for change of name of a company, as provided in the Companies Act, 1956.

Answer

Procedure for the Change of name under the Companies Act, 1956:

According to Section 21 of the Companies Act, 1956, a company may, by special resolution, and with the approval of the Central Government, signified in writing, change its name. This power has been delegated to the Registrar of Companies. The application for change of name is required to be made to Registrar of Companies in form IA with a fee of Rs. 500. Where the Registrar is satisfied with the company's proposal, he may accord to the proposal which will be valid for a period of six months.

However, such an approval of the Central Government would not be necessary where the only change in the name of the company is the addition thereto or the deletion there from of the words 'private' consequent upon the conversion as per the provisions of this Act of a public company into a private company or vice versa (Proviso to Section 21).

Further, according to Section 22 of the above Act, if through inadvertence etc., the name is identical with, or too nearly resembles, the name by which a company, in existence, has been previously registered, it may be changed by ordinary resolution with the sanction of the Central Government within twelve months of the registration. The company shall make the change by ordinary resolution and with the previous approval of the Central Government within three months of the date of the direction of the Central Government being received or such longer period as the Central Government may deem fit to allow.

According to Section 23 of the above Act, where the name of a company has been changed, the Registrar of Companies shall issue fresh certificate with the change embodied therein. The change in name shall not affect any of the company's rights or obligations of the company or render defective any legal proceedings by or against it. Any legal proceedings, which might have been continued or commenced by or against the company by its former name, may be continued by its name.

Question 42

Explain the steps to be taken by a company for transfer of its registered office from one State to another?

Answer

Procedure for shifting registered office from one state to another: A company can change its registered office from one State to another only for purpose specified in Section 17(1) of the Companies Act, 1956 and for no other purpose.

1. *Resolution of the Board of Directors:* The first step in changing registered office is that the board of directors must adopt a resolution to that effect.
2. *Special resolution*: A special resolution must be passed by the company in the general body meeting of shareholders/members. [Section 17(1)].
3. *Confirmation by the CLB:* The change shall not take effect unless and until it is confirmed by the CLB on a petition by the Company. [Section 17(2)].
4. *Notice to affected parties:* Before confirming the change the CLB shall ensure that sufficient notice has been given to every person whose interest will be affected by the change and that the consent creditors of the company has been obtained or their debts or claims have been discharged or secured. [Section 17(3)].
5. *Notice to Registrar:* The CLB shall cause notice of the petition for confirmation of the change to be served on the Registrar. The Registrar shall also be given a reasonable opportunity to appear before the CLB and state his objections and suggestions, if any, with respect to the confirmation of the alteration. [Section 17(4)].
6. The CLB as it may think fit impose such terms and conditions.
7. *Copy of the order to be filed with ROC's*: A certified copy of the order confirming the alteration, together with a printed copy of altered memorandum shall be filed by the

company with the registrar of each of the states who shall register the same. All the records of the company shall be transferred.

The aforesaid copy of the order must be filed within three months from the date of the order. The CLB before confirming a resolution will satisfy itself that sufficient notice has been given to every creditor and all other persons whose interests are likely to be affected by the alteration including the Registrar of Companies and the Government of the State in which the registered office is situated. In *Orient Paper Mills Ltd v. State of AIR (1957) Ori. 232,* it was observed that a State whose interests are affected by the change of the registered office to a different State has a locus standi to oppose shift of the registered office of a company. Accordingly, the Orissa High Court declined to confirm change of registered office from Orissa to West Bengal on the ground that the State has the right to protect its revenue and therefore the interest of the State must be taken into account.

But *in Minerva Mills Ltd. v. Government of Maharashtra,* the Bombay High Court held that the CLB cannot refuse confirmation of the shifting of the registered office on the ground of loss of revenue to a state or would adverse effects on the general economy of the State. Similar, view was expressed *in Rank Film Distributors of India Ltd v. Registrar of Companies, West Bengal.*

Question 43

M/s ABC Ltd. a company registered in the State of West Bengal desires to shift its registered office to the State of Maharashtra. Explain briefly the steps to be taken to achieve the purpose.

Would it make a difference, if the Registered Office is transferred from the Jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies within the same State?

Or

VD Company Ltd. is registered in Tamil Nadu within the jurisdiction of the Registrar of Companies, Chennai. The company proposes to shift its registered office to a place within the jurisdiction of Registrar of Companies, Coimbatore. State the steps to be taken by the company to give effect to the proposed shifting of its registered office.

Answer

Transfer of Registered Office of a Company: In order to shift the registered office from the State of West Bengal to the State of Maharashtra, M/s ABC Ltd. has to take the following steps:

(i) To pass a special resolution and thereafter file the same with the Registrar of Companies.

(ii) To file a Petition before the Company Law Board under Section 17, of the Companies Act, 1956.

(iii) To give an advertisement in two newspapers one in English language and the other in local language indicating the change and any member/creditor having objection can write to the Company Law Board.

(iv) To give notice to the State Government of West Bengal.

(v) To submit all the required documents along with the fee to Company Law Board.

The Company Law Board (Central Government)* after hearing the petition passes an order confirming the alteration in the memorandum of association of the company regarding the shifting of the registered office. The Company Law Board's (Central Government)* order should be filed by ABC Ltd with both the Registrars of Companies West Bengal and Maharashtra. After registration of the said order, the Registrar of Companies Maharashtra will issue a certificate which is the conclusive proof that all the formalities have been complied with.

Change of registered office from the jurisdiction of one Registrar to the other Registrar within the same State*:* The procedure and law pertaining to the change of registered office from the jurisdiction of one Registrar to the other Registrar within the same State is contained in Section 17A of the Companies Act, 1956 as amended upto date is as follows:

(i) Company can do so only if the Regional Director permits to it.

(ii) Application for permission has to be made in a prescribed form.

(iii) The Regional Directors are required to confirm the Company's application and inform it accordingly within a period of four weeks.

(iv) After getting the confirmation of the Regional Director, the company must file a copy of the same with the Registrar of Companies within two months from the date of the confirmation together with a copy of the altered memorandum.

(v) The Registrar is required to register the same and inform the company within one month from the date of filing.

(vi) The Registrar's certificate is a conclusive evidence of the fact of alteration and of compliance with the requirements (Section 17-A).

(Note: Students may kindly note that, all Sections of the Companies (Second Amendment) Act, 2002 have not come into force. Till such time, jurisdiction of Company Law Board will continue to remain unchanged.)

Question 44

XY Ltd. has its registered office at Mumbai in the State of Maharashtra. For better administrative conveniences the company wants to shift its registered office from Mumbai to Pune (State of Maharashtra). What formalities the company has to comply with under the provisions of the Companies Act, 1956 for shifting its registered office as stated above? Explain.

Answer

According to Section 17A read with Section 146 of the Companies Act, 1956, the following procedure is to be followed by the company for shifting of the registered office of the company:

(i) A special resolution is required to be passed at a general meeting of the share holders.

(ii) Confirmation of Regional Director is to be obtained and for this company has to apply in the prescribed form.

(iii) The Regional Director shall convey his confirmation within four weeks from the date of receipt of the application.

(iv) Copy of the special resolution within 30 days and certified copy of the confirmation along with a printed copy of the altered memorandum of association must be filed with the Registrar of companies within 2 months from the date of confirmation.

(v) Within one month of the filing, the Registrar of companies shall certify registration, which shall be the conclusive evidence that all requirements with respect to alteration and conformation have been complied with.

Question 45

State with reason, whether the following statement is correct or incorrect, according to the Companies Act, 1956.

Change of Registered Office of Company from one place to another within a State requires confirmation by the Regional Director.

Answer

Correct. A company can change the place of its Registered Office from one place to another within a State, if it s confirmed by the Regional Director. For this purpose the Company has to make an application to the Regional Director for confirmation.

Question 46

What is the importance of registered office of a company? State the procedure for shifting of registered office of the company from one State to another State under the provisions of the Companies Act, 1956.

Answer

Importance of registered office and its change from one state to another:

- Every company must have registered office where : (a) necessary documents may be served upon, or deposited; (b) notices, letters, etc., may be issued ; (c) inspection may be done, and (d) communication may be made. The domicile and the nationality of a company is determined by the place of its registered office. This is also important for determining the jurisdiction of the Court.

- A company must have a registered office as from the day on which it commences business, or as from the 30th day after the date of its incorporation whichever is earlier, it may be noted that the address of the registered office ordinarily is not to be stated in the Memorandum of Association. For if this was done, every change therein would require amendment of the Memorandum. It is advisable to provide in the articles that the registered office should be situated at such place, as the Board should from time to time fix. Otherwise, the registered office cannot be removed outside the city etc., where it is situated, without special resolution.
- Notice of the situation of the registered office and of every change therein must be sent to the Registrar (otherwise than through a statement as to the address of the registered office in the annual report) within 30 days of the date of incorporation of the date of change. This provision is designed to locate the spot where the records of the company could be inspected and where the letters should be addressed and notices served upon the company.

Procedure for shifting the registered office from one state to another state (Section 17, the Companies Act, 1956):

- The Company may by a special resolution, alter the provisions of its memorandum so as to change the place of its registered office from one State to another State.
- The change needs confirmation of the Company Law Board.
- When an application is made for a change as aforesaid, it is the State where the registered office is at present situated, where interests are likely to be affected by the change and thus will have the locus standi to oppose such an application [*orissa Paper Mills Ltd. vs. State AIR 1957, 482*]. Furthermore, it shall be necessary to satisfy the Company Law Board as to the bona fides of the company's application for the proposed change [*Orissa Chemicals and Distilleries Pvt. Ltd., in Re. AIR 1961 Orissa 621*]. The Company Law Board has the power either to confirm or refuse to confirm alteration relating to change/shifting of registered office.
- The company cannot do such change/shifting of office unless the Regional Director confirms it.
- To obtain confirmation, the company has to apply in the prescribed form.
- The confirmation must be communicated to the company within 4 weeks from the date of receipt of the application.
- Certified copy of the confirmation along with the attested copy of the Memorandum of Association must be filed with the ROC for registration within 2 months from the date of confirmation.
- Within one month of filing, the ROC shall certify registration, which shall be the conclusive evidence that all requirements with respect to alteration and confirmation have been complied with.

Question 47

The object clause of the Memorandum of Association of LSR Private Ltd, Lucknow authorized it to do trading in fruits and vegetables. The company, however, entered into a Partnership with Mr. J and traded in steel and incurred liabilities to Mr. J. The Company, subsequently, refused to admit the liability to J on the ground that the deal was 'Ultra Vires' the company. Examine the validity of the company's refusal to admit the liability to J. Give reasons in support of your answer.

Answer

In terms of Companies Act, 1956, the powers of the company are limited to:

(i) Powers expressly given by the Memorandum (which is popularly known as 'express' power), or conferred by the Companies Act 1956, or other statute and

(ii) powers reasonably incidental or necessary to the company's main purpose (termed as "Implied' powers). The Act further provides that the acts beyond the powers of a company are ultra vires and void and cannot be ratified even though every member of the company may give his consent *[Ashbury Railway Carriage Company Vs Richee]*

The object clause enable shareholders, creditors or others to know what its powers are and what is the range of its activities and enterprises. The objects clause therefore is of fundamental importance to the share holder, creditors and others.

M/s LSR Pvt. Ltd is authorised to trade directly on fruits and vegetables. It has no power to enter into a partnership for Iron and steel with Mr. J. Such act can never be treated as 'express' or 'implied' powers of the company. Mr J who entered into partnership is deemed to be aware of the lack of powers of M/s LSR (Pvt) Ltd. In the light of the above, Mr, J cannot enforce the agreement or liability against M/s LSR Pvt. Ltd. Mr. J should be advised accordingly. This conclusion is supported by the decision reported in the case of '*the Ganga Mata Refinery Company (Pvt) Ltd CIT*.

Question 48

The Memorandum of Association of a company was presented to the Registrar of Companies for registration and the Registrar issued the certificate of incorporation. After complying with all the legal formalities a company started a business according to the object clause, which was clearly an illegal business. The company contends that the nature of the business cannot be gone into as the certificate of incorporation is conclusive. Answer the question whether company's contention is correct or not.

Answer

Object clause: The subscribers to the memorandum may choose any object or objects for the purpose of their company. However there are two restrictions on the selection of "object" for a company:

(i) the object should not include anything which is illegal or contrary to law or public policy.

(ii) the objects should not also contemplate doing anything which is prohibited by the Companies Act.

On applying the above provision in the present problem, the company's contention is wrong. Though a certificate of incorporation is a conclusive evidence of its registration, that is, it is conclusive evidence as to the fact that all requirements of the Companies Act for the incorporation of a company have been complied with, and that now company is a legal entity but, it does not mean that all its objects are legal. In *Bowman v. Secular Society Ltd*., the court held that the statute does not provide that all or any of the objects specified in the memorandum, if otherwise illegal, would be rendered legal by the certificate. Therefore, the contention of the company that the nature of business cannot be gone into after the certificate of incorporation has been obtained is not tenable.

Question 49

What are the purposes for which "objects" can be altered by a company under the Companies Act, 1956? Briefly explain the procedure to be applied to such matters.

Or

State the purposes for which the object clause of the Memorandum of Association of a public limited company, registered under the Companies Act, 1956, can be altered.

Or

Explain the provisions of law and procedure relating to alteration of object clause stated in the Memorandum of Association of a company under the Companies Act, 1956.

Or

The management of Ambitious Properties Ltd., has decided to take up the business of food processing activity because of the downward trend in real estate business. There is no provision in the object clauses of the Memorandum of Association to enable the company to carry on such business. State with reasons whether its object clause can be amended. State briefly the procedure to be adopted for change in the object clause.

Answer

Alteration of Objects: Section 17 of the Companies Act, 1956 permits the alteration of the objects, only so far as is considered necessary for specified purpose. Such purposes are as under [Section 17(1)]:

(a) to carry on business more economically.

(b) to attain the main purpose of the company by new or more improved means.

(c) to carry on some business which under the existing circumstances may conveniently or advantageously be combined with the existing business.

(d) to change and enlarge the local areas of operations.

(e) to restrict or abandon any of the existing objects.

(f) to sell or dispose of the whole or any part of the undertaking.

(g) to amalgamate with any other object or body of persons.

Procedure

Companies are now under liberty to alter the object clause of the memorandum of association without the confirmation from Company Law Board. However, alteration can be made only on the grounds stated above.

Object clause can be altered simply by passing a special resolution in general meeting of members. The special resolution should be filed with the Registrar of Companies within one month from the date of resolution along with a printed copy of the memorandum as altered. The Registrar will register the document and issue a certificate, which will be conclusive evidence that all the requirements with respective alterations have been complied with and memorandum so altered shall be the memorandum of the company.

If the documents required to be filed with the Registrar under Section 18 are not filed within the prescribed time, the alteration shall at the expiry of such period, become void and inoperative (Section 19).

Question 50

A company was started with the object of building 'A mall with shops'. The building was destroyed by fire and the company wanted to alter the objects clause in the memorandum by substituting the words 'A mall with shops' with the words "Shops, Residential buildings and Warehouses for letting purposes.' Will this alteration of the memorandum for the purpose be permissible? Decide referring to the provisions of the Companies Act, 1956.

Answer

Alteration of objects: Section 17 (1) of the Companies Act ,1956, permits a company to alter its objects in the memorandum to carry on some business which under the existing circumstances may conveniently or advantageously be combined with the existing business.

Thus, in the given problem the new object of "shops, residential buildings and warehouses for letting purposes" can be conveniently and advantageously combined with the existing object of building a "mall with shops" which is obviously for letting purposes. Accordingly, alteration is permissible.

Question 51

Explain the steps to be taken by a company for starting a business for which there is no provision in the objects clause of the Memorandum of Association.

Answer

Section 149 (2A) prohibits a public limited company from commencing any business other than that covered by the main objects of the company, unless it has by a special resolution, approved for the commencement of such business and a duly verified declaration by one of its Directors or its Secretary in the prescribed form that such a resolution has been passed or as

the case may be the provisions of Section 149(2B) have been complied with, has been filed with the Registrar. In the context of this prohibition, a distinction has been made between a company existing immediately before the commencement of the Amendment Act, 1965 and one formed after such commencement. In the former case, the special resolution is required for commencing a new business, in relation to any of the objects mentioned in its memorandum, which is not germane to the business it was carrying on at the commencement of the Amendment Act. In the latter case, the special resolution is necessary to set up a business in relation to any object other than its main objects, or ancillary to it, on its memorandum.

Thus, for commencing the proposed new business, a special resolution of the company would be necessary. An ordinary resolution would be sufficient if, in addition the Central Government, on an application by the Board of Directors, allows the company to commence such a business [Section 149(2B)].

Question 52

RSP Limited, with a limited liability of its members by guarantee of ₹10 lac to each member. The company increases the liability of the members from ₹ 10 to 15 lac by an alteration made in the liability clause of the Memorandum of Association. Referring to the provisions of the Companies Act, 1956 decide, whether the members of the company are liable for the increased liability.

Answer

According to Section 38 of the Companies Act, 1956, no member of a company shall be bound by an alteration made in the Memorandum or Articles after the date on which he become a member, if such an alteration requires him to take or subscribe for more shares should then the number held by him as the date of alteration or in any way increase his liability. But the section will not apply where the member agrees in writing either before or after a particular alteration is made, so as to bind by the alteration.

Hence, the members of RSP Limited are not bound by any alteration made in the liability clause without obtaining their written permission.

Articles of Association

Question 53

The Articles of Association of a Limited Company provided that 'X' shall be the Law Officer of the company and he shall not be removed except on the ground of proved misconduct. The company removed him even though he was not guilty of misconduct. Decide, whether company's action is valid?

Answer

Removal of Law Officer: The Memorandum and Articles of Association of a company are binding upon company and its members and they are bound to observe all the provisions of memorandum and articles as if they have signed the same [Section 36(1)]. However, company

and members are not bound to outsiders in respect of anything contained in memorandum/articles. This is based on the general rule of law that a stranger to a contract cannot acquire any right under the contract.

In this case, Articles conferred a right on 'X', the law officer that he shall not be removed except on the ground of proved misconduct. In view of the legal position explained above, 'X' cannot enforce the right conferred on him by the articles against the company. Hence the action taken by the company (i.e. removal of 'X' even though he was not guilty of misconduct) is valid. *(Eley V Positive Govt. Security Life Assurance Co., Major General Shanta Shamsher jung V Kamani Bros. P. Ltd.)*

Alteration of Articles

Question 54

Explain the limitations relating to alternation of Articles of Association of a company.

Answer

Limits on the Alteration of Articles: Every company has a right to alter its articles. A company cannot divest itself of these powers. Matters as to which the memorandum is silent can be dealt with by the alteration of articles. Such alteration is effective by passing a special resolution. The right to alter the article is subject to the following limitations:

(i) The alteration must not exceed the powers given by memorandum or conflict with the provisions thereof.

(ii) It must not be inconsistent with any provisions of the Companies Act or any other statute.

(iii) It must not be illegal.

(iv) It shall not be in fraud on minority or inflict a hardship on minority shareholders, without any corresponding benefits to the company as a whole.

(v) It must not be inconsistent with any order of the court, under section 404 any subsequent alteration thereof which is inconsistent with such an order can be made by the company only with the leave of the court.

(vi) It may have retrospective effect so long as it does not affect the things already done by the company *(Allen B. Gold Reef of West Africa [1909] SC 732)*

(vii) If a public company is converted into a private company, then the approval of Central Government is necessary [Section 31(1)] In this regard an injunction cannot be granted to prevent the adoption of new article which constituted a breach of contract. But if the company acts on them it may be liable to damages *[Shirlaw Vs Southern Foundaries Ltd. 1940 AC 701 (760)].*

(viii) An alteration should not increase the liability of a member unless he has agreed thereto in writing (Section 38)

(ix) A reserve capital once created cannot be unreserved but may be cancelled on a reduction of capital *(Midland Railway Carriage Wagon Co. 1907)* Section 99.

(x) Any irregular alteration which have been acted on for many years are binding.

Doctrine of Indoor management

Question 55

Explain clearly the doctrine of 'Indoor Management' as applicable in cases of companies registered under the Companies Act, 1956. Explain the circumstances in which an outsider dealing with the company cannot claim any relief on the ground of 'Indoor Management'.

Answer

Doctrine of indoor Management & Exceptions: One limitation to the doctrine of constructive notice of the memorandum and articles of a company is the doctrine of indoor management. According to the doctrine of indoor management, the outsider, dealing with the company are entitled to assume that as far as the internal proceedings of the company arc concerned, everything has been regularly done. They are bound to lend the registered documents and to see that the proposed dealing is not inconsistent therewith, but they are not bound to do more, they need not inquire into the regularity of the internal proceedings as required by the memorandum and Articles. This limitation of the doctrine of constructive notice is known as the 'Doctrine of Indoor Management', popularly known as rule in *Royal British Bank v. Turquand.* Thus the doctrine of indoor management aims to protect outsiders against the company.

Exceptions: In the following circumstances an outsider dealing with the company cannot claim any relief on the ground of 'indoor Management'

1. *Knowledge of irregularly:* Where a person dealing with a company has actual or constructive notice of the irregularity as regards internal management, he cannot claim the benefit under the rule of indoor management. *(T.R. PRATT (Bombay) Ltd. v. E.D.* Sassoon & Co. Ltd.).

2. *Negligence:* Where a person dealing with a company could discover the irregularity if he had made proper inquiries, he cannot claim the benefit of the rule of indoor management. The protection of the rule is also not available where the circumstances surrounding the contract- are so suspicious as to invite inquiry, and the outsider dealing with the company does not make proper inquiry *(Anand Bihari Lel v. Dinshaw & Co.*) Also the case of *(Under-Wood v. Bank of Liver Pool).*

3. *Act void ab initio and forgery:* Where the acts done in the name of a company are void ab initio, the doctrine of indoor management does not apply. The doctrine applies only to irregularities that otherwise might affect a genuine transaction. It does not apply to a forgery. A Company can never he held liable for forgeries committed by its officers. *(Ruben v. Great Fingall Consolidated Co.).*

4. *Acts outside the scope of apparent authority:* If an officer of a company enters into a contract with a third party and if the act of the officer is beyond the scope of his authority, the company is not bound. *(Kreditbank Cassel v. Schenkers Ltd.).*
5. A person having no knowledge of Articles cannot seek protection under Indoor Management.

Question 56

Briefly explain the doctrine of "Constructive Notice" under the Companies Act, 1956. Are there any exceptions to the said doctrine?

Answer

Doctrine of Constructive Notice: In consequences of the registration of the memorandum and articles of association of the company with the Registrar of Companies, a person dealing with the company is deemed to have constructive notice of their contents *(T.R. Pratt (Bombay) Ltd. v. E.D. Sassoon & Co. Ltd.)*. This is because these documents are construed as 'public documents' under Section 610 of the Companies Act, 1956. Accordingly if a person deals with a company in a manner incompatible with the provisions of the aforesaid documents or enters into transaction which is ultra vires these documents, he must do so at his peril.

The doctrine of constructive notice is not a positive one but a negative one like that of estoppels of which it forms parts. It operates only against the person who has been dealing with the company but not against the company itself; consequently he is prevented from alleging that he did not know that the constitution of the company rendered a particular act or a particular delegation of authority ultra vires.

There is one limitation to the doctrine of constructive notice of the Memorandum and the Articles of a company. The outsiders dealing with the company are entitled to assume that as far as the internal proceedings of the company are concerned, everything has been regularly done. They are bound to read the registered documents and to see that the proposed dealing is not inconsistent therewith, but they are not bound to do more; they need not inquire into the regularity of the internal proceedings as required by the Memorandum and the Articles. This limitation of the doctrine of constructive notice is known as the 'doctrine of indoor management' or the rule in *Royal British Bank v. Turquand*. Thus, whereas the doctrine of constructive notice protects the company against outsiders, the doctrine of indoor management seeks to protect outsiders against the company.

Question 57

Under the Articles of Association of Sunshine Ltd. Company, directors had power to borrow up to ₹ 10,000 without the consent of the general meeting. The Directors themselves lent ₹ 35,000 to the company without such consent and took debentures of the Company. Decide under the provisions of the Companies Act, 1956, whether the company is liable? If so, what is the extent of liability of the company in this case?

Answer

Directors' Power to Borrow under the Companies Act, 1956: An outsider is presumed to know the constitution of company, but not what may or may not have taken place within the doors that are closed to him. However, where a person dealing with a company has actual or constructive notice of the irregularity as regards internal management, he cannot claim the benefit under the rule of indoor management.

In this case, the directors of a company could borrow any amount up to ₹10,000/- without the resolution of the company in a general meeting. But for any amount beyond ₹10,000/- they had to obtain the consent of the shareholders in a general meeting. The directors themselves lent ₹35,000/- to the company without such consent and took debentures. The directors had the notice of the internal irregularity and hence the company was liable to them only for ₹10,000/-

Question 58

Explain the doctrine of 'Indoor management' in brief.

The Secretary of a Company issued a share certificate to 'A' under the Company's seal with his own signature and the signature of a Director forged by him. 'A' borrowed money from 'B' on the strength of this certificate. 'B' wanted to realise the security and requested the company to register him as a holder of the shares. Explain whether 'B' will succeed in getting the share registered in his name.

Answer

The doctrine of Indoor Management as discussed in the *Royal British Bank vs. Turquand (1956) 6E&B 327*. In this case the directors of RBB also gave a bond to T. The Article empowered the directors to issue such bonds under the authority of a proper resolution. In fact no such resolution was passed. Notwithstanding that, it was held that T could sue on the bonds on the ground that he was entitled to assume that the resolution had been duly passed. Thus the persons dealing with the company are entitled to assume that the acts of the directors or the officers of the company are validly performed, if they are within the scope of their apparent authority. But this doctrine is not applicable where the person dealing with the company has notice of irregularity or where the person dealing with the company is put upon on inquiry or when an instrument purporting to be enacted on behalf of the company is a forgery.

In the instant problem the doctrine of indoor management can apply only in case of irregularities which might otherwise affect the transaction, but it cannot apply to forgery which must be regarded as nullity. Hence, 'B' will not succeed in getting the share registered in his name.

Question 59

A Managing Director of a company borrowed a sum of money by executing a document in which he forged the signature of two other directors who are required to sign as per requirements of articles. Can the company deny liability to creditors?

Answer

In Ruben v. Great Fingall Consolidated, it was held that Doctrine of Indoor Management could not be extended to cases of forgery. Transaction effected by forgery is void ab initio. However, in *Sri Krishan v. Mondal Bros. & Co.* it was held that a company may be held liable for any fraudulent Acts of its officers acting under ostensible authority. Therefore, in the instant case, company will not be allowed to deny liability in order to defeat bona fide claims of the creditor.

Pre-Liminary/Pre-Incorporation Contracts and Provisional Contracts

Question 60

Explain the legal validity of Preliminary Contracts entered into by a company?

Answer

Pre-Incorporation Contracts are those contracts which are entered into by agents or trustees or and on behalf of a prospective company before it has come into existence. It is very likely the intention of the promoters that the company should on its formation acquire some property or take over the existing business and for this purpose a preliminary contract may be entered into by them. But as the company is non-existent before incorporation it cannot be bound by any purported rectification *[Kelner v. Baxter (1862)].*

The legal position of pre-incorporation contracts may be discussed under two heads (a) before passing of Specific Relief Act, 1963 and (b) position after passing of the Specific Relief Act.

Position before 1963:

(a) A Pre-incorporation contract never binds a company.

(b) Even if there is a rectification of such contract, the company cannot be bound by such act.

(c) The third party cannot sue or be sued by the company thereof after its incorporations.

Positions since 1963: After passing the Specific Relief Act, 1963, the company may enforce pre-in-corporation act provided such a contract is warranted by the terms of incorporation. Where a person intend to promote a company acquired a lease hold interest for some time for partnership firm which got converted into a company which adopted the lease, the lesser is bound to the company under the lease. *[V.P. Rao v. Sri Ramanuja Ginning and Rice Factory (P) Ltd. 1986].*

Question 61

Pick out the correct answer from the following and give reasons:

(i) Contracts entered into by a company after its incorporation and before it is entitled to commence business are called:

1. provisional contracts

2. pre-incorporation contracts

3. both 1 and 2

4. *None of the above.*

(ii) *The underwriting commission on shares must not exceed:*

1. *2.0 percent of the issued price of shares*
2. *2.5 percent of the issued price of shares*
3. *5.0. percent of the issued price of shares*
4. *5.5 percent of the issued price of shares*

(iii) *Which one of the following required ordinary resolution?*

1. *to change the name of the company*
2. *to alter the articles of association*
3. *to reduce the share capital*
4. *to declare dividends.*

Answer

(i) Provisional Contracts: Reason: As per Section 149 (4) of the Companies Act, 1956, contracts entered into by a company after its incorporation and before it is entitled to commence business are provisional only and are not binding on the company until the trading certificate is issued.

(ii) 5.0 percent of the issued price of shares: Reason: As per Section 76 of the companies Act, 1956, the amount of commission should not exceed, in the case of shares, 5 percent of the price at which the shares have been issued or the amount or rate authorised by the articles, whichever is less.

(iii) To declare dividends; Reason: The Companies Act, 1956 requires that the following matters, inter alia, have to be resolved by the company by a special resolution: (i) to change the name of the company (Section 21) (ii) to alter the articles of association (Section 31) and (iii) to reduce the share capital (Section 100). While for declaration of dividends ordinary resolution is sufficient.

Question 62

XYZ Co. Ltd. was in the process of incorporation. Promoters of the company signed an agreement for the purchase of certain furniture for the company and payment was to be made to the suppliers of furniture by the company after incorporation. The company was incorporated and the furniture was used by it. Shortly after incorporation, the company went into liquidation and the debt could not be paid by the company for the purchase of above furniture. As a result suppliers sued the promoters of the company for the recovery of money.

Examine whether promoters can he held liable for payment under the following situations:

(i) *When the company has already adopted the contract after incorporation?*

(ii) When the company makes a fresh contract with the suppliers in terms of pre incorporation contract?

Answer

The promoters remain personally liable on a contract made on behalf of a company which is not yet in existence. Such a contract is deemed to have been entered into personally by the promoters and they are liable to pay damages for failure to perform the promises made in the company's name *(Scot v. Lord Ebury),* even though the contract expressly provided that only the company shall be answerable for performance.

In *Kelner v. Baxter* also it was held that the persons signing the contracts viz. Promoters were personally liable for the contract.

Further, a company cannot ratify a contract entered into by the promoters on its behalf before its incorporation. Therefore, it cannot by adoption or ratification obtain the benefit of the contract purported to have been made on its behalf before it came into existence as ratification by the company when formed is legally impossible. The doctrine of ratification applies only if an agent contracts for a principal who is in existence and who is competent to contract at the time of contract by the agent.

The company can, if it desires, enter into a new contract, after its incorporation with the other party. The contract may be on the same basis and terms as given in the pre-incorporation contract made by the promoters. The adoption of the pre-incorporation contract by the company will not create a contract between the company and the other parties even though the option of the contract is made as one of the objects of the company in its Memorandum of Association. It is, therefore, safer for the promoters acting on behalf of the company about to be formed to provide in the contract that: (a) if the company makes a fresh contract in terms of the pre-incorporation contract, the liability of the promoters shall come to an end; and (b) if the company does not make a fresh contract within a limited time, either of the parties may rescind the contract.

Thus applying the above principles, the answers to the questions as asked in the paper can be answered as under:

(i) the promoters in the first case will be liable to the suppliers of furniture. There was no fresh contract entered into with the suppliers by the company. Therefore, promoters continue to be held liable in this case for the reasons given above.

(ii) in the second case obviously the liability of promoters comes to an end provided the fresh contract was entered into on the same terms as that of pre-incorporation contract.

Question 63

What do you understand by Pre-incorporation contracts? Distinguish between Pre-incorporation contracts and Provisional contracts.

Answer

Pre-Incorporation Contracts: The promoters of a company usually enter into contracts to acquire some property or right for the company to be incorporated. Such contracts are called pre-incorporation contracts or preliminary contracts. Since a company comes into existence from the date of its incorporation, it follows that any act purporting to be performed by it prior to that date is of no effect so far as the company is concerned. After incorporation, the company may adopt the preliminary contract and it must be by novation. Further a company may enforce a pre-incorporation contract if it is warranted by the terms of incorporation of the company.

Following are the differences between Pre-incorporation and Provisional Contracts:

(i) Contracts, which are made before the company comes into existence, are called pre-incorporation contracts, while contracts which are entered into by a public company after obtaining the certificate of incorporation but before getting the certificate to commence business are known as provisional contracts.

(ii) The company is not bound by the pre-incorporation contract unless the company adopts the same after incorporation. But provisional contracts shall be binding on the company from the date on which the company is entitled to commence business.

(iii) Pre-incorporation contracts can be enforced against the company if it is warranted by the terms of incorporation of the company and for the purposes of the company, while the provisional contracts cannot be enforced and the company should go into liquidation without commencing business.

Question 64

Sunrise Limited submitted the documents for incorporation on 5th October, 2006. It was incorporated and certificate of incorporation of the company was issued by the Registrar on 20th October, 2006. The company on 14th October, 2006 entered into a contract which created its contractual liabilities. The company denies the said liability on the ground that company is not bound by the contract entered into prior to issuing of certificate of incorporation. Decide under the provisions of the Companies Act, 1956, whether the company can be exempted from the said contractual liability.

Answer

Sometimes contracts are made on behalf of a company even before it is incorporated. But no contracts can bind a company before it becomes capable of contracting by incorporation. Two consenting parties are necessary to a contract, whereas the company before incorporation is a non-entity *[Kelner v. Baxter 1866]*.

Pre-incorporation contracts in general are void ab initio and hence not binding on the company. However, under section 19 (e) of the Specific Relief Act, 1963 the party to the contract can enforce the contracts against the company if the company had adopted the same after incorporation and the contract is warranted by the terms of incorporation. Thus unless

the company adopts the contract, the other party cannot enforce the same against the company. However, promoters can be-held personally liable. The problem is based on above case i.e. [*Kelner v. Baxter*]. After application of above provisions it is clear that the company can be exempted from the said contractual liability.

Question 65

Before the incorporation of the company, the promoters of the company entered into an agreement with Mr. Jainson to buy an immovable property on behalf of the company. After incorporation, the company refused to buy the said property. Advise Mr. Jainson whether he has any remedy under the provisions of the Companies Act, 1956?

Answer

Pre-Incorporation Contracts in the Companies Act, 1956: The present case is related to the pre-incorporation contract. The promoters of the company usually enter into contracts to acquire some property or right for the company which is yet to be incorporated. As such contracts are a nullity and the company cannot sue or be sued on such contract when company comes into existence. So in such case 'A' has remedy against the promoters only. They are liable personally for those contracts that are made on behalf of the company before it comes into existence. Even the company cannot ratify such contracts after its registration. Such contracts are deemed to have been entered into personally by the promoters.

Question 66

What is meant by 'Pre-Incorporation Contracts'? Can these contracts be enforced by the prospective company after its incorporation against the third parties with whom the promoters had entered into certain contracts? Explain.

Answer

Pre-incorporation Contracts and its Enforcement: Pre-incorporation contracts are those contracts which are entered into, by the promoters on behalf of a prospective company, before it has come into existence e.g. with the proprietor of business to sell it to the prospective company. Since a company comes into existence from the date of its incorporation, it follows that any act purporting to be performed by it prior to that date is of no effect so far as the company is concerned. Hence the vendor cannot sue or be sued by the company thereof, after its incorporation.

After incorporation, the company may adopt the preliminary agreement. But this must be, by novation. However, in order to facilitate companies to adopt pre-incorporation contracts, special provisions are made in sections 15 and 19 of Specific Relief Act, 1963. Accordingly, pre-incorporation contracts can be enforced by the company, if the contract is for the purposes of the company, the contract is warranted by the terms of its incorporation is within the scope of the company's objects as given in the Memorandum of Association and the company has accepted the contract and has communicated such acceptance to the other party.

Promoters

Question 67

Mars Ltd. was in the process of incorporation. Promoters of the company signed an agreement for the purchase of certain furniture for the company and payment was to be made to the suppliers of furniture by the company after incorporation. The company was incorporated and the furniture was used by it. Shortly after incorporation, the company went into liquidation and the debt could not he paid by the company for the purchase of above furniture. As a result suppliers sued the promoters of the company for the recovery of money.

Examine whether promoters can he held liable for payment under the following situations:

(i) When the company has already adopted the contract after incorporation?'

(ii) When the company makes a fresh contract with the suppliers in terms of pre incorporation contract?

Answer

The promoters remain personally liable on a contract made on behalf of a company which is not yet in existence. Such a contract is deemed to have been entered into personally by the promoters and they are liable to pay damages for failure to perform the promises made in the company's name *(Scot v. Lord Ebury)*, even though the contract expressly provided that only the company shall be answerable for performance.

In *Kelner v. Baxter* also it was held that the persons signing the contracts viz. Promoters were personally liable for the contract.

Further, a company cannot ratify a contract entered into by the promoters on its behalf before its incorporation. Therefore, it cannot by adoption or ratification obtain the benefit of the contract purported to have been made on its behalf before it came into existence as ratification by the company when formed is legally impossible. The doctrine of ratification applies only if an agent contracts for a principal who is in existence and who is competent to contract at the time of contract by the agent.

The company can, if it desires, enter into a new contract, after its incorporation with the other party. The contract may be on the same basis and terms as given in the pre-incorporation contract made by the promoters. The adoption of the pre-incorporation contract by the company will not create a contract between the company and the other parties even though the option of the contract is made as one of the objects of the company in its Memorandum of Association. It is, therefore, safer for the promoters acting on behalf of the company about to be formed to provide in the contract that: (a) if the company makes a fresh contract in terms of the pre-incorporation contract, the liability of the promoters shall come to an end; and (b) if the company does not make a fresh contract within a limited time, either of the parties may rescind the contract.

Thus applying the above principles, the answers to the questions as asked in the paper can be answered as under:

(i) the promoters in the first case will be liable to the suppliers of furniture. There was no fresh contract entered into with the suppliers by the company. Therefore, promoters continue to be held liable in this case for the reasons given above.

(ii) in the second case obviously the liability of promoters comes to an end provided the fresh contract was entered into on the same terms as that of pre-incorporation contract.

National Company Law Tribunal and National Company Law Appellate Tribunal

Question 68

Briefly discuss the provisions relating to constitution of National Company Law Tribunal and National Company Law Appellate Tribunal.

Answer

Part VI-A has been introduced into the Companies Act, 1956 by the Companies (Second Amendment Act, 2002). Its enforcement will mean repeal of the Sick Industrial Companies (Special provisions) Act, 1985 and also abolition of the Board of Industrial and Financial Reconstruction (BIFR). Such cases will go before the National Company Law Tribunal. Section 424A provides for such reference. The Board of Directors of a sick industrial company have to make a reference to the Tribunal. They have to prepare a scheme for its revival and rehabilitation and submit to the tribunal along with an application containing such particulars as may be prescribed. The Tribunal thereafter has to enquire with working of sick industrial companies. The Tribunal is empowered to make suitable orders on completion of the Enquiry (see Section 424-B and 424-C).

The National Company Law Appellate Tribunals have been constituted by central Government by notification with Official Gazette. Any person aggrieved by an order of the Tribunal, can within 45 days file an appeal before the National Company Law Appellate Tribunal, which will pass orders after giving opportunity of hearing to the aggrieved party.

Question 69

Explain the composition and powers of National Company Law Tribunal?

Answer

Composition of NCLT: The Central Government is empowered, under Section 10FB of the Companies Act, 1956, to constitute a National Company Law Tribunal to exercise and discharge such powers and functions as may be conferred on it by or under the Companies Act or any other law for the time being in force.

According to Section 10FC, the Tribunal shall be headed by the President who has been, or is qualified to be a judge of a High Court and consists such number of Judicial and Technical Members not exceeding 62, as the Central Government deems fit, to be appointed by the Government by notification in the official gazette.

Eligibility for Members: As per Section 10FC, the Tribunal will consist of Judicial and Technical members. Persons who have been working as Judiciary, Advocate, Member of the Indian Company Law Service and Member of Indian Legal Service shall be considered for the appointment as Judicial Member, and the members of Indian Company Law Service (Accounts Branch), Chartered Accountant, Cost Accountant, Company Secretary shall be considered for the post of Technical Members. In addition to this, length of service in their particular nature of work will also taken into consideration.

Powers of Tribunal

- Tribunal shall have *power to review* its own order (Section 10 FO).
- The Tribunal, as per section 10 FM, after giving reasonable opportunity of being heard is empowered to pass such an order as it thinks fit. It can also, within a period of two years from the date of order, *rectify any mistake* and shall make amendment in the order passed by it and shall make such amendment if the mistake is brought to its notice by the parties.
- Tribunal may *delegate its powers* and duties subject to specified conditions and limitations to any member or officer or other employee of the Tribunal to manage any industrial company or industrial undertaking or any operating agency under this Act as it may deem necessary.

The Tribunal/any operating agency, on being directed by the Tribunal may *seek an assistance* of Chief Metropolitan Magistrate and District Magistrate within whose jurisdiction, any property, books of accent or any other document of Sick Industrial Company be situate or be found, to take into custody or to take possession thereof.

EXERCISE

1. *XYZ (P) Ltd. was incorporated on January 20, 2009. A similar company with identical name and similar objects was inadvertently incorporated on September 20, 2009. On account of similarity in name and objects, XYZ (P) Ltd filed a petition on January 25, 2010 that the Central Government should direct the company incorporated at a latter date to change its name so that its business interest are protected. State in this connection whether the company incorporated at a latter date can be directed by the Central Government to change its name.*

   [Hints: Yes, as per the provision given under Section 22(1) of the Companies Act, 1956]

2. *The existing number of members in a public limited company is below the requirement as per the Companies Act, 1956. However, the company is continuing its business operations. State the legal consequences arising out of such continuance business.*

   [Hints: Members are personally and severally liable for the whole of the debts contracted, as per provision given under the Section 45 of the Companies Act,1956]

3. *XYZ Ltd., intends to start a new additional business which has no relation to the existing business. State whether it can do so under the provision of Companies Act, 1956.*

[Hints: Yes, as per the provision laid down in Section 17(1) of the Companies Act, 1956]

4. *M/s ABC Ltd. a company registered in the State of West Bengal desires to shift its registered office to some other place in the same State.*

   Would it make a difference, if the Registered Office is transferred from the Jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies within the same State?

   [Hints: Yes, as per the Sections 17 and 17A of the Companies Act, 1956]

5. *The Directors of a Company borrowed ₹ 50,000/- from A on a transaction which is ultra vires the Company. Discuss the rights of A against the Company and its Directors.*

   [Hints: A does not have any right against the company]

6. *Under the Articles, the Directors of a Company had power to borrow upto ₹ 1,00,000 without the consent of the General Meeting. The Directors themselves lent ₹ 2,00,000 to the Company without such consent and took Debentures. Is the Company liable for ₹ 2,00,000*

   [Hints: Company is not liable]

7. *The management of Kamna Real Estate Ltd. has decided to take up the business of food processing activity because of the downward trend in real estate business. There is no provision in the object clauses of the memorandum of association to enable the company to carry on such business. State whether its object clause can be amended.*

   [Hints: No, as per Section 17 of the Companies Act, 1956]

8. *A Managing Director of a Company borrowed a sum of money by executing a document in which he forged the signature of two other directors who are required to sign as per requirements of the articles. Can the Company deny liability to creditors?*

   [Hints: No, as per the decision given in *Sri Kishan v. Mondal Bros. & Co*. where it was held that a Company may be held liable for any fraudulent acts of its officers acting under ostensible authority.]

UNIT – 2: PROSPECTUS

Prospectus

Question 1

Explain the meaning and role of the Prospectus.

Answer

Meaning of Prospectus: Section 2(36) of the Companies Act, 1956 defines the term Prospectus. Accordingly, it means any document described or issued as prospectus, notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of a body corporate. In this context, it should be noted that prospectus is not an offer in itself but an invitation to make an offer, signifying thereby that on acceptance of such an invitation by any member of the public, no binding contract between him and the company comes into being. Application for purchase of shares or debentures or for making a deposit constitutes an offer by the subscriber to the company and it is only on its acceptance by the company that a binding contract comes into existence.

Role: The prospectus is the basic document on the basis of which the intending investors decide whether or not they should subscribe to the shares or debentures. Therefore, the law requires unstinted disclosure of various matters through prospectus and forbids variations of any terms and conditions of a contract contained therein except with the approval and authority of the company in general meeting [Section 61].

Those who issue prospectus holding out to the public great advantage which will accrue to persons who take up shares on the representations contained therein, are bound to state everything with scrupulous accuracy and not only to abstain from stating as fact that which is not so but to omit no fact within their knowledge, the existence of which might in any degree affect the nature or extent or quality of the privilege and advantages which the prospectus holds out as an inducement to take shares [as per *Kindersely V.C. in Burnswick* and *Canada Railway Co. vs. Mullridge*].

It is therefore essential that the information statutorily needing disclosure is stated fully and precisely so that the investing public which is ignorant of the present and future prospects of the company may get all the information which is likely to affect the public mind. It is only to protect the members of the public against their being misguided by half truths or falsehoods that the law casts a liability on various persons connected with the issue of the prospectus to compensate every person (who subscribes on the faith of the prospectus) for any loss or damage he may have sustained because of the inclusion of any untrue statements in the prospectus [Section 62].

When Prospectus is not required to be issued?

Question 2

State the conditions whereunder the issuing of prospectus is not necessary under the provisions of the Companies Act, 1956.

Answer

Non-issuing of Prospectus:

As per Section 56 of the Companies Act, 1956 the issue of prospectus is not necessary in the following cases-

(1) Where shares or debentures are offered to existing holders of shares or debentures.

(2) When the issue relates to shares or debentures uniform in all respects, with shares or debentures previously issued and dealt in or quoted in a recognized stock exchange.

(3) Where a person is bona-fide invited to enter into an underwriting agreement.

(4) Where shares are not offered to the public.

Requirements as to the issue of Prospectus

Question 3

What are the requirements as to the issue of the Prospectus?

Answer

Comprehensive rules and regulations have been incorporated into the Companies Act, 1956 in respect of this basic document which is the only source for the investors to ascertain the soundness or otherwise of the company. Since the prospectus is intended to save the investing public from victimisation, the Legislature has aimed at securing the fullest disclosure of all material and essential particulars and laying the same before all the prospective buyers of shares. Briefly the rules and regulations are as follows:

(i) Dating of prospectus - According to Section 55, every prospectus must be dated. This requirement is designed to ensure a prima facie evidence of the date of its publication. However, this evidence may be rebutted by a contrary evidence.

(ii) Registration of prospectus - It is absolutely necessary for the company to deliver to the Registrar a copy of every prospectus for registration. It must be made on or before the prospectus is published. But the prospectus must not be issued more than 90 days after the date on which a copy of it is delivered to the Registrar for Registration.

(iii) Approval of prospectus by various agencies: The draft prospectus has to be approved by various agencies before it is filed with the ROC of the concerned State.

(iv) The lead financial institution underwriting the issue, if applicable: The draft prospectus is vetted by SEBI to ensure adequacy of disclosures. However, vetting by

SEBI does not amount to approval of prospectus. SEBI does not take any responsibility for the correctness of the statements made or opinions expressed in the prospectus.

Question 4

What are the authorities whose approval must be sought for issue of prospectus?

Answer

Approval of prospectus by various agencies: The draft prospectus has to be approved by various agencies before it is filed with the ROC of the concerned State. The various authorities who approve the prospectus are the following:

(i) All the lead managers to the issue.

(ii) Each of the stock exchanges where the shares of the company are listed and where the shares/debentures are proposed to be listed.

(iii) The lead financial institution underwriting the issue, if applicable.

The draft prospectus is vetted by SEBI to ensure adequacy of disclosures. However, vetting by SEBI does not amount to approval of prospectus. SEBI does not take any responsibility for the correctness of the statements made or opinions expressed in the prospectus.

The Ministry of Corporate Affairs, vide its circular 10/8/87-CL V No. 7/91, dated 28-2-1991 advised the ROCs to ensure that in respect of every prospectus of public issues which comes up for filing with them the merchant bankers to the issue, whether as lead managers, co-managers, advisers or consultants are only those authorised by SEBI. Each merchant bankers has been given a code number.

It was also decided that ROC shall not register a prospectus where prior to registration of the prospectus, the ROC before whom the prospectus is filed for registration is informed by SEBI that the contents of prospectus filed are in contravention of any law or statutory rules and regulations.

Abridged form of Prospectus

Question 5

What is meant by "Abridged Prospectus"? Is it necessary to furnish abridged form of prospectus along with the application form for shares? Under what circumstances an abridged prospectus need not accompany the detailed information regarding prospectus along with the application form?

Answer

(1) Meaning of Abridged Prospectus: - According to Section 2(1) of the Companies Act, 1956, an abridged prospectus means memorandum containing such salient features of a prospectus as may be prescribed. The memorandum containing salient features of the prospectus accompanying the application forms shall be as per rules prescribed by the

Central Government in this behalf. It is however, open to a company to attach full prospectus along with the application forms.

(2) Abridged prospectus to be issued along with application form:- A company can not issue application forms for shares or debentures unless the form is accompanied by abridged prospectus, according to Section 56(3) of the Companies Act, 1956. The abridged prospectus and application form should bear the same printed number. The investor may detach the share application form along the perforated line, after he has had an opportunity to study the contents of this abridged prospectus. The objective of this provision is to reduce the cost of issue as the detailed prospectus is a very bulky document whereas the contents of abridged prospectus are limited. Penalty for failure to comply with Section 56(3) can be a fine of up to ₹ 50, 000.

(3) Circumstances under which the abridged prospectus containing all the prescribed details need not accompany the application forms: An abridged prospectus containing all the prescribed details need not accompany the application form in the following circumstances:

(i) In case of bona fide underwriting agreement [Section 56(3)(a)]

(ii) Where shares and debentures are not issued to the public [Section 56(3)(b)].

(iii) where the offer is made only to existing members or debenture holders of the company [Section 56(5)(a)].

(iv) In case of issue of shares or debentures which are in all respect similar to those previously issued and dealt in a recognized stock exchange [section 56(5)(b)]

Statement by Experts

Question 6

Who is an 'Expert'? When an expert is not liable for the mis-statement in the prospectus of a public company?

Answer

The Experts consent to the issue of Prospectus: A prospectus may contain a statement purporting to be made by an expert. The term expert includes an engineer, a valuer, an accountant, and any other person whose profession gives authority to a statement made by him [section 59 (2) of Companies Act, 1956].

When an expert is not liable?

An expert who would be liable by reason of having given his consent under section 58 to the issue of the prospects containing a statement made by him would not be liable if he can prove:

(i) that having given his consent to the issue of prospectus, he withdrew it in writing before the delivery of a copy of the prospectus for registration, or.

(ii) that after the delivery of a copy of the prospectus for registration but before allotment, he on becoming aware of the untrue statement withdrew his consent in writing and gave reasonable public notice thereof and the reason therefore, or;

(iii) that he was competent to make the statement and he had reasonable ground to believe and did up to the time of allotment of the shares or debentures believe, that the statement was true. [Section 62 (3)].

Question 7

What is the extent of liability of an expert, in relation to publication of prospectus, for any mis-statement in the report given by him?

Answer

An expert is liable for any mis-statement in the prospectus, unless

(a) he has given his written consent to the issue of the prospectus and has not withdrawn such consent before the delivery of the copy of the prospectus to the Registrar for Registration and

(b) Unless a statement as to his consent and non-withdrawal of it appears in the prospectus (Section 58).

Section 59(1) provides a penalty of fine extending to ₹ 50,000/- for the company and any other person who is knowingly a party to the issue of a prospectus in contravention of these provisions.

Shelf Prospectus

Question 8

Explain the concept of "Shelf Prospectus" in the light of Companies (Amendment) Act, 2000. What is the law relating to issuing and filing of such prospectus?

Or

When is a company required to issue a 'shelf prospectus' under the provisions of the Companies (Amendment) Act, 2000? Explain the provisions of the Act relating to the issue of 'shelf prospectus' and filing it with the Registrar of Companies.

Answer

Shelf Prospectus: According to Section 60-A as inserted by the Companies (Amendment) Act, 2000, 'Shelf Prospectus' means a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus.

Any public financial institution, a public sector bank or scheduled bank whose main object is financing, shall file a shelf prospectus. 'Financing' means making loans to or subscribing in the capital of, a private industrial enterprise engaged in infrastructural financing, or such, other company as the Central Government may notify in this behalf.

A company filing a shelf prospectus with the Registrar shall not be required to file prospectus afresh at every stage of offer of securities by it within a period of validity of such shelf prospectus. It shall be required to file an information memorandum. On all material facts relating to new charges created, changes in the financial position as have occurred between the first offer of securities, previous offer of securities and the succeeding offer of securities within the time prescribed by the Central Govt., prior to making of a second or subsequent offer of securities under the shelf prospectus.

An information memorandum shall be issued to the public along with shelf prospectus filed at the stage of the first offer of securities and such prospectus shall be valid for a period of one year from the date of opening of the first issue securities under that prospectus.

Where an update of information memorandum is filed every time an offer of securities is made, such memorandum together with the shelf prospectus shall constitute the prospectus.

Information memorandum

Question 9

What are the provisions relating to "Information Memorandum" contained in Section 60B of the Companies Act, 1956 [inserted by the Companies (Amendment) Act, 2000]?

Answer

Information Memorandum: Section 60B of the Companies Act, 1956 (inserted by the Companies Amendment Act, 2000) provides the following regarding information memorandum:

1. A public company making an issue of securities may circulate information memorandum to the public prior to filing of a prospectus.
2. A company inviting subscription by an information memorandum shall be bound to file a prospectus prior to the opening of the subscription lists and the offer as a red-herring prospectus, at least three days before the opening of the offer.
3. The information memorandum and red-herring prospectus shall carry same obligations as are applicable in the case of a prospectus.
4. Any variation between the information memorandum and the red-herring prospectus shall be highlighted as variations by the issuing company.

   Explanation – For the purposes of Sub-sections (2), (3) and (4), "red-herring prospectus' means a prospectus which does not have complete particulars on the price of the securities offered and the quantum of securities offered.
5. Every variation as made and highlighted in accordance with sub-section (4) above shall be individually intimated to the persons invited to subscribe to the issue of securities.
6. In the event of the issuing company or the underwriters to the issue have invited or received advance subscription by way of cash or post-dated cheques or stock-invest, the company or such underwriters or bankers to the issue shall not encash such subscription

moneys or post-dated cheques or stock invest before the date of opening of the issue, without having individually intimated the prospective subscribers of the variation and without having offered an opportunity to such prospective subscribers to withdraw their application and cancel their post-dated cheques or stock-invest or return of subscription paid.

7. The applicant or proposed subscriber shall exercise his right to withdraw from the application on any intimation of variation within seven days from the date of such intimation and shall indicate such withdrawal in writing to the company and the underwriters.

8. Any application for subscription which is acted upon by the company or underwriters or bankers to the issue without having given enough information of any variations, or the particulars of withdrawing of offer or opportunity for cancelling the post-dated cheques or stock invest or stop payments for such payments shall be void and the applicants shall be entitled to receive a refund, or return of its post-dated cheques or stock-invest or subscription money or cancellation of its application, as if the said application had never been made and the applicants are entitled to receive back their original application and interest at the rate of fifteen per cent from the date of encashment till payment of realisation.

9. Upon the closing of the offer of securities, a final prospectus stating therein the total capital raised whether by way, of debt or share capital and the closing price of the securities and any other details as were not complete in the red-herring prospectus shall be filed in a case of a listed public company with the Securities and Exchange Board of India and Registrar, and in any other case with the Registrar only.

Question 10

What is meant by 'Red-herring prospectus'? State the circumstances under which such prospectus is required to be filed with the Registrar of Companies. What is the requirement relating to filing of final prospectus in such cases?

Answer

Red-herring Prospectus (Section 60 B of the Companies Act, 1956): Red-herring prospectus means a prospectus which does not have complete particulars on the price of securities and the quantum of securities offered [Explanation to Section 60B (4)]. A public company making an issue of securities may circulate information memorandum to the public prior to filing of prospectus [Section 60B (1)]. As per Section 2(19B), information memorandum means a process undertaken prior to the filing of prospectus by which a demand for the securities proposed to be issued by the company is elicited, and the price and terms of issue for such securities is assessed by means of notice, etc.

A company inviting subscription by an information memorandum shall be bound to file a prospectus prior to the opening of the subscription lists and the offer as red-herring

prospectus, at least 3 days before the opening of offer [Section 60B (2)]. Exact issue size or issue price is not mentioned in the red-herring prospectus.

On the basis of offers received, company will finalise the issue price and issue size and then close the offer. After closure of offer of securities, a final prospectus will be prepared stating the total capital raised whether by way of debts, or share capital and the closing price of securities and any other details as were not complete in red-herring prospectus. The prospectus will be filled with ROC and also with SEBI in case of listed company. [Section 60B (9)].

Mis-statement in prospectus and its consequences

Question 11

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

Answer

Mis-leading Prospectus: Any person who takes shares on the faith of statement of facts contained in a prospectus can rescind the contract if those statements are false or untrue. The words 'untrue statement' have to be construed as explained in Section 65(1)(a), which says that a statement included in a prospectus shall be deemed to be untrue, if the statement is misleading in the form and context in which it is included. Again, where the omission from a prospectus of any matter is calculated to mislead, the prospectus is deemed, in respect of such omission to be a prospectus in which an untrue statement is included [Section 65(1)(b)].

In this case, the fact that dividends were paid out of capital profit and not out of trading profits was not disclosed in the prospectus and to that extent the prospectus contained a material misrepresentation of a fact giving a false impression that the company was a profitable one. Hence the allottee can avoid the contract of allotment of shares. (*Rex V. Lord Kylsant*).

Question 12

When director is not liable for a misstatement in a prospectus?

Answer

When a director is not liable [Section 62(2)]: A person who is held liable for the issue of a prospectus containing an untrue statement as a director will be exonerated from such a liability if he can show:

(a) In a suit under Section 62:

(i) that he (having consented to become a director) had withdrawn his consent to become a director before the issue of the prospectus and that it was issued without his authority or consent;

(ii) that the prospectus was issued without his authority or consent; and that on becoming aware of its issue, he forthwith gave reasonable public notice of the issue having been made without his knowledge or consent; or

(iii) that after the issue of the prospectus and before allotment thereunder he, on becoming aware of any untrue statement therein, had withdrawn his consent and given a reasonable public notice of the withdrawal and of the reasons therefore; or

(iv) that he had reasonable ground to believe and, until allotment, did believe that the statement was true. This provision pertains to the untrue statement not purporting to have been made on the authority of an expert or of a public official document or statement.

(v) that the untrue statement, purporting to be a statement by an expert or contained in a report or valuation of an expert was a correct and fair representation of the expert's statement and he had reasonable ground to believe and, until issue of prospectus, did believe that the expert was competent to make it and the expert had given and had not withdrawn his consent to the issue of the prospectus and had not withdrawn it before delivery of a copy of the prospectus for registration; and

(vi) that the untrue statement, arising from the statement made by an official person or from the public official documents was a correct and fair representation or correct copy or correct and fair extract of the document.

(b) In a suit under Section 56:

A director or other person sued for non-compliance of Section 56 may defined himself by proving:

(i) that he had no knowledge of the matter not disclosed;

(ii) that the contravention was an honest mistake of fact;

(iii) that in the opinion of the Court, the matter not disclosed was immaterial or was otherwise such as ought to be excused.

Question 13

An allottee of shares in a Company brought action against a Director in respect of false statements in prospectus. The director contended that the statements were prepared by the promoters and he has relied on them. Is the Director liable under the circumstances? Decide referring to the provisions of the Companies Act, 1956.

Answer

Yes, the Director shall be held liable. A director can escape liability for mis-statements in a prospectus only on the grounds specified under Section 62(2). Relying on statements

prepared by promoters is not a ground included there under. Accordingly, no defence shall be available to the Director. A Director shall not be liable if he puts up the following defences:

(i) If he withdrew his consent before the issue of the prospects and it was issued without his authority or consent.

(ii) If after the issue of the prospectus and before allotment thereunder, he on becoming aware of any untrue statement therein, withdrew his consent to the prospectus and gave reasonable public notice of the withdrawal and reasons therefor.

(iii) If he had reasonable grounds to believe that the statement was true, and he, in fact, believed it to be true up to the time of allotment.

(iv) If the statement is a correct and fair representation or extract or copy of the statement made by an expert who is competent to make it, the Director is not liable.

Question 14

State the remedies available against a company to a subscriber for allotment of shares on the faith of a misleading prospectus. What conditions must be satisfied by such a subscriber before opting for the remedies?

Answer

A person who has been induced to subscribe for shares/debentures on the faith of misleading prospectus has the following remedies against the company. If there is a misstatement of a material information in a prospectus, and if it has induced any shareholder to purchase shares, he can:

1. rescind the contract, and
2. claim damages from the company whether the statement is fraudulent or an innocent one.

Rescission of the Contract

Any person who takes shares on the faith of statements of fact contained in a prospectus, can apply to the Court for the rescission of the contract if those statements are false or fraudulent or if some material information has been withheld. He must, however, apply for the rescission within a reasonable time and before the company goes into liquidation. But he will have to surrender to the company the shares allotted to him, His name is then removed from the register of members and he gets back the money paid by him to the company along with interest. The contract can be rescinded if the following conditions are satisfied:

1. the statement must be a material misrepresentation of facts,
2. the statement must have induced the shareholder to take the shares,
3. the statement must be untrue.
4. the deceived shareholder is an allottee and he must have relied on the statement in the prospectus.

5. the omission of material fact must be misleading before rescission is granted.
6. the proceedings for rescission must be started as soon as the allottee comes to know of a misleading statement in the prospectus on the faith of which he had subscribed for shares and before the company goes into liquidation.

   Rescission is available only if the aggrieved shareholder:

   (a) acts within reasonable time;

   (b) before the company goes into liquidation;

   (c) has not done any act indicating the upholding of the contract to take shares like:

      (1) having attended a meeting of the company or

      (2) accepted dividends declared by the company.

Damages:

Any person induced by a fraudulent statement in a prospectus to take shares is entitled to sue the company for damages. He must prove the same matters in claiming damages for deceit as in claiming rescission of the contract. He cannot both retain the shares and get damages against the company. He must show that he has repudiated the shares and has not acted as a shareholder after discovering the fraud or misrepresentation.

Question 15

With a view to issue shares to the general public a prospectus containing some false information was issued by a company. Mr. X received copy of the prospectus from the company, but did not apply for allotment of any shares. The allotment of shares to the general public was completed by the company within the stipulated period. A few months later, Mr. X bought 2000 shares through the stock exchange at a higher price which later on fell sharply. X sold these shares at a heavy loss. Mr. X claims damages from the company for the loss suffered on the ground the prospectus issued by the company contained a false statement. Referring to the provisions of the Companies Act, 1956 examine whether X's claim for damages is justified.

Answer

According to Section 62 of the Companies Act, 1956, every director, promoter and every person who is responsible for the issue of the prospectus containing false or untrue information are liable to compensate all those persons who subscribe to the shares on the faith of prospectus. It was held in the case of *Peek Vs. Gurney* that the above-mentioned remedy by way of damage will not be available to a person if he has not purchased the shares on the basis of prospectus. Since X purchased shares through the stock exchange open market which cannot be said to have bought shares on the basis of prospectus. X cannot bring action for deceit against the directors. X will not succeed.

Question 16

Peek Ltd. Co. issued and published its prospectus to invite the investors to purchase its shares. The said prospectus contained false statement. Mr. X purchased some partly paid shares of the company in good faith on the Stock Exchange. Subsequently, the company was wound up and the name of Mr. X was in the list of contributors. Decide:

(i) Whether Mr. X is liable to pay the unpaid amount?

(ii) Can Mr. X sue the directors of the company to recover damages?

Answer

False Statement in Prospectus, the Companies Act, 1956

(i) Yes, X is liable to pay the unpaid amount on the shares. As X has purchased partly paid shares, so he is liable for the remaining part of the shares. At the time of winding up he is liable to contribute a contributory. The related case law in this subject matter is *Peak vs. Gurney.*

(ii) No, X cannot sue the directors to recover damages for the misstatement. The shareholder must have relied on the statement in the prospectus in applying for shares. If a person purchases shares in open market, the prospectus ceases to be operative. In the present case, Mr. X purchased shares in good faith on the stock exchange. He had not relied on the statement in prospectus. So he cannot sue.

Question 17

M applies for share on the basis of a prospectus which contains mis–statement. The shares are allotted to him, who afterwards transfers them to N. Can N bring an action for a rescission on the ground of mis-statement? Decide under the provisions of the Companies Act, 1956.

Answer

Mis-statement in prospectus: No, N cannot bring an action for rescission on the ground of mis-statement as N had not contracted with the company on the basis of prospectus containing mis-statement. The right to rescind the contract is available only to original allottees *(Peek vs Gurney).*

Question 18

Modern Furnitures Limited was willing to purchase teakwood estate in Chhattisgarh State. Its prospectus contained some important extracts from an expert report giving the number of teakwood trees and other relevant information in the estate in Chhattisgarh State. The report was found inaccurate. Mr. 'X' purchased the shares of Modern Furnitures Limited on the basis of the above statement in the prospectus. Will Mr. 'X' have any remedy against the company? When will an expert not be liable? State the provisions of the Companies Act, 1956 in this respect.

Answer

In the event of any mis-statement in a prospectus, the allottees have certain remedies against the company as well as against those who were responsible for the issue of such a prospectus. Thus, in the present case, the allotee Mr. X shall have the right to claim compensation from Modern Furnitures Ltd., for any loss that he might have sustained in terms of the value of shares. But his claim against those responsible for issue of prospectus shall not succeed since they made the statement on the basis of the report of an expert whom they believed to be competent. Section 62(2) of the Companies Act, 1956 provides that in such circumstances, one shall not incur liability. However, the expert can be proceeded against, for the inaccurate report which he had made.

An expert shall not be liable if he proves:

(i) that having given his consent, he withdrew it in writing before delivery of the copy of prospectus for registration or

(ii) that after delivery of prospectus for registration and before allotment he became aware of the untrue statement and withdrew his consent in writing and gave reasonable public notice of the withdrawal and his reasons therefor; or

(iii) that he was competent to make the statement and believed on reasonable grounds that it was true.

Question 19

What is the law relating to criminal liability for mis-statement in the prospectus under the Section 63 of the Companies Act, 1956?

Answer

Criminal Liability for misstatements in the prospectus [Section 63, of the Companies Act, 1956]: Apart from the liability to compensate shareholders who have suffered a loss due to untrue statement in the prospectus, directors and other persons responsible for the issue of the prospectus may also render themselves punishable with imprisonment for a term which may extend to two years or with fine up to fifty thousand rupees, or with both. That is to say, every person who had authorised the issue of the prospectus containing an untrue statement is prima facie guilty of criminal offence under Section 63 of the Act. However, such persons may plead that the statement was immaterial or that they had reasonable ground to believe and did, up to the time of the issue of the prospectus, believe that the statement was true in order to exonerate them from this criminal liability.

Question 20

State the liability of an 'Expert' in case of misrepresentation in the prospectus. When an expert will not be liable for his untrue statements made in the prospectus?

Answer

Liability of an 'Expert' in case of misrepresentation in the prospectus -

Sometimes an expert's opinion in the form of expert report, may also be published in the prospectus of the company. Expert is a person who may be an engineer, a valuer, an accountant and any other person whose profession gives authority to a statement made by him. If untrue statement has been made in the prospectus, the liability of an expert stands but his liability is limited only to the extent of untrue statement made by him.

i. *Compensation for mis-statement: Expert who is responsible for the issue of the prospectus containing false or untrue information is liable to compensate all those persons who subscribe to the shares on the faith of the prospectus.*

ii. *Criminal Liability for mis-statements: Expert who is responsible for the issue of the prospectus may also render himself punishable with imprisonment for a term which may extend to two years or with fine up to fifty thousand rupees, or with both.*

When an expert is not liable: An expert who would be liable by reason of having given his consent to the issue of the prospectus containing a statement made by him would not be liable if he can prove:

i. *that having given his consent to the issue of the prospectus, he withdrew it in writing before the delivery of a copy of the prospectus for registration; or*

ii. *that after the delivery of a copy of the prospectus for registration but before allotment, he on becoming aware of the untrue statement withdrew his consent in writing and gave reasonable public notice thereof and the reasons there for; or*

iii. *that he was competent to make the statement and he had reasonable ground to believe, and did up to the time of allotment of the shares or debentures believe, that the statement was true.*

Offer for sale or Prospectus by implication or Deemed prospectus

Question 21

Explain the concept of "Deemed Prospectus" under the Companies Act, 1956. Point out the circumstances where under issuing the prospectus is not mandatory.

Answer

Deemed Prospectus: In order to avoid the rigorous requirements of prospectus, one practice was to issue shares to another person. Such other person (often called 'Issue House') would then make further offer of sale of their shares to public by advertisements, etc. In order to curb this tendency, Section 64 provides that 'offer of sale' or advertisement of such 'Issue House' will be deemed to be prospectus issued by the company. This is called deemed prospectus. All enactments and rules of law as to the contents of prospectus and as to the liability in respect of statements, omissions from prospectus under Section 60, the persons making the offer of sale to the public are to be deemed as directors of the company [Section 64(4)].

The 'offer of sale' by Issue House will not be considered as 'Prospectus' only when (a) company receives full consideration in respect of shares/debentures allotted to Issue House or agreed to be allotted to them and (b) offer of sale is made at least 6 months after the shares were allotted to them [Section 64(2)].

Additional information to be stated in such documents are (1) net amount of consideration received or to be received by the company in respect of shares or debentures to which offer relates and (2) place and time at which the contract under which the shares or debentures have been allotted or are to be allotted may be inspected [Section 64(3)].

When Prospectus need not be issued: The issue of prospectus under Section 56 of the Companies Act, 1956 is not necessary in the following circumstances even though the shares are offered and applications forms issued to the public by the company:

(i) Where a person is a bona fide invitee to enter into an underwriting agreement with regard to shares or debentures. (Section 56(3)(a)].

(ii) Where shares or debentures are not offered to the public (Section 56(3)(b)].

(iii) Where shares or debentures offered are in all respects uniform with shares or debentures already issued and quoted at a recognised Stock Exchange. (Section 56(5)].

(iv) Where the shares or debentures are offered to the existing shareholders or debenture-holders respectively [Section 56(5)].

Small Depositors

Question 22

Define the term 'Small Depositors'. State the legal provisions relating to acceptance, repayment and further deposits of such small depositors under the Companies Amendment Act, 2000.

Answer

Definition of 'Small Depositors': According to Section 58A of the Companies (Amendment) Act, 2000 a 'small depositor' means a depositor who has deposited in a financial year a sum not exceeding twenty thousand rupees in a company and includes the successors, nominees and legal representatives. It does not include those depositors who renew their deposits and those depositors whose repayment is not made due to death or has been stayed by a competent court.

Acceptance, repayment and further deposits:

1. Every company accepting deposit from the small depositor shall intimate to the Company Law Board (now Tribunal) within fifty days, the name and address of each small depositor to whom it had defaulted in repayment of deposit or interest thereon. Thereafter the intimation shall be given on a monthly basis.

2. On receipt of the intimation, it shall direct the company to repay the deposit and for this purpose an appropriate order is to passed within thirty days if it is delayed an opportunity to the small depositor must be given of being heard, for this purpose presence of the small depositor is not essential.
3. Restriction on the company:
   (a) Unless the company repays all matured deposits along with interest due thereon, it shall not accept further deposits from small depositors.
   (b) If on any occasion, if company makes default in repayment of small deposits, it shall state in all its future advertisement and application inviting deposits the details regarding total number of small depositors and the amount due thereon.
   (c) Where the interest accrued on small deposits has been waived, such fact must be mentioned in every future advertisement and application for inviting deposits.
   (d) The application form inviting deposits must contain a statement that the applicant had been appraised of every past default, waiver of interest, etc.
   (e) If the company subsequent to acceptance of small deposits avails any working capital from any bank, it shall first be utilized for repaying the principal and interest due to small depositors before applying the funds for any other purpose.
   (f) The penalty for failure to comply with the provisions of section 58AA or order of Company Law Board (now, Tribunal) is subject to a fine of ₹500 per day and imprisonment upto three years. The directors are also liable to be proceeded against. Such offence shall be cognizable offence under the Criminal Procedure Code. No court shall take cognizance of any offence under this provision except on a complaint made by the Central Government or any officer authorized by it in this behalf.

Question 23

Several small depositors of Overtrading Company Ltd., have made complaints about non-refund of the deposits after due date. Explain briefly (1) the meaning of small depositor and (2) the duty of the company after the default has taken place in the matter of repayment of the deposits.

Answer

Meaning of Small Depositor: According to Section 58AA of the Companies Act, 1956, a small depositor means a depositor who has deposited in a financial year a sum not exceeding ₹ 20,000/- in a company and includes his successors, nominees and legal representatives.

Duty of company in case of default in repayment of deposits: Every company accepting deposits from small depositors should intimate the Company Law Board/Tribunal within 60 days of the date of default the name and address of each small depositor to whom it had defaulted in repayment of deposit or interest thereon. Thereafter, the company should also give intimation to the Company Law Board/ Tribunal on a monthly basis.

Allotment of Shares

Question 24

What do you mean by Allotment of shares?

Answer

Allotment is the acceptance by the company of such offers to take shares. It is an appropriation of shares to an applicant for shares and appropriation out of the previously unappropriated capital of the company. That is why, if the shares which have been forfeited are reissued, you cannot call it an allotment. The word allotment gives us the notion of a lot. Therefore, there must first be a lot of shares, then the division of them into value or classes and lastly allocation of them among various applicants [*Calcutta Stock Exchange Association, In re., 61 C.W.N. 418 - 0957 Cal. 438*].

Minimum Subscription and Refund & Restriction on use of Application Moneys

Question 25

Define Minimum Subscription. When it is liable to be refunded? Can share application money be deposited in any bank?

Answer

Minimum subscription is the minimum amount as stated in the prospectus, which in the opinion of directors must be raised by the issue of share capital to start with. The amount shall be utilised to meet the following expenditure:

1. Purchase price of the property bought or to be bought.
2. Any preliminary expenses.
3. Underwriting commission.
4. The repayment of money borrowed by the company for the above purposes.
5. Working capital and
6. Any other expenditure stating the nature and purpose with estimated amount in each case.

Section 69(3) of the Companies Act, 1956 provides the amount payable on application on each share shall not be less than 5% of the nominal amount of share capital and Part I of schedule II to the Companies Act stipulates that a declaration should be made in the prospectus that if the company does not receive the minimum subscription of 90% within 90 days from the closing of the issue, the company must refund the amount. In case of development, no time-limit is prescribed therein. Hence a company is believed to obtain the minimum subscription plus development amount within 90 days of the closure of the issue.

From the above provisions, it may be inferred that the amount of minimum subscription cannot be less that 90% of the 5% of the nominal value of the public issue, It may be noted that the

public issue may be made for a sum which is larger than the amount required by way of minimum subscription and the minimum subscription may be stipulated as larger than the sum payable on application.

The SEBI Regulations provides that if minimum subscription plus development amount (i.e., the amount payable by underwriters in case of under subscription of shares as per the underwriting, contract) if any, is not received within a period of 120 days of the opening of the issue, all monies received from the applicants for shares must be forthwith repaid to them without interest. In case any such money is not repaid within 10 days after such 120 days, the company shall be liable to repay that money with interest at prescribed rate (presently 15% p.a).

The time limit requirements of 120 days differ from the provision of schedule II of Companies Act which requires a time limit of 90 days from the closing of the issue for obtaining minimum subscription.

Section 73 of the Companies Act provides for payment of interest on excess application money from the expiry of the 78th day from the closing of subscription list. Hence, the refund of application money within 120 days from the opening of subscription list is without prejudice to the company's liability for payment of interest on delayed refunds pursuant to Section 73 of the Companies, Act.

Pursuant of Part I of Schedule II, the company is also required to make a declaration of any delay in refund at the prescribed rate under Section 763(2), (2A).

Question 26

What is 'Minimum Subscription' and "Opening of Subscription List" in Public Issue of Shares?

Answer

According to Section 69 of the Companies Act, 1956 minimum subscription is the amount which in the opinion of the Board of Directors of the company must be raised by the issue of those shares which are offered to the public for subscription with a view to provide for the following purposes:

(1) The purchase price of any property which requires to be out of the proceeds of the issue.

(2) Any preliminary expenses payable by the company and any commission payable for the sale of shares.

(3) The repayment of any monies borrowed by the company for any of the above said two matters.

(4) Working capital.

(5) Any other expenditure stating the nature and purpose thereof and the estimated amount.

The purpose behind the provision of minimum subscription is to prevent a company from starting its business without adequate financial resources. This is also an investor protection

measure as the company has to refund the amounts collected on applications in case the minimum subscription as stated in the prospectus is not received. Shares cannot be issued immediately after the issue of prospectus. According to Section 72(1), no allotment shall be made until the beginning of the 5th day from the date of issue of prospectus. This is known at the time of opening of subscription list. The subscription list for public issues should be kept open for at least 3 working days and this fact should be stated in the prospectus. The maximum period of keeping the subscription list open is 22 days if the issue was underwritten and 10 days in other cases. The object of this provision is to give applicants sufficient time to study the prospectus and to withdraw their offer to subscribe for the shares in case they are not satisfied with the prospectus.

Question 27

State with reason, whether the following statement is correct or incorrect, according to the Companies Act, 1956.

In the case of Public issue of shares, the subscription list is to be kept open for a minimum period of 3 working days.

Answer

Correct. The subscription list for public issues should be kept open for at least 3 working days and a disclosure to this effect should be made in the prospectus.

Question 28

What is Minimum Subscription? Briefly state important provisions of the Companies Act, 1956 on refund and deposit?

Answer

Minimum subscription is the minimum amount as stated in the prospectus, which in the opinion of directors must be raised by the issue of share capital to start with. The amount shall be utilized to meet the following expenditure:

1. Purchase price of the property bought or to be bought.
2. Any preliminary expense.
3. Underwriting commission.
4. The repayment of money borrowed by the company for the above purposes.
5. Working capital; and
6. Any other expenditure stating the nature and purpose with estimated amount in each case.

Section 69(3) of the Companies Act, 1956 provides the amount payable on application on each share shall not be less than 5% of the nominal amount of share capital and Part I of schedule II to the companies act stipulates that a declaration should be made in the

prospectus that if the company does not receive the minimum subscription of 90% within 90 days from the closing of the issue, the company must refund the amount. In case of development, no time limit is prescribed therein. Hence, a company believed to obtain the minimum subscription plus development amount within 90 days of the closure of the issue.

Question 29

In what way does the Companies Act, 1956 regulate and restrict the following in respect of a company going/or public issue of shares:

(i) Minimum Subscription, and

(ii) Application Money payable on shares being issued? Explain.

OR

If a company does not receive the minimum subscription, it should refund money received from applicants within 120 days of issue of prospectus.

Answer

The Companies Act, 1956 by virtue of provisions as contained in Section 69 (1) and Section 69 (3) to (6) regulate and restrict the minimum subscription and the application money payable on shares being issued by a company going for public issue of shares. These sections provide as under:

Minimum subscription [Section 69 (1)]

No Allotment shall be made of any share capital of a company offered to the public for subscription; unless; -

(a) the amount stated in the prospectus as the minimum amount has been subscribed, provided that such amount shall not be less than 5% of the nominal amount of the shares being issued; and

(b) the sum payable on application for such amount has been paid to and received by the company-

If the application are not received by the company for such quantum of shares for making the minimum subscription, within 120 days after the issue of prospectus, all money received from the applicants for share shall be repaid without interest. If any such money is not repaid within 130 days after the issue of prospectus, moneys will be repaid with interest at the rate of 6% from the expiry of 130 days.

Application money: Section 69 (3) provides that the amount payable on application on each share shall not be less than 5% of the nominal amount of the share. All moneys received from application for shares shall be deposited and kept deposited in a Schedule Bank:

(a) until the certificate to commence business is obtained under Section 149, or

(b) where such certificate has already been obtained, until the entire amount payable on application for shares in respect of the minimum subscription has been received by the

company, and where such amount has not been received by the company within the time on the expiry of which the moneys received from the applicant for shares are required to be repaid without interest under Sub-section (5), all moneys received from applications for shares shall be returned in accordance with the provisions of that sub-section, as stated above.

Question 30

State briefly the provisions relating to minimum subscription and consequence of non-receipt of minimum subscription as per the Companies Act, 1956 and the provisions as per SEBI guidelines.

Answer

In terms of Section 69(1) of the Companies Act, 1956 every prospectus for shares must contain an indication as to the minimum amount which in the opinion of the Board of directors must be raised. The amount so stated in the prospectus which shall be reckoned exclusively of any amount otherwise than in money is referred to as the 'minimum subscription'. The amount payable on application of each share shall not be less than 5% of the nominal amount of the shares.

If the applications are not received by the company for such quantum of shares for making minimum subscription within 120 days of the issue of prospectus, all moneys received from the applicants for shares shall be repaid without interest. If such money is not repaid within 130 days after the issue of prospectus, money will be repaid with interest @6% p.a. after the expiry of 130 days.

Position as Per SEBI Regulations: As per SEBI Regulations, the minimum subscription in respect of public and rights issue shall be 90% of the issue amount. The requirement of 90% minimum subscription shall not be mandatory in case of offer for sale of securities. In case of non-receipt by the company of 90% of the issued amount from public subscription plus accepted development from underwriters or from other sources in case of under-subscribed issues, within 60 days from the date of closure of the issue, the company shall refund forthwith the subscription amount in full without interest and with interest @15% p.a. if not paid within 10 days after expiry of the said 60 days.

[SEBI (DIP) Guidelines are rescinded and replaced by the SEBI (ICDR) Regulations, 2009]

Question 31

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

Answer

Every public company is required before issuing shares for public subscription by issue of prospectus to make an application for listing the security in one or more recognised stock

exchanges [(Section 73(1)]. The prospectus shall state the names of the stock exchanges to which application has been made. If the permission has not been granted by the stock exchange or each stock exchange before the expiry of 10 weeks from the date of the closing the subscription the allotment made shall become void. [Section 73(lA)]. An appeal may be preferred against the decision of any recognised stock exchange refusing the aforesaid permission for enlistment under Section 22 of the Securities Contracts (Regulation) Act, 1956 and then such allotment shall not be void, until the dismissal of the appeal. It shall be deemed that permission has not been granted if the application for permission has not been disposed of within the period specified in [Section73(lA)], i.e. before the expiry of 10 weeks from the closing of the subscription lists [Section 73(5)]. Where the permission has not been applied for or having been applied for has not been granted, the application money received must be refunded to the applicants forthwith without any interest. If the money is not refunded within 8 days after the company becomes liable to repay it, the company and every director of the company who is in default shall, on and from the expiry of the eighth day be jointly and severally liable to repay the money with interest at such rate which shall not be less than 4% and not more than 15% as may be prescribed, having regard to the length of the period of delay in making the repayment of such money [Section 73(2)]. All moneys received as application and allotment money shall be kept in a separate bank account maintained with a scheduled bank until the permission is granted, failure to do so is a punishable offence [Section 73(3)].

Question 32

Explain the consequences of failure to get the shares listed in Stock Exchanges named in the prospectus by a public company, under the provisions of the Companies Act, 1956.

Or

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

Answer

Listing of Shares: Every public company is required before issuing shares for public subscription by issue of prospectus, to make an application for listing the security in one or more recognised stock exchanges [section 73(1)]. The prospectus shall state the names of the stock exchanges to which application has been made. If the permission has not been granted by the stock exchange or each stock exchange before the expiry of 10 weeks from the date of the closing the subscription the allotment made shall become void. [Section 73(1A)]. An appeal may be preferred against the decision of any recognised stock exchange refusing the aforesaid permission for enlistment under section 22 of the Securities Contracts (Regulation) Act, 1956 and then such allotment shall not be void, until the dismissal of the appeal. It shall be deemed that permission has not been granted if the application for permission has not been disposed of within the period specified in section 73(1A) i.e. before the expiry of 10

weeks from the closing of the subscription lists [section 73(5)]. Where the permission has not been applied for or having been applied for, has not been granted, the application money received must be refunded to the applicants forthwith without any interest. If the money is not refunded with 8 days after the company becomes liable to repay it, the company and every director of the company who is in default shall, on and from the expiry of the eighth day be jointly and severally liable to repay the money with interest at such rate which shall not be less than 4% and not more than 15% as may be prescribed, having regard to the length of the period of delay in making the repayment of such money [section 73(2)]. All moneys received as application and allotment money shall be kept in a separate bank account maintained with a scheduled bank until the permission is granted, failure to do so is a punishable offence [section 73(3)].

Question 33

When is an Allotment of Shares treated as an irregular allotment? State the effects of an irregular allotment.

Answer

Irregular allotment: Allotment of shares is irregular when it has been made by a company in violation of Section 69 and 70. Thus:

1. where the company has issued a prospectus, the allotment is irregular if it; (i) has not been able to raise the amount of minimum subscription, (ii) has not collected application money (which shall not be less than 5% of the nominal amount of the shares); and (iii) has not kept the money so received in a Scheduled Bank.
2. where the company has not issued a prospectus, the allotment is irregular if it does not file with the Registrar for registration, a statement in lieu of prospectus at least 3 days before 'the first allotment of shares.

Inspite of these stringent provisions, sometimes on allotment is made by the directors in under disregard of the provisions, such an allotment is treated by the Act not as void ab initio but as irregular.

Effects of irregular allotment:

Allotment is voidable at the option of the allotee: The option must be exercised by the allotee: (a) within 2 months after holding of the statutory meeting of the company, or (b) where the company is not required to hold a statutory meeting, or where the allotment is made after the holding of statutory meeting, within 2 months after the date of allotment.

Notice of avoidance given within this time will be sufficient, though actual legal proceedings if necessary, may be commenced thereafter. Such an allotment is avoidable even if the company is in the course of winding up *(Re National-Motor Mail Coach Co. Ltd. 1908 Ch. 228).*

It is not necessary that the allottee should commence actual legal proceedings within 2 months. It is enough for him to give a notice to the company of his intention to revoke the allotment.

Compensation: Any director, who has knowledge of the fact of the irregular allotment of shares, shall be liable to compensate the company and the shareholder respectively for any loss, damages or costs which the company or the allotee may have sustained or incurred there by Proceedings to recover any such loss, damages or costs can be only be commenced within 2 years from the date of the allotment.

Question 34

After receiving 80% of the minimum subscription as stated in the prospectus, a company allotted 100 equity shares in favour of 'X'. The company deposited the said amount in the bank but withdrew 50% of the amount, before finalisation of the allotment, for the purchase of certain assets. X refuses to accept the allotment of shares on the ground that the allotment is violative of the provisions of the Companies Act, 1956. Comment.

Answer

Allotment of Shares: The company has received 80% of the minimum subscription as stated in the prospectus. Hence, the allotment is in contravention of section 69(1) of the Companies Act, 1956 and the allotment is irregular attracting the provisions of Section 71 of the Companies Act, 1956.

The consequences of such irregular allotment are as follows: The allotment is rendered voidable at the option of the applicant. The option must however be exercised -

(i) With in 2 months after the holding of the statutory meeting of the Company; or

(ii) Where the Company is not required to hold a statutory meeting or where the allotment is made after the holding of the statutory meeting, within 2 months after the date of allotment [Section 71(1)].

The irregular allotment is voidable even if the company goes into liquidation on the meantime [section 71(2)].

In view of the above, refusal by 'X' to accept the allotment of shares on the ground that the allotment is violative of the provisions of the Companies Act is valid provided he has exercised his option to avoid the allotment within the period mentioned in Section 71(1) of the Companies Act, 1956.

The Company has also violated the provisions of Section 69(4) of the Companies Act, 1956 in withdrawing 50% of the amount deposited with the bank before receiving the entire amount payable on application for shares in respect of the minimum subscription.

Question 35

The Board of Directors of M/s Reckless Investments Ltd. have allotted shares to the investors of the company without issuing a prospectus or filing a statement in lieu of prospectus with the

Registrar of Companies, Mumbai. Explain the remedies available to the investors in this regard.

Answer

According to the provisions of Section 70 and 71 of the Companies Act, 1956, any allotment of shares by a company without filing a prospectus or statement in lieu of prospectus will become irregular allotment. The effect of it is that the allotment made by M/s Reckless Investment Ltd will become voidable at the instance of the allottee i.e., the applicant for the shares within a period of two months from the date of allotment. The allotment is voidable at the option of the investor applicant even if the company is in the course of winding up. Further, the directors liable for the default are also liable to compensate the company and the allottee respectively for any loss to which the company may have sustained or incurred thereby. There is a time limit of two years for claiming damages for loss. etc., by the investors.

Question 36

Mars India Ltd. owed to Sunil ₹1,000. On becoming this debt payable, the company offered Sunil 10 shares of ₹100 each in full settlement of the debt. The said shares were fully paid and were allotted to Sunil.

Examine the validity of these allotments in the light of the provisions of the Companies Act, 1956.

Answer

Allotment of Shares: As per the Section 75 of the Companies Act, 1956 when shares are allowed to a person by a company, payment may be made – (i) in cash, or (ii) in kind (with the consent of the company).

'Cash' here does not necessarily mean the current coin of the country. It means "such transaction as would in an action at law for calls, support a plea of payment."

On the basis of the above provision and decision of the related case *Coregam Gold Mining Co. of India V. Roper, (1892), A.C. 125*, the allotment of fully paid up shares in full satisfaction of Sunil's debt is valid.

Question 37

Explain the provisions and main contents of "Return of Allotment" under the Companies Act, 1956.

Answer

Return of Allotment (Section 75, Companies Act, 1956): Within thirty days of allotment of shares, a company is required to send the Registrar a report, known as the "return as to allotment". It must contain the following particulars:

1. The number of nominal amount of shares allotted; the names, addresses, the occupation of the allottees; the amount, if any, paid or payable on each share. No share should be

shown as allotted for cash unless cash has actually been received in respect of the allotment.

2. Contracts in writing under which shares have been allotted for any consideration other than cash, must be produced for examination of the Registrar.
3. Where bonus shares have been issued, the returns must show the nominal amount of the shares allotted; names and addresses and occupations of the allottees and a copy of the resolution authorizing the issue of such shares.
4. Where the shares have been issued at a discount, the return must include a copy of the resolution authorizing such an issue, a copy of the Tribunal's order sanctioning the issue, and where the rate of discount is more than ten percent, a copy of the order of the Central government permitting the issue.

Underwriting

Question 38

Explain clearly the meaning of the term 'Underwriting' and 'Underwriting Commission'. In what way, does the Companies Act, 1956 regulate payment of such Commission? Explain.

Or

In what way does the Companies Act, 1956 regulate the payment of 'underwriting commission'? Explain the provisions of the Act, state the conditions to be complied with before payment of such commission can be made to underwriters of the company.

Answer

'Underwriting' is a contract entered into between the company and certain parties (called underwriters) before the shares or debentures are offered to the public for subscription. The contract is that in case the whole or an agreed portion of the shares or debentures are not applied for, then the underwriters will themselves apply for subscribed shares or debentures; alternatively, they will procure persons to apply for them. The company is least concerned with how the underwriters procure the purchasers. Thus, the underwriters expose themselves to a great risk in 'placing' the shares before the public. And in return for this exposure to the risk the underwriters get commission. The commission is payable on the amount of shares underwritten. It will be payable even if the underwriters are not ultimately called upon to take up any shares.

Conditions to be satisfied: Payment of underwriting commission is regulated by the provisions of Companies Act, 1956 stating certain conditions as contained in Section 76. The conditions to be fulfilled are:

(i) the payment of commission should be authorised by the articles.

(ii) the names and addresses of the underwriters and the number of shares or debentures underwritten by each of them should be disclosed in the prospectus.

(iii) the amount of commission should not exceed, in the case of shares, 5% of the price at which the shares have been issued or the amount or rate authorised by the articles whichever is less, and in the case of debentures it should not exceed 2-1/2%.

(iv) the rate should be disclosed in the prospectus, or in the statement in lieu of prospectus (or in a statement in prescribed form signed in the like manner as the statement in the lieu of prospectus) and should be filed with the Registrar along with a copy of the underwriting contract before the payment of the commission.

(v) the number of shares or debentures which persons have agreed to subscribe absolutely or conditionally for commission, should be disclosed in the manner aforesaid.

(vi) a copy of the contract for the payment of the commission should be delivered to the Registrar along with the prospectus or the statement in lieu of prospectus for registration.

Section 76 (4A) clarifies that commission to the underwriters is payable only in respect of those shares or debentures which are offered to the public for subscription. However where, (i) a person, who for a commission has subscribed (or agreed to subscribe) for shares or debentures of a company and before the issue of the prospectus (or statement in lieu of prospectus) for such shares or debentures, some other person (or persons) has subscribed for any or all of them, and (ii) such a fact together with the aggregate amount of commission payable to the underwriter is disclosed in such prospectus (or statement in lieu of prospectus), then the company may pay commission to the underwriter in the respect of his subscription irrespective of the fact that the shares or debentures have already been subscribed.

Question 39

The Board of Directors of a company decide to pay 5% of issue price as underwriting commission to the underwriters. On the other hand the Articles of Association of the company permit only 3% commission. The Board of Directors further decide to pay the commission out of the proceeds of the share capital. Are the decisions taken by the Board of Directors valid under the Companies Act, 1956?

Answer

Underwriting Commission

Considering the provisions of Section 76 of the Companies Act, 1956:

(i) The payment of commission should be authorised by the articles.

(ii) The amount of commission should not exceed, in the case of shares, 5% of the price at which the shares have been issued or the amount or rate authorised by the articles whichever is less, and in the case of debentures, it should not exceed 2-1/2%.

Answer to problem:

Thus taking into account the above provisions it is concluded that the Board of Director's decision to pay 5% is not valid, since the payment cannot exceed 3% as provided in the Articles of the company. Secondly, decision of the Board to pay the commission out of capital is valid since underwriting commission can be paid both out of capital as well as out of profits *(Madan Lal Fakir Chand v. Shree Changdeo Sugar Mills Ltd. MR (1962)S.C. 1543).*

Question 40

The Articles of Association of MSW Ltd. contained a provision that upto 4% of issue price of the shares may be paid as underwriting commission to the underwriters. The Board of directors decided to pay 5% underwriting commission. Can the Board of directors do so? State the provisions of law in this regard as stated under the Indian Companies Act, 1956.

Answer

According to the provisions of Section 76 (1) of the Companies Act, 1956 a company may pay a commission to any person who agrees to subscribe or procure subscription for an agreed number of shares or debentures of the company. Such commission may be paid to the underwriters who offer guarantee to procure applications for certain number of shares and guarantee to purchase the balance quantity of shares. For this, the underwriter gets underwriting commission. Maximum total commission payable cannot exceed 5% of the price of shares or the underwriter may be paid a lower rate if so prescribed by articles. In case of debentures it is 2½% or a lower rate if so prescribed in the articles.

In the given problem, the articles of MSW Ltd has prescribed 4% underwriting commission but the directors decided to pay 5% underwriting commission. The directors cannot do so because under Section 76 (1) as aforesaid, such commission cannot be more than that prescribed in the articles. Therefore, the directors are not empowered to do so. Further, such amount of commission payable must be authorized by articles. The agreed commission should be disclosed in the prospectus or the statement in lieu of prospectus. Copy of the contract for payment of commission must be filed with Registrar of companies at the time of the delivery of the prospectus or letter of offer. [Section 76 (1)]. An underwriter must be also registered with SEBI.

Question 41

Unique Builders Limited, decides to pay 2.5 percent of the value of debentures as underwriting commission to the underwriters but the Articles of the company authorize only 2.0 percent underwriting commission on debentures. The company further decides to pay the underwriting commission in the form of flats. Examine the validity of the above arrangements under the provisions of the Companies Act, 1956.

Answer

As per Section 76 of the Companies Act, 1956 the amount of underwriting commission should not exceed, in the cases of shares, 5 percent of the price at which the shares have been issued and in the case of debentures it should not exceed 2 1/2 percent or the amount or rate authorized by the Articles whichever is less.

(i) Hence the decision of Unique Builders Limited, to pay underwriting commission exceeding the percentage prescribed under Articles is not valid.

(ii) The company may pay the underwriting commission in the form of flats as decided in the *Booth Vs New Afrikander Gold Mining Co. (1903)* case. Underwriting commission may be paid in cash or kind or as lump sum or by way of percentage but in no case can it go beyond the statutory limits of 5% or 2 ½ % as the case may be.

Purchase of own shares and financial assistance for purchase of own shares

Question 42

Apex Metals Limited wants to provide financial assistance to its employees, to enable them to subscribe for certain number of fully paid shares. Considering the provision of the Companies Act, 1956, what advice would you give to the company in this regard?

Answer

Financial assistance for purchase of own shares: Section 77 of the Companies Act, 1956 provides that no public company and no private company being a subsidiary of a public company, can give financial aid to any person, either directly or indirectly and whether by way of loan, guarantee or surety or otherwise, for or in connection with purchase or subscription made or to be made of any of its own shares or of its holding company.

There are, however, certain exceptions to this rule, namely-

(a) a banking company may lend money for the purpose in the ordinary course of its business but not on the security of its own shares, or

(b) The company in pursuance of a scheme for the purchase of or subscription for fully paid shares of the company(or those of its holding company) to be held by trustees for the benefit of the employees of the company, may advance loan for the purpose.

(c) The company may advance a loan to a person bonafide in its employment (other than directors or managers) to enable them to purchase or subscribe for fully paid shares for an amount not exceeding their salary or wages for a period of six months. (section 77)

However, the exception to this rule allows making of loans by a company, to its bonafide employees for purchasing or subscribing to the fully paid shares of the company. Section 77(3) provided that such financial assistance should not exceed six months' wages or salary of the employee.

Question 43

A Company wants to provide financial assistance to its employees to enable them to subscribe for fully paid shares of the company. Does it amount to purchase of its own shares. If, in the instant case, the company itself purchasing to redeem its preference shares, does it amount to acquisition of its own shares?

Answer

Section 77 of the Companies Act, 1956 allows advancing of loan by a company to its bona fide employees for purchasing or subscribing to fully paid shares of the company. However, such financial assistance should not exceed six months wages or salary of the employee. If the company is purchasing for redeeming its preference shares, it does not attract Section 77.

Question 44

The Board of Directors of XYZ Private Limited, a subsidiary of SRN Limited, decides to grant a loan of ₹ 2.00 lac to P, the Finance Manager of the company getting salary of ₹ 30,000 per month, to buy 400 partly paid-up equity share of ₹1,000 each of XYZ Limited. Examine the validity of Board's decision with reference to the provisions of the Companies Act, 1956.

Answer

According to Section 77 of the Companies Act, 1956 no public company and no private company (being subsidiary of a public company) can give financial aid to any person (either directly or indirectly) and whether by way of loan, guarantee or surety or otherwise, for, or in connection with, purchase or subscription made or to be - made of any shares of its own or of its holding company. But there are few exceptions of the Section 77 of the above Act, out of them one exception is as under.

The company may advance a loan to a person bonafide in its employment (other than directors, or managers) to enable them to purchase or subscribe for fully paid shares for an amount not exceeding their salary or wages for a period of six months.

On the basis of above provisions, the proposals of the Board of Directors of XYZ Limited is not valid because P is a Finance Manager and he wants to purchase partly paid up shares of the company. The amount of loan is also higher than the six months salary of P.

Whether a company can 'buy back' its own shares?

Question 45

A public company proposes to purchase its own shares. State the source of funds that can be utilised by the company for purchasing its own shares and the requirements to be complied with by the company under the Companies Act before and after the shares are so purchased.

Or

ADJ Company Limited decides to buy-back its own shares. Advise the company's Board of Directors about the sources out of which the company can buy-back its own shares. What

conditions are attached to the buy-back scheme of the company in accordance with the provisions of the Companies Act, 1956? Explain.

Or

Choose the correct answer from the following and give reasons:

Sources of funds for buy back of shares are:

(a) Free reserves or securities premium account

(b) The proceeds of any shares or other specified securities

(c) (a) and (b) both

(d) None of the above.

Answer

Sources of funds for buy-back of shares: A company can purchase its own shares or other specified securities. The purchase should be out of:

(i) its free reserves; or

(ii) the securities premium account; or

(iii) the proceeds of any shares or other specified securities.

However, buy-back of any kind of shares or other specified securities cannot be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities [Section 77A(l)].

'*Specified securities'* includes employees' stock option or other securities as may be notified by the Central Government from time to time. [Explanation (a) under Section 77A],

Requirements to be complied with before buy-back: The company shall not purchase its own shares or other specified securities unless:

(a) the buy-back is authorised by its articles;

(b) a special resolution (also Declaration of Solvency to be filed with ROC & SEBI in case shares are listed on any recognised stock exchange), authorising the buy-back is passed in general meeting of the company;

(c) the buy-back is or less than 25% of the total paid-up capital and free reserves of the company;

Provided that the buy-back of equity shares in any financial year shall not exceed 25% of its total paid up equity capital in that financial year.

(d) the ratio of the debt owed by the company is not more than twice the capital and free reserves after such buy-back;

Provided that the Central Government may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies. The expression 'debt' includes all amounts of unsecured and secured debts,

The expression "free reserves" shall have the same meaning assigned to it in Clause (b), Explanation to Section 372A, which means those reserves which, as per latest audited balance-sheet of the company are free for distribution as dividend and shall include balance to the credit of the securities premium account but shall not include share application money.

(e) all the shares or other specified securities for buy-back are fully paid-up;

(f) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by SEBI in this behalf;

(g) the buy-back in respect of shares or other specified securities other than those specified in Clause (f) is in accordance with guidelines as may be prescribed. [Sections 77A(2) and 77A(6)].

The notice of the meeting at which special resolution is proposed to be passed shall be accompanied by an explanatory statement slating;

(a) a full and complete disclosure of all material facts;

(b) the necessity for the buy-back;

(c) the class of security intended to be purchased under the buy- back;

(d) the amount to be involved under the buy-back; and

(e) the time limit for completion of buy-back. [Section 77A(3)].

Requirements to be complied with after buy-back: These are dealt with in Sections 77A and 77AA of the Companies Act, 1956 [as amended by the Companies (Amendment) Act, 1999] and narrated below:

(1) The securities bought back should be extinguished and physically destroyed within 7 days after completion of buy-back [Section 77A(7)].

(2) After completion of buy-back, a company cannot issue same kind of shares or security (which was bought back) for a period of 24 months. Allotment of rights issue renounced by members is also not permissible in this period. However, following are permitted:

(i) issue of security of a different class that is other than one which was bought back,

(ii) bonus issue,

(iii) subsisting obligations such as conversion of warrants,

(iv) stock option to employees

(v) sweat equity

(vi) conversion of preference shares or debentures into equity shares [Section 77A(8)].

(3) The company should maintain a register showing securities bought back and consideration paid for the buy-back, date of cancellation of securities, date of extinguishment and physical destruction of securities other prescribed particulars [Section 77A(9)].

(4) After completion of buy-back, a return has to be filed with the Registrar of Companies and Securities and Exchange Board of India if the company is listed within 30 days giving details as prescribed [Section 77A(10)].

(5) If the buy-back is from free reserves, a sum equal to the nominal value of shares purchased will be transferred to capital redemption reserve account. Details of such transfer will be disclosed in the balance sheet of the company (Section 77A).

Question 46

ABC Company Limited at a general meeting of members of the company pass an ordinary resolution to buy-back 30% of its Equity Share Capital. The articles of the Company empower the company for buy-back of shares. The company further decide that the payment for buy-back be made out of the proceed of the company's' earlier issue of equity shares. Explaining the provisions of the Companies Act, 1956, and stating the sources through which the buy-back of companies own shares be executed. Examine.

(i) Whether company's proposal is in order?

(ii) Would your answer be still the same in case the company instead of 30% decide to buy-back only 20% of its Equity Share Capital?

Answer

Buy Back of own Shares: Sources of Funds etc. A company can purchase its own shares or other specified securities. The Purchase should be *out of:*

(i) its free reserves; or

(ii) the securities premium account,. or

(iii) the proceeds of any shares or other specified securities.

However, buy back of any kind of other specified securities cannot be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities [Section 77A(i)].

'Specified securities' includes employees' stock option or other securities as may be notified by the Central Government from time to time (Explanation (a) section 77A).

In accordance with the provisions of the Companies Act, 1956, as contained in section 77A, the company deciding for buy back of shares must pass a special resolution in a general

meeting of its members authorizing the company for the buy back. Secondly, the buy back is or less *than* 25% of the total paid-up *capital and* free reserves of the company.

Taking into account these two provisions (conditions) itself, the questions as asked in the problem can be answered as under:

1. The company's proposal for buy-back is not in order as it has passed only an ordinary resolution and the percentage of 30% buy-back is in violation of the provisions.
2. The answer to the second question shall also be the same since there also the resolution passed by the company is an ordinary resolution and not special resolution, though the percentage of buy-back, i.e. 20% is not violative.

Question 47

ADJ Company Limited decides to buy-back its own shares. Advise the company's Board of Directors about the sources out of which the company can buy-back its own shares. What conditions are attached to the buy-back scheme of the company in accordance with the provisions of the Companies Act, 1956? Whether there is any time limit for the completion of buy–back of its shares? Explain.

Or

What are the conditions for the company for the buy–back of its own shares? Whether there is any time limit for the completion of buy–back of its shares?

Answer

Buy-back of shares sources and conditions (Section 77A of the Companies Act, 1956): In accordance with the provisions of the Companies Act, 1956, as contained in sec. 77A, a company desirous of buy back of its own shares, can be advised to buy-back out of the following sources:

1. Company's free reserves; or
2. Company's securities premium *Alc;* or
3. Out of the proceeds of any shared or other specified securities. {Section 77A (1)}. However, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

Conditions

(1) Buy-back is authorised by the Company's Articles.

(2) A special resolution has been passed in general meeting of the company authorising buy-back.

(3) The buy-back is less than 25% of the total paid-up capital and free reserves of the company. The buy-back, however, cannot exceed 25% of company's paid up equity share capital in a financial year. Further the companies (Amendment) Act 2001 (w.e.f.

23-10-2001) has authorised the buy back by passing a resolution of a meeting of the Board of Directors provided the buy back does not exceed 10% of the total paid up equity share capital and free reserves. However, there cannot be more than one such buy-back in any period of 365 days.

(4) The ratio of debt owed by the company is not more than two times the equity capital and free reserve after such buy back. However, the Central Government may prescribe a higher ratio of the debt for a class or classes of companies.

(5) All shares or other specified securities are fully-paid-up,

(6) The buy back with respect to listed securities is in accordance with the regulations made by the SEBI in this behalf.

Time limit for completion of buy–back: Every buy–back shall be completed within 12 months from the date of passing the special resolution or a resolution passed by the Board under the clause (b) of sub– section (2) of Section 77A.

Question 48

DJA Company Ltd., desirous of buying back of all its equity shares from the existing shareholders of the company, seeks your advice. Examining the provisions of the Companies Act, 1956 advise whether the above buy back of equity shares by the company is possible. Also state the sources out of which buy-back of shares can be financed.

Answer

Buy-back of Shares by Company (Section 77A of the Companies Act, 1956): The Company cannot buy back its entire equity shares from the existing shareholders. According to Section 77A of the Companies Act, 1956, buy back is restricted to 10% of its paid-up equity capital and free reserves authorised by the Board by means of a resolution passed at its meeting and upto 25% by way of a special resolution in a financial year. The sources out of which buy-back of shares can be finalised are:

(a) Free reserves or

(b) Security Premium account or

(c) Proceeds of any shares or other specified securities

Membership

Question 49

Describe the ways to become a member of a company.

A company issued 20 partly paid equity shares and registered them in the name of the minor describing him as minor. The father of the minor signed the application on the minor's behalf. After some time company went into liquidation. The company filed a suit against father of the minor to recover the remaining amount on the shares. Whether the company will succeed? Advise.

OR

State the manner in which a person may acquire membership of a public company.

Answer

The membership of a company may be acquired in the following ways:

1. *By subscribing to memorandum (Section 41)*: This section provides that the subscribers of the memorandum of association shall be deemed to have agreed to become the members of the company and on its registration shall be entered as members in the register of members.
2. *By allotment:* A person may become a shareholder by agreeing to take shares in the company by allotment.
3. *By transfer:* Section 41 says that every subscribers to the memorandum of a company and every other person who agrees in writing to become a member of the company and whose name is entered in its register of members. Thus it requires two thing a) an agreement in writing to become a member and b) an entry in the register.
4. *By transmission:* Here a person may become a shareholder by transmission of shares through death, lunacy or insolvency.
5. *By estoppel:* This arises when a person holds himself out as a member or knowingly allows his name to remain on the register when he has actually parted with his shares. In the event of winding up he will be liable like other genuine members as a contributory *(Hansraj A. Ashtana).* However, he may escape liquidity by applying for removal of his name under Section 155.

Answer to the problem:

Every person who is competent to contract may become a member. A minor and a person of unsound mind, being incompetent to contract, cannot be members of the company. It has been held in *Mohori Bibi vs. Dharmadas Ghose (1930)* that since a minor has no contractual capacity, the agreement with the minor is void ab intio.

The Companies Act, 1956 prescribes no qualification for membership. Therefore, in India, the minor may be allotted shares. His name may remain on a company's register of members, but during minority he incurs no liability. In the given problem the company issued 20 partly paid shares and registered it in the minor's name. The transaction was void and the father who signed the application on the minor's behalf could not be treated as having contracted for the shares; as such he could not be placed on the list of contributions when the company goes in liquidation. The facts of this problem are related to *Palaniappa B. Official Liquidator AIR 1942 Mod. 470).*

Question 50

How far can a minor become a member of a company under the Companies Act, 1956?

OR

Explain the position of a minor in relation to obtaining membership in a company under the provisions of the Companies Act, 1956.

Answer

Position of a minor as a member in a company:

The Company Law Board has laid down in *Nandita Jain v. Bennet Coleman & Co. Ltd.* that a minor can become a member provided four conditions are fulfilled:

(a) Company must be a Co. Ltd. by shares.

(b) Shares are fully paid up.

(c) Application for transfer is made on behalf of minor by lawful guardian.

(d) The transfer is manifestly for the benefit of the minor.

This was also confirmed in S.L. Bagree v. Britannia Industries.

In also *Diwan Singh v. Minerva Films Ltd. [(3958) 28 Comp. Cases 191 (Punj.), (1959) 29 Comp. Cases 263 (Punj.)],* the Punjab High Court held that there is no legal bar to minor becoming a member of a company by acquiring shares (by way of transfer) provided the shares are fully paid and no further obligation or liability is attached to them.

Minor can become member by transfer or transmission, but a company may not allow a minor to be a member by allotment.

Question 51

M/s Honest Cycles Ltd. has received an application for transfer of 1,000 equity shares of ₹10 each fully paid up in favour of Mr. Balak. On scrutiny of the application form it was found that the applicant is minor. Advise the company regarding the contractual liability of a minor and whether shares can be allotted to the Balak by way of transfer.

Answer

The Companies Act, 1956 does not prescribe any qualification for membership. Membership entails an agreement enforceable in a court of law. Therefore, the contractual capacity as envisaged by the Indian Contract Act, 1872 should be taken into consideration. It was held in the case of *Mohori Bibi Vs. Dharmadas Ghose (1930) 30 Cal. 531 (P.O.)* that since minor has no contractual capacity, the agreement with a minor is void. Therefore, a minor or a lunatic cannot enter into an agreement to become a member of the company. However, the Punjab High Court held in the case of *Diwan Singh vs. Minerva Films Ltd (AIR 1956 Punjab 106)* that there is no legal bar to a minor becoming a member of a company by acquiring shares by way of transfer provided the shares are fully paid up and no further obligation or liability is attached to these. The same view was upheld by the Company Law Board in the case of *S.L. Bagree Vs. Britannia Industries Ltd (1980).*

In view of the above, M/s Honest Cycles Ltd can give membership to Balak through 1000 shares, received by way of transfer, in favour of Mr. Balak a minor because the shares are fully paid up and no further liability is attached to these.

Question 52

RSP Limited, allotted 500 fully paid-up shares of ₹100 each to Z, a minor, in response to his application without knowing that he was a minor and entered his name in the Register of Members. Later on, the company came to know of this fact. The company cancelled the allotment and struck-off his name from the Register of Members and also forfeited his entire share money. He filed a suit against the action of the company. Decide whether Z would be given any relief by the court under the provisions of the Companies Act, 1956.

Answer

A minor, being incompetent to contract, cannot be member of a company. It is true that the Companies Act, 1956 prescribes no qualification for membership but membership entails an agreement and this agreement can be enforced in the Court. Therefore, the contractual capacity as envisaged by the Indian Contract Act, 1872 should be taken into consideration. It has been held in *Mohori Bibi vs. Dharmadas Ghose (1930)* that since a minor has no contractual capacity, the agreement with a minor is void. Therefore, a minor or a lunatic cannot enter into an agreement to become a member of a company.

In the case *Palaniappa vs Official Liquidator AIR 1942*, it was observed that if the directors allot share to a minor in response to his application, without knowing that he was a minor and enter his name in the Register of Members. As soon as the company comes to known of this fact, it can eschew the allotment and strike the name of the minor off the Register of Members. But the company must refund the entire money to the minor, which it obtained in relation to the shares allotted.

On the basis of above decision the contention of Z is not valid. The company is empowered to cancel the allotment and strike the name of Z off the Register of Member. But the decision of the company to forfeit the entire share money of Z is wrong. The company must refund the money to the Z.

Question 53

"Every shareholder of a company is also known as a member, while every member may not be known as a shareholder." Examine the validity of the statement and point out the distinction between a 'member' and a 'shareholder'.

Or

In what way a 'Member' of a company is different from that of a 'shareholder' of the company?

Answer

'Member' or 'Shareholders' of a company are the persons who collectively constitute the company as a corporate. Entity, the terms 'Member' and 'Shareholder' and 'holder of a share'

are used interchangeable. *(Balkrishan Gupta v. Swadeshi Polytex Ltd.)* They are synonymous in the case of a company limited by shares, a company limited by guarantee and having a share capital and on unlimited company whose capital is held in definite shares. But in the case of an unlimited company or a company limited by guarantee, a Member may not be a shareholder, for such a company may not have a share capital.

A shareholder may be distinguished from a Member as follows:

(1) A registered shareholder is a member but a registered member may not be a shareholder because the company may not have a share capital.

(2) A person who owns a bearer share warrant is a shareholder but he is not a member as his name is struck off the register of members. [Section 115(i)]. This means that a person can be a holder of shares without being a member.

(3) A legal Representative of a deceased Member is not a member until he applies for registration. He is, however, a shareholder even though his name does not appear on the register of members.

(4) A person who subscribes to the Memorandum of Association immediately becomes the member, even though no shares are allotted to him. Till shares are allotted to the subscriber, he is a member but not a shareholder of the company.

(5) A person who has transferred his shares ceases to be a holder of those shares from the date of the transfer, but he continues to be a member till such time the transfer is registered in the name of the transfers in the books of the company.

Question 54

State whether the following statements are correct or incorrect:

Every shareholder is a member, but every member may not be a shareholder of the company.

Answer

Every share holder is a member, but every member may not be a share holder of the company. This statement is correct.

Question 55

M Company Limited issued 2,00,000 equity shares of ₹10 each. You are allotted 100 shares. Explain any ten rights you have as a member of the company.

Answer

A member of a company has the following rights against the company:

1. Right to have the certificate of shares held or the certificate of stock issued to him within the prescribed time.

2. Right to have his name borne on the register of members.

3. Right to transfer shares subject to any restrictions imposed by the articles of the company.
4. Right to attend meeting of shareholders, received proper notice and to vote at the meetings.
5. Right to associate in the declaration of dividends and to apply to the Court for an injunction restraining the directors from paying dividends on an ultra virus declaration or out of capital.
6. Right to inspect the registers, indexes, returns and copies of a certificates etc. kept by the company and to obtain extracts or copy thereof.
7. Right to obtain copies of Memorandum and Articles on request and on payment of the prescribed fees.
8. Right to have the first option in case of issue of new shares or a further issue of shares (i.e. right to pre-emption) by the company.
9. Right to receive a copy of the Statutory Report.
10. Right to apply to the court to have any variation or abrogation to his rights set aside by the Court.
11. Right to have notice of any resolution requiring special notice.
12. Right to obtain on request minutes of proceedings at general meeting.
13. Right to remove directors by joining with others.
14. Right to obtain a copy of the profit and loss account and the balance sheet with the auditor's report.
15. Right to apply for the appointment of one or more competent inspectors by the Government to investigate into the affairs of the company as well as for reporting thereon.
16. Right to participate in the appointment of an auditor at the AGM.
17. Right to inspect the auditor's report-at the AGM of the company.
18. Right to receive a share in the capital of the company and in the surplus assets, if any, on the company's liquidation.
19. Right to participate in passing of the special resolution what the company may be wound up by the court or voluntarily.
20. Right to participate in the appointment and in fixation of remuneration of one or more liquidators in the case of a Member's voluntary Winding-up and to fill any vacancy in the office of a liquidators so appointed by him.

Question 56

Choose the correct answer from the following and give reasons:

(i) An index of members must be maintained by a company when its membership exceeds:

(a) 20

(b) 50

(c) 70

(d) 80

(ii) Sources of funds for buy back of shares are:

(a) Free reserves or securities premium account

(b) The proceeds of any shares or other specified securities

(c) (a) and (b) both

(d) None of the above.

Answer

(i) Answer (b): Reason: As per Section 151 of the Companies Act, 1956, every company having more than 50 members must maintain an index of members except where the Register of Members in itself constitutes an index.

(ii) Answer (c): Reason: As per Section 77A of the Companies (Amendment) Act, 1999, a company can purchase its own shares or other specified securities. The purchase should be out of:

(i) its free reserves; or

(ii) the securities premium account; or

(iii) the proceeds of any shares or other specified securities.

Service of Documents

Question 57

Explain the provisions of the Companies Act, 1956 relating to the 'Service of Documents' on a company and the members of the company. When is service of document deemed to be effective in case the document is sent by post? Explain.

Answer

According to Section 53 of the Companies Act, 1956, a company may serve a document on its member either personally, or by sending it by post to him to his registered address, or if he has no registered address in India, to the address, if any, within India supplied by him to the company for the giving of notices to him [Section 53 (1)]. If a person residing abroad has not supplied to the company an address within India for the purpose of giving notice to him, then a document advertised in a newspaper circulating in the neighbourhood of the registered office of the company shall be deemed to be duly served on him on the day on which the advertisement appears [Section 53 (3)]. In the case of joint holders of a share, notice may be served on the joint holder named first [Section 53(4)]. When a share holder dies, it becomes

the duty of the legal representative to furnish their address for a notice to be sent and if they fail to send the intimation to the company, the company is entitled to serve at the address which is recorded with it. The same rule applies in the case of insolvent member, when the assignees have not furnished their address [Section 53 (5)].

Where a document is sent by post, it is enough if the letter containing the document is properly addressed and sent by ordinary post. But at the request of any member, notice may be served by registered post or under certificate of posting, provided the member has deposited adequate money to meet the expenses {Section 53 (2) (a)].

Where a document is served by post, service shall be deemed to have been effected:

(1) In the case of notice of a meeting at the expiration of 48 hours after the letter containing the same is posted, and

(2) In any other case at the time at which the letter would be delivered on the ordinary course of post.

[Note: The Ministry of Corporate Affairs through Circular No.17/2011, dated 21st April, 2011 has adopted the electronic mode for the service of the documents]

Question 58

The Articles of Association of Mars Company Ltd. provides that documents may be served upon the company only through Fax. Ramesh despatches a document to the company by post, under certificate of posting. The company does not accept it on the ground that it is in violation of the Articles of Association. As a result Ramesh suffers loss. Explain with reference to the provisions of the Companies Act, 1956:

(i) What refusal of document by the company is valid?

(ii) Whether Ramesh can claim damages on this basis?

Answer

Problem on service of document upon a company: The problem as asked in the question is based on the provisions of the Companies Act, 1956 as contained in Section 51. Accordingly a document may be served on a company or on its officer at the registered office of the company. It must be sent either by post or by leaving it at its registered office. If it is sent by post, it must be either by post under a certificate of posting or by registered post. When a notice has been addressed to the company and served on the directors, it constitutes a good service *(Benabo v. Jay (William) and Partners Ltd.)* The articles of a company which contain the provisions contrary to Section 51 cannot be enforced nor can they limit the mode of service to only one of the modes provided by the Statute *(Sadasiv Shankar Dandige V. Gandhi Seva Samaj Ltd.).*

Accordingly in the first case, the refusal by the Mars Company Ltd. of the service of the document is not valid.

In the second case, Ramesh can claim damages on this account from the Company.

Question 59

The Articles Association of PQR Ltd. provided that documents upon the company may be served only through E-mail. Arvind sent a document to the company by registered post. The company did not accept the document on the ground that sending documents to the company by post was in violation of the Articles. As a result Arvind suffered loss. Decide the validity of argument of the company and claim of Arvind for damages in the light of provisions of the Companies Act, 1956.

Answer

Service of Documents, the Companies Act, 1956: Section 51 of the Companies Act, 1956, contains the law relating to service of documents on company. The Section provides that a document may be served on a company or an officer thereof by sending it to the company or officer at the registered office of the company by post under a certificate of posting or by registered post, or by leaving it at its registered office.

Since, as per Section 9 of the Companies Act, any provision in the Articles of Association contrary to the provisions of the Act shall be void, the requirement in the Articles that documents shall be served on the company only through E-mail is not valid. Accordingly, company's refusal to accept the document is not valid and company shall be held liable in damages to Arvind.

Question 60

Discuss the provisions of law contained in the Companies Act, 1956 as regards to the service of documents.

Answer

Service of documents: Under section 51 of the Companies Act, 1956, a document may be served on a company or on its officer at the registered office of the company. It may be sent either by post or by leaving it at its registered office. If it is sent by post, it must be either by post under a certificate of posting or by registered post. When a notice has been addressed to the company and served on directors, it constitutes a good service. The articles of a company which contains the provisions contrary to section 51 cannot be enforced nor can they limit the mode of service to only one of the modes provided by the statute [Sadasiv Vs. Gandhi Seva Samaj (1958) Bombay 247].

When the securities are held within a depository, the records of beneficial ownership may be served by such depository on the company by means of electronic mode or by delivery of floppies or discs [Amendment in section 51 through deposit or IES related laws (Amendment) Act, 1997].

A document may be served on the Registrar by sending it to him at his office by post under a certificate or posting or by registered post, or by delivering it to or leaving it for his office (section 52).

Under section 53 of the Companies Act, 1956, a company may serve a document on its member either personally or by sending it by post to him to his registered address; or if he has no registered address in India, to the address (if any) within India supplied by him to the company for giving notice to him. The Ministry of Corporate Affairs through Circular No. 17/2011 has clarified that a company would have complied with section 53 of the Companies Act, 1956, if the service of document has been made through electronic mode provided the company has obtained e-mail addresses of its members by giving an advance opportunity to every share holders to register their e-mail address.

In cases where any member has not registered his e-mail address with the company, the service of document etc., will be effected by other modes of service as provided under section 53 of the Companies Act, 1956.

EXERCISE

1. *A minor by false declaration of his age in the share application form acquired fully paid up shares. The company on coming to know of the fact wants to remove his name. Can they do so?*

   [Hints*:* Yes, because minor has no contractual capacity]

2. *X applied for 500 shares in a limited company in a fictitious name. The shares were allotted in that fictitious name. Referring to the relevant provisions of Companies Act, 1956 state whether X will incur any liability.*

   [Hints: X shall be punishable as per Section 68A (1) The Companies Act, 1956]

3. *A limited company willing to purchase a tea estate in Assam. Extracts from experts report mentioning number of tea plants and other relevant information was incorporated in the prospectus. The expert report was found to be incorrect. Does any prospective applicant shareholder buying the shares on the basis of false information has any remedy against the company?*

   [Hints: Yes, as per Section 65 of the Companies Act, 1956].

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

   [Hints: Yes allottee can avoid the contract as per the provision given under the Section 65 of the Companies Act, 1956]

5. *The Articles of Association of Star Company Ltd. provides that documents may be served upon the company only through Fax. Vikas despatches a document to the company by post, under certificate of posting. The company does not accept it on the ground that it is in violation of the Articles of Association. As a result Vikas suffers loss. Explain with reference to the provisions of the Companies Act, 1956:*

   (i) Whether refusal of document by the Company is Valid?

   (ii) Whether Vikas can claim damages on this basis?

[Hints: Refusal is not valid and Vikas can claim damages as per the provision given under Section 51 of the Companies Act, 1956]

6. *A Public Limited Company wants to increase its subscribed share capital by offering the new shares to the persons who are not the members of the company. Referring to the provisions of the Companies Act, 1956, advice the company about the procedure the company has to adopt to give effect to the above proposal.*

[Hints: Yes, company can offer the new shares to the non-members as per the provisions of the Companies Act, 1956 contained in Section 81]

7. *A company issued 20 partly paid equity shares and registered them in the name of the minor describing him as minor. The father of the minor signed the application on the minor's behalf. After some time company went into liquidation. The company filed a suit against father of the minor to recover the remaining amount on the shares. Whether the company will succeed? Advice.*

[Hints: No, as the transaction was void and the father who signed the application on the minor's behalf could not be treated as having contracted for the shares (*Palaniappa B. Official Liquidator AIR 1942 Mod. 470)]*

8. *State whether television advertisements and visual clips giving all required details can be treated as a prospectus?*

[Hints: No, because a prospectus must be in writing]

UNIT – 3: SHARE CAPITAL

Concept of Capital

Question 1

A Company by special resolution declared that ₹ 50 out of each ₹ 100 share should be there serve Capital. The company then issued debentures charging its undertaking and property including its uncalled capital. Two years later, the company went into liquidation. The debenture holders claimed a first charge on the reserve capital. Is their claim justified? Give reasons referring to the provisions of the Companies Act, 1956.

Answer

No, the debenture holders claim is not justified. A company cannot borrow on the security of its reserve capital. This is because reserve capital is not capable of being called up except in the event of the company being wound up. Thus the reserve capital of ₹ 50 per share cannot be subject to the charge (*Mayfair Propertyco. Re).*

Shares

Question 2

Explain in brief 'Equity Share Capital' and 'Preference Share Capital'.

Answer

As per the Section 85 and 86 of the Companies Act 1956, there will now be two types of share capital as under:

(i) equity share capital and

(ii) preferential share capital.

Equity Share Capital shall be:

(i) with voting rights

(ii) with differential rights. The expression 'Shares with differential voting rights" is defined as a share that is issued in accordance with the provisions of Section 86.

Equity shares carry voting rights on the ground meetings of the company and have the right to control the management of the company. They have right to share in the profits of the company in the form of distribution of dividend and bonus shares. In the event of winding up of the company, equity shares capital is repayable only after repayment of the claims of the creditors and preference share capital.

Preference share capital means that part of share capital which fulfils both the following requirements, namely

(a) as respect dividend, it carries or will carry a preferential right to be paid a fixed amount or an amount calculated at a fixed rate, and

(b) as respect capital, it carries or will carry on the winding up or repayment of capital, a preferential right to be repaid the amount of the capital paid up or deemed to have been paid up, whether or not there is a preferential right to the payment of either or both of the following amounts, namely –

(i) any money remaining unpaid, in respect of the amount specified in clause (a), upto the date of winding up or repayment of capital; and

(ii) any fixed premium any fixed scale, specified in the memorandum or articles of the company (Section 85)

Variation of shareholders rights

Question 3

What are the rights of preference shareholders if dividends remained unpaid? Would your answer be different if preference shares are non-cumulative?

Or

ABC Ltd. has not given dividend to its preference shareholders. In this regard state the rights of preference shareholders and non-cumulative Preference Shareholders on dividend.

Answer

Shareholders holding not less than l0%, in the aggregate, of issued shares of that class, being persons who have not consented to or voted for the resolution for the variation of the rights may apply to the Court to have the variation cancelled. The application has to be made within 20 days from the date of passing of the resolution. In the case where an application has been made, the variation shall be effective only after it has been confirmed by the Court. The decision of the Court on any such application shall be final. If the court has made an order, the company must, within 30 days after the service on the company of any order by it, forward copy of it to the Registrar (Section 107).

Every holder of preference shares has a right to vote only on a resolution which directly affects the rights attached to the preference share capital. A resolution for the winding up of the company or repayment or reduction of its share capital is deemed to directly affected the rights of holders of preference shares. Where preference shares are cumulative as to dividend and the dividend thereon has remained unpaid for an aggregate period of not less than 2 years preceding the date of any meeting of the company, the preference shareholders shall have the right to vote on every resolution placed before the meeting. On the other hand, if the preference shares are not cumulative as regards dividend, then the holders thereof will be able to exercise the above mentioned extended right of voting only if dividend due on shares has remained unpaid or not less than 2 years ending with the expiry of the financial year immediately preceding the commencement of the meeting or for 5 an aggregate period of not less than 3 years out of 6 years ending with the expiry of the financial year aforesaid. In all the above cases, the right of preference shareholders to vote on a poll shall be in the same

proportion as the capital paid up on such shares bears total to the paid-up equity capital of the company.

Voting rights of a holder

Question 4

Examine the different aspects of the voting rights of a member.

Answer

Voting rights of a member: Section 87 governs the voting rights of members. Every holder of an equity share has the right to vote, by virtue of his share in the capital, on every resolution placed before the company. And his voting right on a poll shall be in proportion to the amount paid upon his share. A member's right to vote may be exercised by him personally or through a proxy.

Every holder of preference shares has a right to vote only on a resolution which directly affects the rights attached to the preference share capital. A resolution for the winding up of the company or repayment or reduction of its share capital is deemed to directly affect the rights of holders of preference shares. Where preference shares are cumulative as to dividend and the dividend thereon has remained unpaid for an aggregate period of not less than 2 years preceding the date of any meeting of the company, the preference shareholders shall have the right to vote on every resolution placed before the meeting. On the other hand, if the preference shares are not cumulative as regards dividend, then the holders thereof will be able to exercise the above-mentioned extended right of voting only if dividend due on shares has remained unpaid for not less than 2 years ending with the expiry of the financial year immediately preceding the commencement of the meeting or for an aggregate period of not less than 3 years out of 6 years ending with the expiry of the financial year aforesaid. In all the above cases, the right of preference shareholders to vote on a poll shall be in the same proportion as the capital paid up on such shares bears to the total paid-up equity capital of the company. Dividend on preference shares, whether declared or not, shall be deemed to be due on the last date of the period specified for payment in the articles or other instrument executed by the company in that behalf. Alternatively, if no such date is specified, the dividend shall be deemed to be due on the day immediately following such period. The provisions stated above are, however, subject to the provisions of Sections 89 and Section 92(2) which we shall discuss hereunder:

A company may, be making a provision in the articles, restrain a shareholder from exercising his voting rights in respect of any shares registered in his name on which any call or other amount due has not been paid or on which the company has a lien or exercised a lien. But a public company or a private company which is a subsidiary of the public company cannot prohibit a member from voting on the ground that he has not held his share or other interest for a specified period before the time of voting or on any other ground except as mentioned above.

A company may, if so authorised by its articles, accept from any member the whole or any part of the uncalled amount on shares, but the member will not be entitled to voting rights in respect of the sum paid by him until it becomes payable [Section 92]. It is in an exception to the rule that the voting rights of equity and preference shareholders on a poll will be in the same proportion as the capital paid up on those shares bears to the total paid-up equity capital.

Further issue of capital

Question 5

Write a note on the powers of the Central Government in regard to conversion of debentures and loans into shares of the company under the following heads:

(i) When terms of issue of such debenture or terms of loan do not include term providing for an option of conversion;

(ii) Matters considered in determining the terms and conditions of such conversion.

(iii) Remedy available to the company if conversion or terms of conversion is not acceptable to it.

Answer

(i) Under Section 81 of the Companies Act, 1956 where any debentures have been issued to or loans have been obtained from the Government by a company, whether such debentures have been issued or loans have obtained before or after the commencement of Companies Amendment Act, 1963 (w.e.f. 1.1.1964), the Central Government may, if in its opinion it is necessary in the public interest so to do, 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 that Government to be reasonable in the circumstances of the case, even if the terms of issue of such debentures or the terms of such loans do not include term providing for an option for such conversion.

(ii) In determining the terms and conditions of such conversion, the Central Government shall have due regard to the following circumstances:

(i) The financial position of the company;

(ii) The terms of issue of the debentures or the terms of the loans, as the case may be;

(iii) The rate of interest payable on the debentures or the loans;

(iv) The capital of the company, its loan liability, its reserves, its profits during the preceding five years; and

(v) The current market price of the shares in the company.

A copy of every order proposed to be issued by the Central Government shall be laid in draft before each House of Parliament.

The above powers of the Central Government are exercised notwithstanding anything contained in sub-sections (1), (2) and (3) of Section 81 of the Companies Act, 1956.

(iii) Remedies open to the company: If the terms and conditions of such conversion are not acceptable to the company, the company may, within 30 days from the date of communication of such order or within such further time as may be granted by the Court, prefer an appeal to the court in regard to such terms and conditions and the decision of the Court on such appeal and, subject only to such decision, the order of the Central Government shall be final and conclusive.

Section 81 of the Companies Act, 1956

Question 6

When can a Public Company offer the new shares (further issue of shares) to persons other than the existing shareholders of the Company? Can these shares be offered to the Preference Shareholders?

Answer

Issue of Further Shares: Section 81 of the Companies Act, 1956 provides that if, at any time after the expiry of 2 years from the formation of the company or after the expiry of one year from the first allotment of shares, whichever is earlier, it is proposed to increase the subscribed capital by allotment of further shares, it should be offered to the existing equity shareholders of the company in proportion to the capital paid up on those shares.

The new shares of a company may-be offered to outsiders or any persons (including the equity shareholders) if-

(a) a special resolution to that effect is passed by the company.

(b) an ordinary resolution is passed and the approval of the Central Government is obtained. The Central Government will accord its approval if it is satisfied that the proposal is most beneficial to the company.

(c) if any shareholder to whom the shares are offered declines to accept the shares. In such a case the Board of Directors may dispose of the shares in such a manner as they think most beneficial to the company.

(d) if the new shares are issued within 2 years from the formation of the company or 1 year of the allotment made for the first time.

Preference Shareholders - whether (Further Issue of Capital) be offered to: From the wordings of Section 81, it is quite clear that these shares can be issued only to equity shareholders, unless procedure as stated above has been adopted for issue of these shares to outsiders, etc. Therefore, in general these shares cannot be offered to preference Shareholders.

Question 7

VRS Company Ltd. is holding 45% of total equity shares in SV Company Ltd. The Board of Directors of SV Company Ltd. (incorporated on January 1, 2007) decided to raise the share capital by issuing further Equity shares. The Board of Directors resolved not to offer any shares to VRS Company Ltd, on the ground that it was already holding a high percentage of the total number of shares already issued, in SV Company Ltd. The Articles of Association of SV Company Ltd. provides that the new shares be offered to the existing shareholders of the company. On March 1, 2007 new shares were offered to all the shareholders except VRS Company Ltd. Referring to the provisions of the Companies Act, 1956 examine the validity of the decision of the Board of Directors of SV Company Limited of not offering any further shares to VRS Company Limited.

Answer

The problem as asked in the question is based on the application of the provisions of the Companies Act, 1956 as contained in Section 81 and the ruling given in *Gas Meter Co. Ltd. Vs Diaphragm & General leather co. Ltd.*

According to Section 81, if at any time after the expiry of two years from the formation of the company or after the expiry of one year from the first allotment of shares, whichever is earlier, it is proposed to raise subscribed capital by allotment of further shares, it should be offered to the existing equity share holders of the company in proportion to the capital paid upon those shares. Further in case of *Gas Meter Ltd. Vs Diaphragm, & General; leather Co. Ltd* where the facts of the case were similar to those given in the problems asked in the question, the articles of Diaphagm Co. provided that the new shares should first be offered to the existing share holders. The company offered new shares to all shareholders excepting Gas Co., which held its controlling shares. It was held that D company could be sustained from doing this.

In the given case, applying the provisions and the ruling in the above case, SV Ltd.'s decision not to offer any further shares to VRS Co. Ltd on the ground that VRS Co. Ltd already held a high percentage of shareholding in SV Co. Ltd. is not valid for the reason that it is violative of the provisions of Section 81 and against the ruling in the above case.

Secondly, the offer for issue of the shares was made on 1st March 2007, i.e. after two years of the formation of the company. Therefore Board of Directors of SV Ltd cannot take a decision not to allot shares to VRS Company, unless the same is approved by the Co. in general meeting by means of special resolution as required under Section 81 (A).

Question 8

A listed company at Bombay Stock Exchange, intends to offer its new shares to non-members. State whether it is permitted under the Companies Act, 1956.

Answer

Issue of Shares to Non-Member: As per the provisions of the Companies Act, 1956 contained in section 81(1) to (3) the directors of the company are under obligation to make

offer of the new shares (known as rights shares) to the existing members of the company in proportion to their share holding. These shares can be offered to the persons who are not the members of the company or to the outsiders or any person (including the equity shareholders) if the following procedure has been adopted:

(1) A special resolution has been passed to that effect by the shareholders in general meeting.

(2) If an ordinary resolution is passed and the approval of the Central Government is obtained, the Central Government will accord its approval if it is satisfied that the proposal is most beneficial to the company.

(3) If any shareholder to whom the shares are offered, decline to accept the shares, in such a case the Board of directors of the company may dispose of the shares in such manner, as they think most beneficial to the company.

(4) If the new shares are issued within 2 years from the formation of the company or 1 year of the allotment made for the first time.

The provisions of section 81, however, do not apply:

1. to a private company.
2. to the increase of the subscribed capital of a company caused by the exercise of an option attached to debentures issued or loans raised by the company to convert such debentures or loans into shares in the company, or to subscribe for shares in the company. But the terms of issue of such debentures or the terms of such loans should include a term providing for such option and such term:
   (i) either has been approved by the Central Government before the issue of debentures or the raising of the loans, or is a conformity with the rules, if any, made by the Central Government in this behalf, and
   (ii) in the case of debentures or loans (other than debentures issued to, or loans obtained from, the government or any institution specified by the Central Government) has also been approved by a special resolution passed by the company in general meeting before the issue of the debentures or the raising of the loans.

Question 9

J held 100 partly paid up shares of LKM Limited. The company asked him to pay the final call money on the shares. Due to some unavoidable circumstances he was unable to pay the amount of call money to the company. At a general meeting of the shareholders, the chairman disallowed him to caste his vote on the ground that the articles do not permit a shareholder to vote if he has not paid the calls on the shares held by him. J contested the decision of the Chairman. Referring to the provisions of the Companies Act, 1956 decide whether the contention of J is valid.

Answer

Section 181 of the Companies Act, 1956 lays down the grounds on which right of a shareholder to vote at the general meeting may be excluded. These are:

(a) Non-payment of calls by a member;

(b) Non-payment of other sums due against a member;

(c) Where company has exercised the right of lien on his shares.

The article of the company also confirms one of the grounds stated in above section.

Hence J's contention is not valid and the decision of the chairman is valid.

Alteration of share capital

Question 10

The Directors of Mars India Ltd. desire to alter capital clause of Memorandum of Association of their company. Advise them, under the provisions of the Companies Act, 1956 about the ways in which the said clause may be altered and the procedure to be followed for the said alteration.

Answer

Alteration of Capital (Section 94 the Companies Act, 1956): A limited company with a share capital can alter the capital clause of its memorandum of association in any of the following ways, provided authority to alter is given by the articles.

(i) it may increase its capital by issuing new shares

(ii) consolidated the whole or any part of its shares capital into shares of larger amount

(iii) convert shares into stock or vice versa

(iv) sub-divide the whole or any part of its share capital into shares of smaller amount

(v) cancel those shares which have not been taken up and reduce its capital accordingly.

Provisions regarding confirmation, resolution and notices: Any of the above things can be done by the company by passing a resolution at general meeting, but do not require to be confirmed by the National Company Law Tribunal. Within thirty days of alteration notice must be given to the Registrar who will record the same and make necessary alteration in the company's memorandum and articles. Notice to the Registrar has similarly to be given when redeemable preference shares have been redeemed. Similar information is also required to be sent where the capital has been increased beyond the authorized limit, or where a company, being not limited by shares, has increased the number of its members.

Question 11

Distinguish between 'alteration' and 'reduction of share capital'.

Answer

Alteration of Share capital (Section 94): A limited company having a share capital may, if so authorised by its articles, alter its share capital in the following manner:

(i) by increasing its nominal capital by issuing new shares;

(ii) by consolidating and dividing all or any of its share capital into shares of larger denomination;

(iii) by converting fully paid-up shares into stock or vice versa;

(iv) by sub-dividing its shares or any of them into shares of smaller amount;

(v) by cancelling shares which have not been taken up and diminishing the amount of its share capital by the amount of the shares so cancelled,

The powers conferred by Section 94 shall be exercised by passing an ordinary resolution of the company in a general meeting and shall not require to be confirmed by the Court.

Reduction of the share capital: Section 100 of the Companies Act, provides that a company, limited by shares or guarantee and having share capital, if so authorised by the articles, may by special resolution and the confirmation of the Court, reduce its share capital in any way and in particular by:

(a) extinguishing or reducing the liability of members in respect of the capital not paid up;

(b) writing off or cancelling any paid-up capital which is in excess of the needs of the company.

(c) paying off any paid-up share capital which is in excess of the needs of the company.

Reduction of share capital may in reality take three forms, namely, (i) reducing the value of shares in order to absorb the accumulated losses suffered by the company without any payment to the shareholders; (ii) extinction of liability of capital not paid; and (iii) paying off any paid-up share capital. Only in the circumstances referred to in (ii) and (iii) is the interest of creditors really involved.

Reduction of the share capital

Question 12

Can a Public Limited Company reduce its Share Capital? If so, when and how? Also state the procedure it has to follow for doing so.

Answer

Reduction of Share Capital: A company is allowed to reduce its share capital subject to special safeguards.

Section 100 of the Companies Act, 1956 provides that a company, limited by shares or guarantee and having share capital, if so authorised by the articles, may by special resolution and the confirmation of the Court, reduce its share capital in any way and in particular by.

(a) extinguishing or reducing the liability of members in respect of the capital not paid up;

(b) writing off or cancellation any paid-up capital which is in excess of the needs of the company,

(c) paying off any paid-up share capital which is in excess of the needs of the company.

Reduction in (b) and (c) may be made either in addition or without extinguishing or reducing the liability of the member for uncalled capital.

Reduction of share capital may in reality take three forms, viz..

1. Reducing the value of shares in order to absorb the accumulated losses suffered by the company without any payment to the shareholders.
2. Extinction of liability of capital not paid; and
3. Paying off any paid up share capital,

The interest of creditors is involved only in the cases stated in 2 and 3.

Procedure to be adopted

1. A special resolution is to be passed under Section 100.
2. An application is to be made under Section 101 to the Court for an order confirming the reduction.
3. After the petition for Court's confirmation is filed, the Court must settle the list of creditors who are entitled to object such as creditors having a debt or a claim admissible on a winding up.
4. The Court must ascertain the names of those creditors and the nature and amount of their debts or claims.
5. The Court may publish notices fixing a day or days within which the creditors not entered on the list are to claim to be so entered or are to be excluded from the right of objecting to the reduction.
6. The Court has power to dispense with the consent of the dissenting creditor, on the company securing the paying of the debt or claim by appropriating the full amount of the amount fixed by the Court.

However, the Court has discretionary power having regard to any special circumstances of the case to direct that the provisions of Section 101(2) shall not apply as regards any classes of creditors. The special circumstances should be convincing to the Court.

After being satisfied the Court may make an order confirming the reduction on such terms and conditions as it thinks fit. The company then has to put the words "and reduced" to the name of the company.

Reduction and Diminution

Question 13

Distinguish between 'Reduction of Share Capital' and Diminution of Share Capital'.

or

"Diminution of capital does not constitute reduction of capital within the provisions of the Companies Act, 1956," – Comment.

Answer

(i) Reduction of capital may be a reduction in nominal capital, subscribed capital or paid up capital whereas diminution denotes a cancellation of that portion of the issued capital which has not been subscribed [Section 94(1) (e)]

(ii) Both require authorization by Articles but reduction of capital can be effected only by a special resolution whereas diminution can be effected by an ordinary resolution.

(iii) Reduction of capital needs confirmation by the court [Section 101] whereas diminution needs no such confirmation [Section 94(2)]

(iv) In case of reduction, Court (now Tribunal) may order the company to add the words 'and reduce' after its name [Section 102(3)] but no such order can be passed in case of diminution [Section 94]

(v) In case of diminution notice is to be given to the Registrar within 30 days from the date of cancellation, whereas in the case of reduction more detailed procedure regarding notice to the Registrar has been prescribed by section 103, though there is no such time limit as aforesaid.

Question 14

Under what circumstances a company can reduce its share capital?

Answer

Section 100 of the Companies Act 1956, provides that a company, limited by shares or guarantee and having share capital, if so authorised by the articles, may by special resolution and with the confirmation of the Court, reduce its share capital in any way and in particular by:

(a) extinguishing or reducing the liability of members in respect of the capital not paid up:

(b) writing off or cancelling any paid-up capital which is in excess of the needs of the company.

(c) paying off any paid-up share capital which is in excess of the needs of the company.

Reduction in (b) and (c) may be made either in addition or without extinguishing or reducing the liability of the members for uncalled capital. Reduction of share capital may in reality take three forms, namely, (i) reducing the value of shares in order to absorb the accumulated

losses suffered by the company without any payment to the shareholders; (ii) extinction of liability of capital not paid; (iii) paying off any paid-up share capital. Only in the circumstances referred to in (ii) and (ii) is the interest of creditors really involved.

Issues of shares at a discount

Question 15

Can a company issue shares at discount? What is the law, in this relation, laid down in the Companies Act, 1956?

Or

What are the rules relating to issue of shares at a discount?

Or

Whether a company may issue shares at discount? State the conditions which must be fulfilled before issuing the shares at discount contained in the Companies Act, 1956.

Answer

A company shall not issue shares at a discount disregarding the provisions of section 79 of the Companies Act, 1956. If a company issues the shares at a price less than the face value of the shares, it is called issue of shares at discount. The following conditions have to be fulfilled as stated in Section 79.

1. *The issue of shares at discount should be authorized by a resolution, passed by the company in General Meeting and approved by the Company Law Board.*
2. *The issue must be of a class of shares already issued.*
3. *The maximum rate of discount must not exceed 10% or such higher rate as CLB may permit in a specified case.*
4. *Not less than one year has at the date of issue elapsed since the date on which the company was entitled to commence business.*
5. *The shares at a discount must be issued within two months of the sanction of CLB or within such extended time as it may allow.*
6. *Every prospectus at the date of issue must mention particulars of the discount allowed on the issue of shares or the exact amount of the discount as has not been written off. In default, the company and every officer of the company shall be punished with a fine up to ₹ 500/-.*

Issue of sweat equity

Question 16

Explain the meaning of 'Sweat Equity Shares' and state the conditions a company has to fulfill for issuing such shares.

Answer

Meaning of Sweat Equity Shares*:* Sweat equity shares mean equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual properly rights or value additions, by whatever name called. [Explanation II to Section 79A, Companies (Amendment) Act, 2000].

Conditions to be fulfilled before issue of Sweat Equity Shares: Notwithstanding anything contained in Section 79 (Providing for issue of shares at a discount), a company may issue sweat equity shares if the following conditions are fulfilled:

1 Shares of a class which have already been issued only can be issued as 'sweat equity shares'.

2. Issue of 'sweat equity-shares' should be authorised by a special resolution passed by the company in general meeting.

3. The resolution should specify number of shares, current market price, consideration, if any and class or classes of directors or employees to whom the 'sweat equity shares' may be issued.

4. The 'sweat equity shares' may be issued only one year after the company was entitled to commence business.

5. If the company is listed on stock exchange 'sweat equity shares' can be issued as per regulations made by SEBI. If the company is not listed on the stock exchange 'sweat equity shares' will be issued in accordance with guidelines of-Central Government. (Section 79A(I)).

6. The 'sweat equity shares' have same limitations restrictions and rights as are applicable to other equity shares. [Section 79A(2)].

Issue of a securities at a premium

Question 17

Whether a company can issue shares at premium?

State the purposes for which the Share Premium account can be used under the provisions of the Companies Act, 1956.

Or

Explain the provisions of the Companies Act, 1956, relating to the utilization, by a company, of the amount standing to the credit of Securities Premium Account.

Answer

Issue of shares at premium (Section 78): If the market exists, a company may issue its shares at premium i.e. the price higher than their nominal value. There is no restriction

contained in the Companies Act, 1956 on the sale of shares at a premium. But SEBI guidelines have to be observed as they indicate when an issue has to be at par and when premium is chargeable. Premium may be received in case or kind. Where the value of assets received by a company as a consideration for allotment is greater than the nominal value of shares, it is in essence an allotment at a premium. An amount equal to extra value of the assets would have to be carried to the securities premium account. The amount to the credit of share premium account has to be maintained with the same sanctity as share capital and can be reduced only in the manner of share capital. The act does regulate the disbursement of the amount collected as premium. Such account be used in the following ways be the company.

(a) it may be applied to issue to the members as fully paid by way of bonus the unissued shares of the company.

(b) it may be used to write off preliminary expenses.

(c) it may be used to write off commission or discount account.

(d) it may be spent in providing for the premium payable on the redemption of preference shares or debentures of the company.

Share certificate

Question 18

Ramesh, who is a resident of New Delhi, sent a transfer deed, for registration of transfer of shares to the company at the address of its Registered Office in Mumbai. He did not receive the shares certificates even after the expiry of four months from the date of dispatch of transfer deed. He lodged a criminal complaint in the Court at New Delhi. Decide, under the provisions of the Companies Act, 1956, whether the Court at New Delhi is competent to take action in the said matter?

Answer

Jurisdiction of Court, now Tribunal, the Companies Act, 1956: According to Section 113(1) of the Companies Act, 1956 every company, unless prohibited by any provision of law or of any order of court, Tribunal or other authority, shall within two months after the application for the registration of transfer of any such shares, deliver the certificates of all shares transferred. In the case of a listed company under the listing agreement this period has been reduced to 30 days.

The facts of the given case are similar to *H.V. Jaya Ram Vs. ICICI Ltd., 1998*. In this case the Special Court for Economic Offences in the State of Karnataka rejected the appellant's complaint against the respondent company on the ground that since the company had its registered office at Mumbai it is only the court which has territorial jurisdiction over the registered office of the company that can entertain the petition and not the court located in the State of Karnataka where the shareholder is residing. The High Court also upheld the order of the Special Court. On appeal Supreme Court held that cause of action for failure to deliver

share certificate arises where the registered office of the company is situated and not in the jurisdiction of the Court located in the place where the complaint resides.

Accordingly in the present case also, the Court in New Delhi cannot entertain the complaint against a company having its registered office in Mumbai.

Question 19

Who is responsible to prove delivery of share certificate?

Answer

Cardiff Chemicals Ltd. Vs. Fortune Bio-Tech Ltd. and another [2004] 414 CLB.

The petitioner company has allotted some shares against application and the company has failed to deliver the share certificates in spite of its repeated demands. Hence, the appellant filed petition under section 113 of the Companies Act, 1956 before the Company Law Board seeking directions against the company for delivery of share certificates. The respondent company challenged the petition on the ground that the director of the petitioner took physical delivery of share certificates from the company. However, the respondent company has failed to produce conclusive proof that it had delivered the share certificates to the petitioner. It was held that, the burden of proving delivery of the share certificates to the petitioner is upon the company; failure of which it could not be said that the company becomes discharged its obligations imposed under section 113(1). Hence, Company Law Board upheld the default of company in delivering the share certificates and further directed the company to deliver share certificates to the petitioner.

Share warrant

Question 20

Differentiate between 'Share Warrant' and 'Share Certificate' under the Companies Act, 1956.

Answer

Distinction between a share warrant and a share certificate:

Sl. No.	*SHARE CERTIFICATE*	*SHARE WARRANT*
(i)	A share certificate is a prima facie evidence of document of title, stating that the holder is entitled to specified number of shares	A share warrant is a bearer document stating that the holder is entitled to certain number of shares specified therein.
(ii)	Share certificate can be issued by a public and private company	Share warrant can be issued only by public companies.
(iii)	A share certificate can be issued for a fully paid and partly paid up shares	A share warrant can be issued only with respect of fully paid up shares

(iv)	The holder of a share certificate is normally a member of the company	The bearer of a share warrant can be a member only if the articles provide.
(v)	A share certificate is not a negotiable instrument	A share warrant is by mercantile usage a negotiable instrument
(vi)	The shares can be transferred by execution of a transfer deed and its delivery along with the share certificate. The transfer is complete when it is registered by the company.	A share warrant can be transferred by mere delivery and no registration of transfer with the company is required.
(vii)	Stamps duty is payable on transfer of shares specified in a share certificate	No stamp duty is payable on transfer of a share warrant
(viii)	In order to qualify as a Director, the person should acquire shares in his own name.	This is not applicable to share warrants.

Question 21

Mr. 'Y', the transferee, acquired 250 equity shares of BRS Limited from Mr. 'X', the transferor. But the signature of Mr. 'X', the transferor, on the transfer deed was forged. Mr. 'Y' after getting the shares registered by the company in his name, sold 150 equity shares to Mr. 'Z' on the basis of the share certificate issued by BRS Limited. Mr. 'Y' and 'Z' were not aware of the forgery. State the rights of Mr. 'X', 'Y' and 'Z' against the company with reference to the aforesaid shares.

Answer

According to Section 84(1) of the Companies Act, 1956, a share certificate once issued amounts to a declaration by the company to all the world that the person in whose name the certificate is made out and to whom it is given is a share holder in the company; in other words, the company is estopped from denying his title to the shares. However, a forged transfer is a nullity. It does not give the transferee (Y) any title to the shares. If the company acts on a forged transfer and removes the name of the real owner (X) from the Register of Members, then the company is bound to restore the name of X as the holder of the shares and to pay him any dividends which he ought to have received (*Barton v. North Staffordshire Railway Co. 38 Ch D 456*).

In the above case, 'Z' being the bona fide purchaser must be compensated by the company. 'Z' shall have therefore a right to claim the market price of those shares at that time. However 'Z' cannot insist on being placed on the register of members to which 'X' alone is eligible as he cannot be said to have consented to the transfer. 'Y' shall of course be liable to the company to indemnify the loss on account of payment to 'Z'. A similar decision was given in *Dixon v. Kennaway*.

Question 22

What is the law and procedure for issuing a duplicate share certificate under the provisions of the Companies Act, 1956 in case the original share certificate is lost or destroyed?

Answer

Law for issuing a duplicate share certificate under the Companies Act, 1956: Section 84(2) of the Companies Act, 1956 provides that a company may renew or issue a duplicate certificate if it is proved to have been lost or destroyed or having been defaced, mutilated or torned, after the certificate is surrendered to the company. Section 84(4) makes it obligatory for companies to follow the rules prescribed by Government known as - The Company (Issue of Certificate) Rules, 1960.

Further, Section 84(4) of the Companies Act, 1956 makes it obligatory for companies to follow the rules prescribed by the Government in regard to the following matters:

(i) The form of a certificate (original or renewed or a duplicate thereof).

(ii) The particulars to be entered in the Register of Members or in the register of renewed or duplicate certificate.

(iii) The form of such registers.

(iv) The fee on payment of which the terms and conditions, if any including terms and conditions as to evidence and indemnity and reimbursement for expenses incurred in connection with investigating evidence on which a certificate may be renewed or duplicate thereof may be issued.

Procedure:

(i) The duplicate share certificate must not be issued in lieu of the lost or destroyed share certificate, without prior consent of the Board having been obtained or without payment having been made of fees not exceeding ₹ 2 on such reasonable terms as regards evidence, etc., as the Board thinks fit. [Rule 4(3)]

(ii) When a certificate is issued in lieu of one lost or destroyed, it must contain the statement "Duplicate issued is lieu of certificate N...." In addition, the word 'duplicate' shall be stamped or punched in bold letters across the face of the share certificate. [Rule 5(3)]

(iii) Entries must also be made in a register in respect of certificates issued under renewed and duplicate certificates indicating against the names of members, the number and date of issue of certificate, in lieu whereof the new certificate has been issued. The entries should be authenticated either by the Secretary or by a person appointed by the Board.

Question 23

State whether the following statement is correct or incorrect

'A holder of share-warrant of a company is not a member of the company'.

Answer

Correct

Call on share

Question 24

"Moonstar Ltd" is authorised by its articles to accept the whole or any part of the amount of remaining unpaid calls from any member although no part of that amount has been called up. 'A', a shareholder of the Moonstar Ltd., deposits in advance the remaining amount due on his shares without any calls made by "Moonstar Ltd.".

Referring to the provisions of the Companies Act, 1956, state the rights and liabilities of Mr. A, which will arise on the payment of calls made in advance.

Answer

Mr. A, a shareholder of the 'Moon Star Ltd'., deposited in Advance the remaining amount due on his shares without any calls made by 'Moon Star Ltd'. 'Moon Star Ltd' was authorized to accept the unpaid calls by its articles. According to section 92(1) of the Companies Act, 1956, a company may, if so authorized by the articles, accept from any member the whole or a part of the amount remaining unpaid or any shares by him although no part of that amount has been called up. The amount so received or accepted is described as payment in advance of calls. When a company receives payment in advance of calls, the rights and liabilities of the shareholder will be as follows:

(i) The shareholder is not entitled to voting rights in respect of the moneys so paid by him until the same would, but for such payment become presently payable. [Section 92(2)].

(ii) The shareholder's liability to the company in respect of the call for which the amount is paid is distinguished.

(iii) The shareholder is entitled to claim interest on the amount of the call to the extent payable according to the articles of association. If there are no profits, it must be paid out of capital, because shareholder becomes the creditor of the company in respect of this amount.

(iv) The amount received in advance of calls is not refundable.

(v) In the event of winding up the shareholder ranks after the creditors, but must be paid his amount with interest, if any before the other shareholders are paid off.

(vi) The power to receive the payment in advance of calls must be exercised in the general interest and for the benefit of the company.

Transfer of shares

Question 25

A company refuses to register transfer of shares made by X to Y. The company does not even send a notice of refusal to X or Y within the prescribed period. Has the aggrieved party any right(s) against the company for such a refusal? Advise.

Answer

The problem as asked in the question is based upon Section 111 of the Companies Act, 1956 dealing with the refusal to register transfer and appeal against refusal.

On refusal to register a transfer or transmission by operation of law, of the right to any shares in, or debentures thereof, the company has to send notice of refusal giving reasons to the transferee or the transferor or to the person giving intimation of such transmission, or on delivery of transfer deed to the company, as the case may be within a period of 2 months from the date of the intimation or delivery of the transfer deed to the company. In the given case the company has failed to give such notice of refusal to the aggrieved parties within the stipulated time of 2 months. Failure to give notice of refusal gives a right/remedies to the aggrieved parties.

Rights/remedies to aggrieved parties: The aggrieved parties may apply to the Company Law Board (Tribunal) under sub-section (2) or (4) of Section 111 against refusal or for rectification of the register of members, if his name is entered in the register without sufficient cause, or for omission of his name from the register or default in making an entry of his name in the register. The time of filing such appeal is 4 months from the date of lodgement of transfer application. There is no limitation period provided for making an application for rectification of register of members, under subsection (4). The company is also punishable under sub-section (12) with a fine upto ₹ 500 per day.

Question 26

The Articles of Association of a private limited company contain provisions restricting the right to transfer shares and limiting the number of members to fifty. What restrictions are generally incorporated in the articles in restricting the right to transfer shares?

Answer

The right of transfer of shares and limiting the number of members to 50 is generally restricted in the following manner:

(i) By authorising the directors to refuse transfer of shares to persons whom they do not approve or by compelling the shareholder to offer his shareholding to the existing shareholders first. It may be noted that it can only restrict the right of sale to a member. On this consideration, the articles usually provide that before selling or transferring his share by the shareholder, the directors must be communicated in writing of such intention of the shareholder.

(ii) By specifying the method for calculating the price at which the shares may be sold by without interest and with interest @15% p.a. if not paid within 10 days after expiry of the said one member to another. Generally, it is left to be determined either by the auditor of the company or by the company at a general meeting.

(iii) By providing that the shareholders who are employees of the company shall offer the shares to specified persons or class of persons when they leave the company's service or from other sources in case of under-subscribed issues, within 60 days from the date of closure of the issue, the company shall refund forthwith the subscription amount in full 60 days.

Question 27

State the differences in restrictions in transfer and effect of refusal to transfer of shares in a public and a private company?

Answer

One of the most important features of a company is that its shares are freely transferable. The Companies Act, 1956 empowers every shareholder to transfer his shares laid down in the Articles and in accordance with the various provisions of law. However, a private company place certain restrictions on the right of its members to transfer the share to existing member of the company, before offering to non–members so long as a fair price is offered.

In the case of a public company also, there may be some restriction on the members to transfer the share Regulation 21(Table A) provides that the Board of directors may refuse to register the transfer of partly paid shares to a person whom they do not approve. Further, the Board may refuse to register the transfer of any share, which has a lien.

How nomination facility shall operate in case of transmission of shares?

Question 28

Examine the provisions of the Companies Act, 1956 regarding 'nomination' in case of transmission of shares.

Answer

Operation of nomination facility in case of transmission of shares under the provisions of Companies Act, 1956: If nominee becomes entitled to any shares by virtue of nomination, he will apply to company along with proof of death of holder/joint-holders. He can either request Board to register himself as the shareholder or he can transfer the shares of deceased shareholder [Section 109B(1)]. Thus, the nominee can either register his name or directly transfer the shares in some others' name.

If he elects to be registered holder of shares, he will have to send a written notice to the company stating that he elects to be the registered holder. Such notice should be accompanied by death certificate of shareholder [Section 109B(2)].

All limitations, restrictions and provisions of the Act relating to the right of transfer and registration of transfer will apply as if the application is for transfer of shares [Section 109B(3)]. In other words, transfer in name of nominee or other person to whom nominee intends to transfer shares can be declined only on the grounds on which any transfer can be declined, and no other grounds.

The nominee is entitled to all rights of deceased member like dividend and bonus. However, he will not be eligible for voting rights or other rights as a member, unless he makes application in writing and is registered as a member in respect of the shares.

The nominee must either register himself as member or transfer the shares in some others name. If he does neither, company can send him a notice to elect either to become a member or transfer the shares. If the nominee does not comply within 90 days, Board can withhold payment of dividends, bonuses or other money payable, till the requirement of notice is complied with [Section 109B(4)].

Question 29

How nomination facility shall operate in case of transmission of shares under the provisions of the Companies Act, 1956?

Answer

Section 109 of the Companies Act, 1956 provides that any person who becomes a nominee by virtue of the provisions of Section 109 A, upon the production of such evidence as may be required by the Board and subject as hereinafter provided, elect, either

(a) to be registered himself as holder of the share or debenture, as the case may be; or

(b) to make such transfer of the share or debenture, as the case may be as the deceased shareholder or debenture holder, as the case may be, could have made.

If the person being a nominee, so becoming entitled, elects to be registered as holder of the share or debenture, himself as the case may be, he shall deliver or send to the company a notice in writing signed by him stating that he so elects and such notice shall be accompanied with the death certificate of the deceased shareholder or debenture holder, as the case may be. (Sub-section 2)

Certification of transfer

Question 30

A who holds one share certificate of 1000 Equity shares in a company, wants to transfer 300 shares in favour of B. Explain the procedure to be followed for executing the partial transfer under the provisions of the Companies Act, 1956.

Answer

Certification of Transfer: Where a shareholder wishes to transfer only part of his shareholding or wishes to sell to them to two or more persons, he is required to lodge the

share certificate with the company. Where he has already lodged with the company the relevant share certificate, together with an instrument of transfer for part of the shares, he may request the company to certify on the instrument of the transfer that the share certificate for the shares covered by the instrument of transfer has been *lodged* with the company. This is known as certification.

An instrument of transfer shall be deemed to be certified if it bears the words 'certificate lodged' or the words to the like effect. [Section 112(3)(a)]. Certification is, therefore, the act of noting by the secretary etc. stating that the share certificate has been lodged with the company. When only a portion of shares is transferred, the company usually issued him a ticket for the balance of shares which have not been transferred. Such a ticket is called a 'balance ticket'.

The certification by a company of a transfer as above is to be taken as a representation by the company to any person acting on faith of certification that there has been produced to the company such documents as, on the face of them, show prima facie title to the shares in the transfer. It is, however, not a representation that the transferor has any title to the shares. [Section 112(1)].

The company will be responsible for the certification only if:

(a) the person issuing the installment is authorised to issue such installment on the company's behalf;

(b) the certificate is signed by any officer or servant of the company or any other person authorised to certify transfer on the company's behalf.

Thus X holding 1000 shares in AJD Co. Limited is advised to act for certification of transfer in accordance with the provisions for partial transfer of his holding.

Blank Transfer & Forged transfer

Question 31

Explain the following with reference to transfer of shares in a company registered under the Companies Act 1956:

(i) Blank Transfers

(ii) Forged Transfers.

Or

"A forged transfer of shares is a nullity." Comment.

Answer

(i) Blank Transfers: A blank transfer is an instrument of transfer signed by the transferor in which the name of the transferee and the date of the transfer are not filled. The ownership of the shares in a company is generally transferred from one person to another by the execution of a document by the seller and the buyer. This document is variously described as a "transfer instrument" or "transfer deed" or simply "transfer". But in a blank transfer, the seller fills in his name and signs it. Neither the buyers' name nor

his signature and the date of sale is filled in the transfer. This practice enables the buyer to -sell it again and the subsequent buyer also can sell these shares again by the same transfer deed. This process can be used for a number of times. For such ultimate transfer and registration the first seller will be treated as the transferor.

(ii) Forged Transfers: A Forged transfer is a nullity. It does not give the transferee concerned any title to the shares. If the company acts on a forged transfer and removes the name of the real owner from the Register of Members, then it is bound to restore the name of the real owner on the register as the holder of the shares and to pay him dividends which he ought to have received.

2A buyer of shares on the basis of forged transfer does not get any title to the shares, since forgery is nullity. However, the company shall be liable to compensate the purchaser in so far as the company had issued a certificate to transfer and was therefore estopped from denying the liability accruing from it own acts.

Question 32

'A' commits forgery and thereby obtains a certificate of transfer of shares from a company and transfers the shares to 'B' for value acting in good faith. Company refuses to transfer the shares to 'B'. Whether the company can refuse? Decide the liability of 'A' and of the company towards 'B'.

Answer

Problem relating to forged transfer: A forged transfer is a nullity. It does not give the transferee concerned any title to the shares. Since the forgery is an illegality therefore it cannot be a source of a valid transfer of a title. Although the innocent purchaser acting in good faith could validly and reasonably assume that the person named in the certificate as the owner of the shares was really the owner of the shares represented by the certificate. Even then the illegality cannot be converted into legality. Therefore, in this case company is right to refuse to do the transfer of the shares in the name of the transferee B.

Here, as regards to the liability of A against 'B', A does not stand directly responsible according to provisions of company law as he has already committed forgery which is illegal but A is liable to compensate the company as he has lodged the forged transfer and the company has suffered the loss.

As regards to the liability of the company towards B, the company shall be liable to compensate to B in so far as the company had issued a certificate to transfer and was, therefore, stopped from denying the liability accruing from its own act. Further, as the company has refused to register him as a shareholder, company has to compensate B. However, in this case the interest of the original shareholder will be protected.

Question 33

X, a registered shareholder of Y Limited left his share certificates with his broker. A forged the transfer deed in favour of Z, accompanied by these share certificates lodged the transfer deed alongwith the share certificates with the company for registration. The Company Secretary

who had certain doubts, wrote to X informing him of the proposed transfer and in the absence of a reply from him (X) within the stipulated time, registered the transfer of shares in the name of Z. Subsequently, Z sold the shares to J and J's name was placed in the register of shareholders. Later on, X discovered that forgery has taken place.

Referring to the provisions of the Companies Act, 1956, state the remedy available to X and Z in the given case. Explain.

Answer

In the given case, there is a forged transfer of shares. The company in such a case should first inquire into the validity of the instrument of transfer. It should also send a notice to the transfer or of his address and inform him that such a transfer has been lodged and if no objection is made before this specified date, it would be registered.

Remedies available to X: Since a forged transfer is a nullity, it does not pass any legal title to the transferee. The true owner can have his name restored on the register of member. A forged document can never have any legal effect.

Can also claim any dividend, which may not have been paid to him during the intervening period. *(Barton V North Staffordshire)*

Transmission of shares

Question 34

Explain the meaning of "transmission of Shares" under the Companies Act, 1956. In what ways is "transmission of shares" different from "Transfer of Shares"?

Answer

Transmission and transfer of shares: Under Section 109B of the Companies Act, 1956, transmission of shares takes place when shares are transferred under the operation of law, either on the death of the registered shareholder or on his being adjudged as insolvent. It also takes place where the holder is a company if it goes into liquidation. Upon the death, the shares of the deceased vest in his executors or administrators and the estate becomes liable for calls if the shares are not fully paid up. In the like manner the official assignee or the receiver, as the case may be, is also entitled to be registered as a member in the place of shareholder who has been adjudged as insolvent *[R. W. Key and Sons (1902) IC, 467]*. However, the executors or administrators may decline to be registered as members for various reasons. In that event the legal representatives, by virtue of Section 109, shall be entitled to transfer the shares of the deceased irrespective of whether they are partly paid or fully paid. Similarly, the official assignee has the statutory power to transfer the shares under Section 58(1) of the Presidency Towns Insolvency Act.

Distinction between transfer and transmission of shares

	Transfer of shares		Transmission of shares
1.	It is affected by a voluntary/deliberate act of the parties.	1.	It takes place by operation of law e.g. due to death, insolvency or lunacy of a member.
2.	It takes place for consideration.	2.	No consideration is involved.
3.	The transferor has to execute a valid instrument of transfer.	3.	There is no prescribed instrument of transfer.
4.	As soon as the transfer is complete, the liability of the transferor ceases.	4.	Shares continue to be subject to the original liabilities.

Forfeiture and surrender of shares

Question 35

What conditions as required under the Companies Act, 1956 must be satisfied by a company for the forfeiture of shares of a member, who has defaulted the payment of calls? What are the consequences of such forfeiture?

Answer

Forfeiture of Shares and the Consequences

Conditions to be satisfied for forfeiture*:*

1. In accordance with the Articles: Forfeiture-must be authorized by the Articles of the company and must be for the benefit of the company.
2. Notice prior to forfeiture: Before shares can be forfeited, the company must serve a notice on the defaulting shareholder requiring payment of unpaid call together with any interest which may have accrued. (Article 29: Table A).
3. Give not less than 14 days time from the date of service of notice for the payment of the amount due;
4. State that in the event of non-payment of the amount due within the period mentioned in the notice, the shares in respect of which the call was made will be liable to be forfeited, (article 30. Table A). The notice of forfeiture must also specify the exact amount due from the shareholder. If the notice is defective in any respect, the forfeiture will be invalid.
5. Resolution of the Board: If a defaulting shareholder does not pay the amount within the specified time as required by the notice, the directors must pass a resolution forfeiting the shares (Article 31). If tins resolution is not passed, the forfeiture is invalid. If, however, the notice threatening the forfeiture incorporates the resolution of forfeiture as well, e.g., when it states that in the event of default the shares shall be deemed to have been forfeited, no further resolution is necessary.

6. Good faith: The power to forfeit shares must be exercised by the directors in good faith and for the benefit of the company.

Effect of forfeiture*:*

1. Cessation of membership: A person whose shares have been forfeited ceases to be a member in respect of the shares so forfeited. He, however, remains liable to pay to the company all moneys which, at the date of forfeiture were payable by him to the company in respect of the shares.
2. Cessation of liability: The liability of the person whose shares have been forfeited ceases if and when the company receives payment in full of all such money in respect of the shares,
3. If a company is wound up more than 1 year after the forfeiture, the member whose shares have been forfeited cannot be held liable as a contributory.
4. Forfeited shares become the property of the company and may be reissued or otherwise disposed of on such terms and in such manner as the Board thinks fit. The purchaser would be liable to pay all the calls due on the shares including the call for which shares were forfeited. But where the articles provide that a shareholder whose shares have been forfeited is to remain liable for the call occasioning the forfeiture, the purchaser is liable only for the difference between the amount of the call and the sum realized on reissue, should this be less than the call.

Question 36

What are the conditions and procedure whereunder shares may be forfeited under the Companies Act, 1956?

Answer

Procedure and Conditions for Effecting Forfeiture:

Shares can be forfeited if the following conditions are fulfilled:-

(1) Shares can be forfeited only if authorised by Articles of Association of the Company. Ordinarily forfeiture of shares can take place only for the non-payment of calls due to company and in such cases, calls must have been validly made. But articles may provide other grounds for forfeiture. *(Naresh Chandra Sanyal V. Calcutta Stock Exchange Association Ltd.)*

(2) Forfeiture is in the nature of penal proceedings. It is valid if only if the provisions of the Articles are strictly complied with.

(3) The power of forfeiture must be exercised bonafide, in the interests of the company.

Procedure

The procedure to be followed is laid down in Table A of Schedule I to the Companies Act. Articles of a company, usually, contain similar provisions. The procedure to be followed is narrated below.

(1) The company must serve a notice on the defaulting shareholder requiring payment of the unpaid call together with any interest which may have accrued (Articles 29 of Table A).

(2) The notice must -

   (a) give not less than 14 days time from the date of service of notice for the payment of the amount due.

   (b) state that in the event of non-payment of the amount due within the period mentioned in the notice, the shares in respect of which the call was made will be liable to be forfeited (Article 30 of Table A).

   The notice of forfeiture must also specify the exact amount due from the shareholder. If the notice is defective in any respect e.g. where it does not specify the amount claimed by the company, or where it claims a wrong amount, the forfeiture will be invalid.

(3) If the defaulting share holder does not make the payment of amount within the specified time as required by the notice, the directors must pass a resolution forfeiting the shares (Article 31 of Table A).

Debentures

Question 37

What is a Debenture Certificate? When and within what time it should be issued? Is there any penalty for the delay or default in the issue of such certificate?

Answer

Meaning of Debenture Certificate: Debenture Certificate is an acknowledgement by a company that the certificate holder is a creditor of the company to the extent of the number of debentures multiplied by the face value of each debenture. Thus, if the certificate states 100 debentures of ₹100/- each, then the person having the certificate is entitled to get R.s.10,000/- from the company at the time of the redemption of such debentures by the company.

Thus, this certificate entitled the holder to get repayment of principal sum at the appointed date and the payment of interest at a fixed rate. This certificate is issued by the company to the Debenture Holders of the company. The debentures are issued under the common seal of the company.

Debenture certificate is to be issued within three months of the allotment of debentures or debenture stock and within two months after the application for registration of the transfer of any such debentures or debenture stock, deliver the certificates of all debentures and

debenture stock allotted or transferred in accordance with the procedure laid down in Section 53 of the Companies Act, 1956.

The C.L.B. (Now Central Government) is empowered to extend the period within which the debenture certificate may he delivered to a further period not exceeding nine months, if it is satisfied that it is not possible for the company to deliver the certificates within the said period,

Penalty: Where the default is made in the delivery of debenture certificate within the specified time, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years and the company and every officer of the company who is in default shall be punishable with the fine which may extend to ₹ 5000 per day of default.

If a company on which a notice has been served requiring it to make good the default fails to do so within 10 days of the service of the notice, the CLB (Central Government) may on an application made by the aggrieved person, make an order directing the company and any officer of the company to deliver the securities within the period mentioned in the order. The order may provide that all costs incidental to the application shall be borne by the company or by the officer of the company responsible for the default.

Question 38

Explain the meaning and significance of the 'Pari Passu' clause in a debenture. State the particulars to be filed with the Registrar of Companies in case of such debentures secured by a charge on certain assets of the company.

Answer

'Pari Passu': *Pari Passu* clause in a debenture means that all the debentures of the series are to be paid rateably, if, therefore, security is insufficient to satisfy the whole debts secured by the series of debentures, the amounts of debentures will abate proportionately. If the clause is not made a use of then the debentures rank in accordance with the date of issue, and if they are all issued on the same date they will be payable according to their numerical order. A company, however, cannot issue a new series of debentures so as to rank *'pari passu'* with prior series unless the power to do so is expressly reserved and contained in the

Registration: In the event of the *'pari passu'* clause being included in the debentures secured debenture deed of the previous series by a charge, it is enough if the following particulars are filed with the Registrar of Companies within 30 days after the execution of the deed containing the charges or where there is no deed after the, execution of debentures of the series:

(i) the total amount secured by the whole series;
(ii) the dates of the resolutions authorising the issue of the series;
(iii) the date of deed, if any, by which security is created;
(iv) a general description of the property charged; and
(v) the name of the trustees for debenture holders, if any, together with the deed containing the charge or a certified copy of the deed or, if there is no deed, one of the debentures of the series (Section 128).

Where more than one issue is made of debentures in the series, particulars of the date and the amount of each issue must be filed with the Registrar. But an omission to do so will not affect the validity of the debentures issued.

Question 39

State the types of debentures which may be issued by a public company.

Answer

Types of debentures:

Different types of debentures may be enumerated as follows:

(i) *Naked or unsecured debentures:* Such debentures do not carry any charge on the assets of the company. The holders of these debentures do not have any security as to repayment of principal or interest thereon.

(ii) *Secured debentures:* Such debentures are secured by a mortgage of the whole or part of the assets of the company and known as mortgaged or secured debentures.

(iii) *Redeemable debentures:* Debentures that are redeemable at the expiry of a certain period are known as redeemable debentures. Such redeemable debentures may be reissued again under section 121 of the Companies Act, 1956.

(iv) *Perpetual debentures:* Where the debentures are redeemed on the happening of specified events which may not happen for an indefinite period e.g. winding up, they are known as perpetual debentures.

(v) *Bearer Debentures:* These Debentures are payable to a bearer and are transferred by delivery and no stamp duty is payable on transfer. The Debenture holder is not registered in the stock of the company but is entitled to claim interest and repayment of principle. A bonafide transferee for value is not affected by the defect in the title of the transfer.

(vi) *Registered Debentures:* The debentures are payable to registered holder. A registered holder is one whose name appears on the debenture certificate/ letter of allotment and is registered on the company's register of debenture holders maintained under section 152 of the Companies Act, 1956.

Company may also issue convertible debentures which may be classified as:

(a) Fully Convertible Debentures

(b) Non Convertible Debentures

(c) Partly Convertible Debentures

Convertible debentures may be converted into equity share capital.

Question 40

Distinguish between Fully Convertible Debentures and Partly Convertible Debentures.

Answer

Distinction between fully convertible and partly convertible debentures:

Convertible debentures can be fully or partly convertible. The major points of distinction between fully and partly convertible debentures are highlighted below:

	Features	*Fully convertible debentures*	*Partly convertible*
(*i*)	Classification for debt equity ratio computation	Classified as equity for debt equity for computation.	Convertible portion classified as 'equity' and non-convertible portion a 'debt'.
(*ii*)	Flexibility in financing	Highly favourable debt equity ratio.	Favourable debt equity ratio.
(*iii*)	Capital base	Higher equity capital on conversion of debentures.	Relatively lower equity capital on conversion of debentures.
(*iv*)	Suitability	Better suited for companies without established track record.	Better suited for companies with established track record.
(*v*)	Servicing of equity	Higher burden of servicing of equity.	Relatively lesser burden of equity servicing.
(*vi*)	Debenture redemption reserve	Not required.	Required to be created for 50% of the face value of the non-convertible portion.
(*vii*)	Buyback arrangements	Not required.	Arrangement may be made buyback of the non-convertible portion of the debentures.
(*viii*)	Popularity	Highly popular with investors.	Not so popular with investors.

Question 41

What are the provisions of the Companies Act, 1956 relating to the appointment of 'Debenture Trustee' by a company? Whether the following can be appointed as 'Debenture Trustee':

(i) A shareholder who has no beneficial interest.

(ii) A creditor whom the company owes ₹499 only.

(iii) A person who has given a guarantee for repayment of amount of debentures issued by the company.

Answer

Appointment of Debenture Trustee: Section 117 B as introduced by the Companies (Amendment) Act, 2000 deals with the appointment and duties of debenture trustees. It is now provided that before issue of prospectus or letter of offer for the debentures, the company should appoint one or more debenture trustees and disclose their names and also state that they have given their consent. It is also provided that (i) a shareholder who has beneficial interest in shares (ii) creditor or (iii) a person who has given guarantee for repayment of principal and interest in respect of the debentures cannot be appointed as a debenture trustee.

Thus based on the above provisions answers to the given questions are:

(i) A shareholder who has no beneficial interest can be appointed as a debenture trustee.

(ii) A creditor whom company owes ₹499 cannot be so appointed. The amount owed is immaterial.

(iii) A person who has given guarantee for repayment of principal and interest thereon in respect of debentures also cannot be appointed as a debenture trustee.

Question 42

Explain briefly the distinction between shares and debentures and state whether a company can issue debentures with voting rights.

Answer

The distinction between a share and a debenture is as under:

(i) Shares are a part of the capital of a company whereas debentures constitute a loan.
(ii) The shareholders are the owners of the company whereas debenture holders are creditors.
(iii) Shareholders generally enjoy voting right whereas debenture holders do not have any voting right.
(iv) Interest on debentures is payable even if there are no profits. Dividend can be paid to shareholders only out of the profits of the company.
(v) Debentures have generally a charge on the assets of the company but shares do not carry any such charge.
(vi) The rate of interest is fixed in the case of debentures whereas on equity shares the dividend may vary from year to year.
(vii) Debentures get priority over shares in the matter of repayment in the event of liquidation of the company.

Issue of Debentures with voting rights: No company can issue any debentures carrying voting rights at any meeting (i.e., members' general meeting) of the company, whether

generally or in respect of any particular class of shares (Section 117). This provision applies to debentures issued after the commencement of the Companies Act (Section 117 of 1956 Act).

Question 43

State with reasons whether the following statements are correct or incorrect

Issue of debentures with voting rights is not permissible.

Answer

Correct

Reason: As given under Section 117 of the Companies Act, 1956, no company can issue any debentures carrying voting rights at any meeting of the company, whether generally or in respect of any particular classes of business.

Registration of charge

Question 44

What do you understand by the term 'Charge'? State the list of charges which are required to be filed for Registration with the Registrar of Companies.

Answer

The word "Charge" has not been adequately defined in the Companies Act, 1956. Section *124 of* the Companies Act, 1956 provides that the expression "charge" shall include a mortgage. The meaning of the term, is not clearly explained here too. However, it can be understood that where in a transaction for value, both parties evidence the intention that -property existing or future shall be made available as security for the payment of a debt and that the creditor/mortgage shall have a present right to have it made available, there is a charge.

The conditions of borrowing as they normally do, confer charge on the company's assets (movables as well as immovables). It is thus important to those who are dealing with the company to know how much of its assets are subjected to charges which encumber company's property(ies) without actually delivering possession thereof to be filed and registered on the file of the company at the office of the registry i.e. the Registrar of the Companies concerned.

List of charges to be registered:

1. a charge to secure any issue of debentures.
2. a charge on an uncalled share capital of the company.
3. a charge on an immovable property, wherever situated or any interest therein.
4. a charge on book-debts of the company.
5. a charge, not being a pledge on any movable property of the company.
6. a charge on calls made but not paid.

7. a charge on goodwill on a patent or a copyright.
8. a floating charge on the undertaking or any property of the company including stock-in-trade.
9. a charge on a share or every share in ship.

Question 45

Is registration of a charge compulsory? If not, what are the effects of non-registration?

Answer

It is important for those dealing with the company to know how much of its assets are subjected to charges or actually charged or to be charged are not. To this end, Sections 125 and 134 contains provisions relating to registration of certain charges and duty of the company as regards registration. The expression charge created implies only charges founded on a contract or intended to be covered. Where a charge is created by an order of the court it will not require registration since it is not created by the company.

Section 125 lists out certain charges which must be registered with the Registrar of Companies within 30 days after the date of creation. As to who should effect registration of charges, it is the primary duty of the company to file with the Registrar for registration the particulars of every issue of debenture of a series requiring registration. Individual creditors have no right to challenge a charge on the grounds of non-registration. This was decided in *Ayala Holdings Ltd. 1996 BCLC 250.*

The consequences of non-registration of a charge are:

(1) It shall be void as against the subsequent encumbrancers as well as against the liquidator and the creditor.

(2) When a charge becomes void under section 125, the money secured thereby shall become immediately payable.

(3) When a charge becomes void for non-registration, no right of lien can be claimed on the documents of title as they are only ancillary to, and were delivered pursuant to the charge

(4) default is made in filing with the registrar for registration the particulars of any charge created by the company or on satisfaction of a debt which has been charged or issue of debentures which requires registration, then unless registration has been effected on the application of some other person, the company and every officer of the company who is in default shall be punishable with fine.

(5) The holder of an equitable charge whose charge is void on account of non-registration has no lien on the title deeds or documents deposited with him

Question 46

State with reason, whether the following statement is correct or incorrect, according to the Companies Act, 1956.

If a register able charge is not registered, the debt is not recoverable.

Answer

Incorrect. If any charge required to be registered is not so registered, it is void as against subsequent encumbrances as well as against the liquidator and creditors. This does not mean that the debt is not recoverable. So long as the company does not go into liquidation, the mortgage or charge is good and may be enforced.

Question 47

ABC Limited realised on 2nd May, 2010 that particulars of charge created on 12th March, 2010 in favour of a Bank were not filed with the Register of Companies for Registration, What procedure should the Company follow to get the charge registered with the Registrar of Companies? Would the procedure be different if the charge was created on 12th February, 2010 instead of 12th March, 2010? Explain with reference to the relevant provisions of the Companies Act, 1956.

Answer

Registration of charge: The prescribed particulars of the charge together with the instrument, if any by which the charge is created or evidenced, or a copy thereof shall be filed with the Registrar within 30 days after the date of the creation of charge. [Section 125 (1)]. In this case particulars of charge have not been filed within the prescribed period of 30 days.

However, the Registrar is empowered under proviso to section 125 (1) to extend the period of 30 days by another 30 days on payment of such additional fee not exceeding 10 times the amount of fee specified on Schedule X as the Registrar may determine. Taking advantage of this provision, ABC Ltd., should immediately file the particulars of charge with the Registrar and satisfy the Registrar that it had sufficient cause, for not filing the particulars of charge within 30 days of creation of charge.

If the charge was created on 12th Feb., 2010, then the company has to apply to the Company Law Board (Now tribunal) under Section 141 and seek extension of time for filing the particulars for registration. The company must satisfy the Company Law Board (Now tribunal) (a) that the omission was accidental or due to inadvertence or due to some other sufficient cause or was not of the nature to prejudice the position of creditors or shareholders of the company, or that it is just and equitable to grant relief on the other grounds. On such satisfaction, the Company *Law* Board (Now tribunal) may extend the term for the registration of charge or; such terms and conditions as it may think expedient. Once the time is extended and it is made out that the particulars have been filed within the extended time, the registrar is bound to register the charge.

Question 48

A charge requiring registration with Registrar of Companies was created on 1st February, 2008 by XYZ Limited. The Secretary of the Company realised on 15th March, 2008 that the charge was not filed with the Registrar. State the steps to be taken by the Secretary to get the charge registered with the Registrar.

Answer

Registration of Charge: Steps for belated registration (Section 125 of the Companies Act, 1956): A charge should be registered within 30 days after the date of its creation. In this case the charge was created on 1st Feb, 2008. Hence the particulars of charge are required to be filed with the Registrar on or before 2nd March, 2008 [Section 125 (11)]. The Secretary of the company realised only on 15th March, 2008 that the charge was not filed with the Registrar. It is, however, open to the Registrar to allow the particulars of the charge to be filed within 30 days next following the expiry of the period of 30 days if the company satisfies the Registrar that it had sufficient cause for not filling the particulars within 30 days. [Proviso to Section 125(1)]. The Secretary may take advantage of this provision and immediately file the particulars of charge with the Registrar giving adequate reasons for the delay. If the Registrar is satisfied, he may allow registration on payment of additional fee.

Question 49

What is the concept of "charge" under the provisions of the Companies Act, 1956? Point out the circumstances where under a floating charge becomes a fixed charge.

Answer

Meaning of Charge: The word 'charge' has not been adequately defined in the Companies Act, 1956 except that Section 124 provides that the expression charge shall include a mortgage. However, it can be understood that where in transaction for value, both parties' evidence the intention that property existing or future shall be made available as security for the payment of a debt and that the creditor/mortgage shall have a present right to have it made available, there is a charge.

The conditions of borrowing, as they normally do confer charge on the company's assets (movables as well as immovables). It is thus important for those dealing with the company to know how much of its assets are subjected to charges or actually charged. To this end, Section 125 of the Act contain provisions whereby particulars of charges which encumber company's properties without actually delivering possession thereof to be filed and registered on the company's file at the office of the registry i.e. Registrar of Companies.

Under Section 125 of the Act certain charges are required to be registered with the Registrar of Companies. If any of these charges are not registered, then the unregistered charge shall be void against the liquidators and creditors of the company. *(Monolithic Building (Co.).* The money secured thereby becomes immediately payable. [Section 125(3)].

Crystallisation of a Floating Charge

Floating charge crystallizes under the following circumstances:

1. When the company goes into liquidation, or
2. When the company ceases to carry on business, or
3. When a receiver is appointed, or
4. When default is made in paying the principal and/or interest and the holder of the charge brings an action to enforce his security.

Question 50

Distinguish between "fixed Charge" and "Floating charge".

Answer

Distinction between fixed charge and floating charge:

	Fixed charge		Floating charge
1.	It is a legal charge.	1.	It is an equitable charge.
2.	It is a charge on specific, ascertained and existing asset.	2.	It is a charge on present and future assets. No specific assets.
3.	Company cannot deal with the assets except with the consent of the charge holder.	3.	Company is free to use or deal with the assets the way it likes until the charge becomes fixed.
4.	Registration of fixed charge on movable assets is not compulsory.	4.	Registration of all floating charge on all kinds of assets is compulsory by law.
5.	Fixed charge has always priority over floating charge.	5.	Ambulatory and shifting in character.

Question 51

What is meant by a floating charge? State the characteristics of a floating charge. When does a floating charge crystallise?

Answer

Floating charge: A floating charge is an equitable charge which is not a specific charge on any property of the company. Thus, the company may, despite the charge, deal with any of the assets in the ordinary course of business. It is of the essence of a floating charge that it remains dormant until the undertaking charged ceases to be a going concern or until the person in whose favour the charge is created, intervenes.

The main characteristics of a floating charge as described in *Re. Yorkshire wool combers Association* are as follows:

(i) It is a charge on a class of the company's assets, present and future, that class being one which, in the ordinary course of the business is changing from time to time.

(ii) Generally, it is contemplated that the company carry on its business in an ordinary way with such a class of assets till some event occurs on which the charge is to settle down on the property as then existing and the charge becomes fixed. The moment the charge crystallises, it becomes a fixed charge.

A floating charge crystallises or gets fixed when:

(i) The company goes into liquidation or

(ii) The company ceases to carry on business

(iii) A receiver is appointed or

(iv) A default is made in paying the principal and/ or interest and the holder of the charge brings an action to enforce his security.

Question 52

While sanctioning working limit, the rate of interest had been fixed at a specified percentage above the bank rate as notified by the Reserve Bank of India. There was a change in the interest rate due to Reserve Bank of India notification issued later. The Bank insisted on filing a return of modification of charges. Is the stand of the bank correct? Discuss in the light of the provisions of the Companies Act, 1956.

Answer

Section 135 of the Companies Act, 1956 provides that "whenever the terms or conditions or the extent or operation of any charge registered under this part are or is modified, it shall be the duty of the company to send to the Registrar the particulars of such modifications and the provisions of this part as to registration of a charge shall apply to modification of the charge."

Here the term modification includes variation of any terms of the agreement including variation of rate of interest (other than bank rate), which may be by mutual agreement or by operation of law. In the light of the above, the change in the rate of interest constitutes modification. Therefore the stand of the bank is correct.

Question 53

Explain briefly the provisions relating to registration, modification and satisfaction of charges.

Answer

Registration of charges: The word 'charge' has not been adequately defined in the Companies Act, 1956 except that Section 124 provides that the expression charge shall include a mortgage.

It is important for those dealing with the company to know how much of its assets are subjected to charges or actually charged. To this end, Section 125 of the Act contain

provisions whereby particulars of charges which encumber company's property(ies) without actually delivering possession thereof to be filed and registered on the company's file at the office of the registry i.e. the Registrar of the companies concerned.

The following is a list of such charges:

(a) A charge to secure any issue of debentures.

(b) A charge on an uncalled share capital of the company.

(c) A charge on an immovable property, wherever situation or any interest therein.

(d) A charge on book debts of the company.

(e) A charge, not being a pledge on any movable property, of the company.

(f) A floating charge on the undertaking or any property of the company including stock-in-trade

(g) A charge on calls made but not paid.

(h) A charge on a ship or any share in a ship,

(i) A charge on goodwill or a patent or a copyright.

Modification of charge: The term 'modification' includes variation of any of the terms of the agreement including variation of rate of interest which may be by mutual agreement or by operation of law. Even if the rights of a charge holder are assigned to a third party, it will be regarded as a modification.

Modification constitutes:

1. where the charge is modified by varying any terms and conditions of the existing charge by agreement;
2. where the modification is in pursuance of an agreement for enhancing or decreasing the limits;
3. where the modification is by ceding a pari passu charge;
4. change in rate of interest (other than bank rate);
5. change in repayment schedule of loan; (this is not applicable in working loans which are repayable on demand) and
6. partial release of the charge on a particular asset or property.

Satisfaction of charge: Whenever any charge is created by a company and registered with the Registrar at the instance of the company or the charge holder and is satisfied in full, the company shall be given an intimation thereof to the Registrar as to the payment and satisfaction in full of the said charge within 30 days from the date of such payment or satisfaction, upon which the Registrar will send a notice to the holder of the charge to show cause why payment or satisfaction, as notified by the company should not be recorded. The

best procedure for notifying satisfaction of the charge to the Registrar by the company is to attach with the form (Form No. 17) a certified copy of the charge holder's letter confirming the date of the satisfaction of the charge.

Part payment or satisfaction of charge need not be intimated to the Registrar; only satisfaction in full has to be reported within 30 days from the date of such payment of satisfaction.

EXERCISE

1. *XYZ Limited realised on 3rd May, 2010 that particulars of charge created on 11th July, 2010 in favour of a bank were not filed with the Registrar of Companies for registration. What procedure should the company follow to get the charge registered with the Registrar of Companies? Would the procedure be different if the charge was created on 11th June, 2010 instead of 11th July, 2010? Explain with reference to the relevant provisions of the Companies Act, 1956.*

   [Hints: As per the provisions given under Sections 125(1) and 141 of the Companies Act, 1956]

2. *X had applied for the allotment of 1,000 shares in a company. No allotment of shares was made to him by the company. Later on, without any further application from X, the company transferred 1,000 partly-paid shares to him and placed his name in the Register of Members. X, knowing that his name was placed in the Register of Members, took no steps to get his name removed from the Register of members. The company later on made final call. X refuses to pay for this call. Referring to the provisions of the Companies Act, 1956, examine whether his (X's) refusal to pay for the call is tenable and whether he can escape himself from the liability as a member of the company.*

   [Hints: X is liable as a shareholder, as per the provision laid down in Section 164 of the Companies Act, 1956]

3. *State whether the following statements are correct or incorrect. Give reasons:*

   (i) Right shares means shares which are issued by a newly formed company.

   (ii) A bearer of a share warrant of a company is not member of the company.

   (iii) Debenture with voting rights can be issued only if permitted by the Articles of Association.

   [Hints: (i) incorrect, as per Section 81 of the Companies Act, 1956 (ii) Correct, as per Section 115 of the Companies Act, 1956 (iii) incorrect, as per Section 117 of the Companies Act,1956]

4. *Under what circumstances a company need not hold investments in shares of other companies in its own name?*

   [Hints: Section 69 of the companies Act, 1956 lays down the circumstances where a company need not hold investments in shares of other companies in its own name]

5. *X purchased 100 equity shares of ABC ltd. from Y. Though the amount of transaction was paid to the seller, the transferee name is not appearing in the list of members. Subsequently, the company declared dividend. Referring to the provisions of the Companies Act, 1956 state to whom the company will be paying the dividend*

[Hints: According to section 206 of the Companies Act, 1956 dividend shall be paid only to the registered holder of shares or to his order or to his bankers or to the bearer of a share warrant.]

6. *T, a share broker at Bombay Stock Exchange, is also the Secretary of XYZ Ltd. He applied for the allotment of 1000 equity shares being issued by the Company and paid the full amount. M, one of the clerks of T, owning no shares executed a transfer deed in favour of T without enclosing the share certificate. The Company without asking for the share certificate from M (the clerk) registered the transfer and issued a new share certificate. On declaration of dividend by the Company T was denied the right to get dividend on the grounds that the share certificate issued to T had no validity. T moves the Court praying the Court to declare the share certificate as valid and also claims for damages.*

Examine the case and decide whether T's claim is valid.

[Hints: T's claim is valid and the Company would be estopped from denying the validity of the share certificate]

7. *State whether the given statements are true or false with reasons-*

(i) Deferred shares also called founders' shares.

(ii) To authorise the issue of shares at a discount, a special resolution is required.

[Hints: (i) True. Since deferred shares are often held by the promoters of the company, they are called so.

(ii) False, as per Section 79 of the Companies Act, 1956]

UNIT – 4: MEETINGS AND PROCEEDINGS

Classification of Meetings

Question 1

What are the different types of meetings, under Companies Act, 1956.

Answer

Types of Meetings under Companies Act, 1956:

1. Meetings of shareholders or members:
   (a) Statutory meeting.
   (b) Annual general meeting.
   (c) Extraordinary general meeting.
   (d) Class meetings.
2. Meeting of debenture holders.
3. Meetings of creditors and contributories in winding up.
4. Meeting of creditors otherwise than in winding up.
5. Meeting of directors:
   (a) Board meeting.
   (b) Committee meeting.

Meeting of Shareholders

Question 2

Explain the statutory meeting.

Answer

Statutory Meeting (Section 165): Every public company limited by shares or limited by guarantee and having a share capital must hold a general meeting of the members of the company which may be called the statutory meeting. It is to be convened after not less than one month but within six months from the date which the company is entitled to commence business (sub-section 1).

A meeting held prior to statutory period of one month is not a statutory meeting. The notice for such a meeting must say that it is intended to be statutory meeting *[Gardner Vs. Iredel (1912) I Ch.700]*.

Question 3

Enumerate the particulars to be included in the Statutory Report.

Answer

Statutory Report: The eight particulars to be set out in the statutory report are contained in sub-section (3) of Section 165. These are:

(a) the number of shares allotted, distinguishing fully or partly paid up, otherwise than for cash and stating the extent to which the partly paid up shares have been paid and the consideration for which they have been allotted;

(b) the total amount of cash received on account of shares allotted;

(c) an abstract of receipts and payments up to the date within 7 days of the date of report, exhibiting under distinctive headings the receipts of the company from shares and debentures and other sources, the payment made thereout and particulars concerning the balance remaining in hand and an account or estimate of the preliminary expenses of the company, showing separately any commission or discount paid or to be paid on the issue or sale of shares or debentures;

(d) the names addresses and occupations of the directors and auditors, manager and secretary, if any, and any changes therein, if occurred, since the date of the company's incorporation;

(e) the particulars of any contract or modifications thereof to be submitted to the meeting for its approval;

(f) the extent of non-carrying of each underwriting contract together with the reason therefore;

(g) the arrears due on calls from every director and manager; and

(h) particulars of commission or brokerage paid or to be paid to any director for manager in connection with the issue or sale of shares or debentures.

The report aforesaid must be certified as correct by at least two directors, one of whom should be the managing director, if there be any. The auditors should also certify it to be correct insofar as the report relates to shares allotted by the company, cash received in respect thereof and receipts and payments on revenue as well as on capital account of the company.

Question 4

The Registrar of Companies on examining the statutory report filed with him by M/s Jyothi Company Ltd., finds that the report has been certified as correct, by all the directors of the Company, except the Managing Director. The Registrar refuses to register the said document on the ground that it was not signed by the Managing Director of the Company.

Answer the following in the light of the Companies Act, 1956:

(i) Whether the Registrar of Companies can hold the officers of the Company liable?

(ii) What provisions of the Companies Act have not been complied with by the company and its officers?

(iii) To what penalties are the Company and its officers liable?

Answer

Filing Report without Signature:

(i) Yes, the Registrar can hold the officers of the company liable.

(ii) Section 165(4) of the Companies Act, 1956 requires the statutory report to be certified as correct by at least two directors of the company one of whom must be a managing director, where there is one. Thus, the aforesaid provision of Section 165(4) has not been complied with.

Sub-Section (9) of Section 165 provides for penalties for non-compliance of Sub-section (4). It makes every director or other officer of the Company who is in default punishable with fine upto ₹5,000/-.

Question 5

State with reason, whether the following statement is correct or incorrect, according to the Companies Act, 1956.

The statutory meeting is required to be held by all companies.

Answer

Incorrect. According to Section 165 of the Companies Act, 156 only Public Ltd. Company with a share capital must hold Statutory Meeting. Private Companies and Government Companies are not required to hold such a Meeting.

Question 6

State with reasons whether the following statements are correct or incorrect

A private company is required to hold the statutory meeting.

Answer

Incorrect: Reason: As given under Section 165 of the Companies Act, 1956 every public company limited by shares or limited by guarantee and having a share capital must hold a general meeting of the members of the company, which may be called the statutory meeting. Thus private companies and Government companies are not required to hold such a meeting.

Annual General Meeting

Question 7

In what way does the Companies Act, 1956 regulate the holding of an Annual General Meeting by a public limited company? Explain.

Answer

Provision relating to – regulation of AGM under the Companies Act, 1956: Section 166 of the Companies Act, 1956 regulates the holding of an Annual General Meeting by a public limited company. Accordingly, section provided that:

1. Every company shall in each year hold in addition to any other general meeting an annual general meeting and shall specify the meeting as such in the notices calling it; and not more than 15 months shall elapse between the date of one annual AGM of a company and that of the next. A company may hold its first AGM within a period of not more than 18 months from the date of its incorporation; and if such general meeting is held within that period, it shall not be necessary for the company to hold any AGM in the year of its incorporation or in the following year. However, the Registrar may, for any special reason, extend the time within which any AGM (not being the first AGM) shall be held, by a period not exceeding 3 months.

2. Every AGM shall be called for a time during business, on a day that is not a public holiday, and shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situate.

   The Central Government may exempt any class of companies from the provisions of this sub-section subject to such conditions as it may impose. Further, a public company or a private company which is a subsidiary of a public company, may by its articles fix the time for its AGM and may also by a resolution passed in one AGM fix the time for its subsequent AGMs

Section 167 provides that:

(1) If default is made in holding an AGM in accordance with Section 166, the CLB may, notwithstanding anything in the Act or in the articles of the company, on the application of any member of the company, call, or direct the calling of, a general meeting of the company and give such ancillary or consequential directions as the CLB thinks expedient in relation to the calling, holding and conducting of the meeting.

(2) A general meeting held in pursuance of sub-section (1) shall, subject to any directions of the CLB, be deemed to be an AGM of the company.

   Further, Section 168 provides that if default is made in holding a meeting of the company in accordance with Section 166, or in complying with any directions of the Central Govt. under sub-section (1) of Section 167, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to ₹50,000 and in the case of *a* continuing default, with a further fine which may extent to ₹2,500 for every day after the first during which such default continues.

Question 8

Explain the provisions of the Companies Act, 1956 relating to holding of Annual General Meeting of the Company with regard to the following:

(i) Period within which the first and the subsequent Annual General Meetings must be held.

(ii) Business which may be transacted at an Annual General Meeting.

Answer

Annual General Meeting provisions under the Companies Act, 1956:

(i) Period Within which first and the subsequent AGM must be held:

(a) In accordance with the provisions of the Companies Act, 1956 as contained in incorporation, and so long as the company hold its first annual general meeting within that period, the company need not hold any general meeting in the year of incorporation or in the following year (First proviso to Section 166(1). Further, the date of the first AGM must be within 9 months from the date of the financial year for which profit and loss account has been made,

(b) Any subsequent AGM must be held not later than 6 months from the close of the financial year of the company. The gap between the two consecutive AGMs must not be more than 15 months [Section 166(1)]. Further the second proviso to Section 166(1) states that the Registrar may, for any special reason, extend the time within which any AGM (not being the first AGM) shall be held by a period not exceeding 3 months.

(ii) Business to be transacted at an Annual General Meeting: The following two businesses may be transacted at an annual general meeting:

1. Ordinary Business; Viz.
   (a) Consideration of Annual Accounts, Directors Report etc.
   (b) Declaration of Dividend.
   (c) Election of Directors.
   (d) Appointment of auditors and fixation of their remuneration.
2. Special Business: Any business other than above 4 shall be special business, which may be transacted at any AGM.

Question 9

M/s Low Esteem Infotech Ltd. was incorporated on 1.4.2003. No General Meeting of the company has been held so far. Explain the provisions of the Companies Act, 1956 regarding the time limit for holding the first annual general meeting of the Company and the power of the Registrar to grant extension of time for the First Annual General Meeting.

Answer

According to Section 166 of the Companies Act, 1956, every company shall hold its first annual general meeting within a period of 18 months from the date of incorporation. Since M/s Low Esteem Infotech Ltd was incorporated on 1.4.2003, the first annual general meeting of the company should be held on or before 30th September, 2004. Even though the Registrar of Companies is empowered to grant extension of time for a period not exceeding 3 months for

holding the annual general meeting, such a power is not available to the Registrar in the case of the first annual general meeting. Thus, the company and its directors will be liable for the default if the annual general meeting was held after 30th September. 2004.

Question 10

Can an annual general meeting be held on a public holiday?

Answer

An annual general meeting cannot be held on a public holiday. A public holiday has been defined in Section 2(38) as a public holiday within the meaning of the Negotiable Instruments Act, 1881. Explanation to Section 25 of Negotiable Instruments Act, 1881 states that the expression 'public holiday' includes Sundays and any other day declared by the Central Government, by notification in the official Gazette, to be a public holiday. A day may be declared to be a public holiday after the notices calling the meeting for the day have already been issued. To avoid the difficulties that may be caused from such a situation, Section 2(38) provides that no day declared by the Central Government to be a public holiday shall be deemed to be such a holiday in relation to any meeting, unless the declaration was notified before the issue of the notice convening such meeting.

Question 11

State with reason whether the following statement is correct or incorrect:

A company should file its annual return within six months of the closing of the financial year.

Answer

Incorrect: Section 159 of the Companies Act, 1956 states that a company should file its annual return within sixty days from the date of holding the Annual General Meeting.

Extra ordinary General Meeting

Question 12

State the provisions of the Companies Act regarding calling and holding an extraordinary general meeting with respect to:

(i) Number of members entitled to requisition a meeting.

(ii) Power of the tribunal to order meeting to be called under Section 186.

Answer

(i) Number of members entitled to requisition an extraordinary general meeting:

(a) in the case of a company having a share capital, such number of members who hold at the date of requisition, not less than 1/10th of such of the paid up capital of the company as at that date carries the right of voting in regard to that matter;

(b) in the case of a company not having a share capital, such number of members who have at the date of deposit of requisition not less than 1/10th of the total voting power of all the members having at the said date a right to vote in regard

(ii) Power of Tribunal to order meeting to be called under Section 186:

If for any reason it is impractical to call a meeting, other than an annual general meeting, in any manner in which meetings of the company may be called, or hold or conduct the meeting of the company in the manner prescribed by the Act or the articles, the Tribunal may, either on its own motion or on the requisition of:

(a) Any director of the company or (b) of any member of the company who would be entitled to vote at the meeting:

(b) Order a meeting of the company to be called, held and conducted in such manner as the Tribunal thinks fit; and

(c) Give such ancillary or consequential directions as the Tribunal thinks expedient, including directions modifying, or supplementing in relation to the calling holding and conducting of the meeting, the operations of the provisions of the Companies Act, 1956 and of the company's articles. The Tribunal may give direction that one member present in person or by proxy shall be deemed to constitute a meeting with such order shall, for all purposes, be deemed to be a meeting of the company duly called, held and conducted.

Question 13

To remove the Managing Director, 40% members of Global Ltd. submitted requisition for holding extra-ordinary general meeting. The company failed to call the said meeting and hence the requisitionists held the meeting. Since the Managing Director did not allow the holding of meeting at the registered office of the Company, the said meeting was held at some other place and a resolution for removal of the Managing Director was passed.

Examine the validity of the said meeting and resolution passed therein in the light of the companies Act, 1956.

Answer

Extraordinary meeting: Every shareholder of a company has a right to requisition for an extraordinary general meeting. He is not bound to disclose the reasons for the resolution to be proposed at the meeting *[Life Insurance Corporation of India vs. Escorts Ltd., (1986) 59 Comp. Cas. 548].*

Section 169 of the companies Act contains provisions regarding holding of extraordinary general meetings. It provides that if directors fail to call a properly requisitioned meeting, the requisitionists or such of the requisitionists as represent not less than 1/10th of the total voting rights of all the members (or a majority of them) may call a meeting to be held on a date fixed within 3 months of the date of the requisition.

Where a meeting is called by the requisitionists and the registered office is not made available to them, it was decided in *R. Chettiar v. M. Chettiar* that the meeting may be held any where else.

Further, resolutions properly passed at such a meeting, are binding on the company.

Thus, in the given case, since all the above mentioned provisions are duly complied with. Hence the meeting with the resolution removing the managing director shall be valid.

Question 14

Examine the validity of the following with reference to the relevant provisions of the Companies Act, 1956:

(i) The Board of Directors of a company refuse to convene the extraordinary general meeting of the members on the ground that the requisitionists have not given reasons for the resolution proposed to be passed at the meeting.

(ii) The Board of Directors refuse to convene the extraordinary general meeting on the ground that the requisitions have not been signed by the joint holder of the shares.

(iii) Adjournment of extraordinary general meeting called upon the requisition of members on the ground that the quorum was not present at the meeting.

Answer

As per Section 169 of the Companies Act 1956, the Board of directors must convene a general meeting upon request or requisition if certain conditions are satisfied.

(i) The requisitions must state the objects of the meeting, i.e., it must set out the matters for the consideration of which the meeting is to be called [Section 169 (2)]. However, the requisitionists are under no obligation to attach the explanatory statement to the requisition. It is for the Board of directors, on receipt of the requisition, to include in the notice convening the meeting, the necessary explanatory statement (*Life Insurance Corporation of India v. Escorts Ltd. 1986.).*

In given problem (i) the Board of Directors may refuse to convene the meeting because reasons for the resolution is not given.

(ii) Where two or more persons hold any shares or interest in a company jointly, a requisition, or notice calling a meeting, signed by one or some of them shall, for the purposes of this section, have the same force and effect as if it had been signed by all of them [Section 169 (8)].

On the basis of above section the Board of Directors has no right to refuse to convene the meeting in the given problem (ii).

(iii) As per Section 147 of the Companies Act, 1956, if in a requisitioned meeting, there is no quorum present within half an hour, the meeting stands dissolved.

The stand taken by the Board of Directors is proper in the given problem (iii).

Question 15

40 out of 100 members of a company submitted a requisition for holding of an extra ordinary general meeting in order to remove Managing Director from office. On the failure of the company to call the meeting, the requisitionists themselves called the meeting at the registered office of the company. On the appointed day, they could not hold the meeting at the registered office as it was kept under lock and key by the Managing Director himself. The members held the meeting elsewhere and adopted a resolution removing the Managing Director from office. Is the resolution valid?

Answer

Section 169 of the Companies Act, 1956 contains provisions regarding holding of extra-ordinary general meetings. It provides that if directors fail to call a properly requisitioned meeting, the requisitionists or such of the requisitionists as represent not less than 1/10th of the total voting rights of all the members may call a meeting to be held on a date fixed within 3 months of the date of the requisition.

Where a meeting is called by the requisitionists and the registered office is not made available to them, it was decided in *R. Chettair v. M. Chettair* that the meeting may be held anywhere also.

Further, resolutions properly passed at such a meeting, are binding on the company.

Question 16

A scheme of amalgamation of XYZ Ltd. with ABC Ltd. was approved at statutory meeting of company XYZ Ltd. convened under Section 391 and the scheme was presented to the High Court for sanction. They exchange ratio of shares of company XYZ Ltd. for that of company ABC Ltd. was not to the satisfaction of XYZ Ltd.'s shareholders. Examine if the shareholders of XYZ Ltd. can requisition an EGM to ask their company to renegotiate with the other company. Can the High Court prevent the shareholders from discussing the terms of amalgamation?

Answer

It can be noted that the Court cannot prevent shareholders from requisitioning a meeting, discussing and passing a resolution, proposing a modification to an amalgamation scheme, even when the scheme is pending for sanction before Court. Thus, in *Pravin Kantilal Vakil Vs. Mrs. Rohini Ramesh Save (1985) Comp. Cas. 31 (Bom.)*, a scheme of amalgamation of company C with company B was approved at a statutory meeting convened under Section 391, after which the scheme was presented to the High Court for sanction. The scheme, inter alia, provided for exchange ratio of share of B for 5 shares of C. While the scheme was pending in the High Court, an extraordinary general meeting was requisitioned for the purpose of asking the company C to re-negotiate with B, as according to the requisitionists the ratio was not fair and equitable. The question was whether the Court could prevent the

shareholders from discussing the modification on the ground that the scheme of amalgamation was already pending before the Court.

Held that Section 392 gives vide powers to the Court to give such direction in regards to any modification in the compromise or arrangement as it may consider necessary for the proper working of the compromise or arrangement arrived at. Under the said Section 392 the Court even at the instance of any shareholder could consider any such modification in the scheme. In that event, a mere discussion by the shareholder at a properly requisitioned meeting about the proposed modification to the scheme pending before the Court for sanction and if approved passing a resolution to that effect would not by itself affect either the scheme or the Court's powers to consider the modification and sanction of the scheme with or without modification. Thus, the shareholders could requisition the meeting for proposing a modification to the scheme pending for sanction before the Court.

Therefore, the High Court cannot prevent the shareholders from discussing the terms of amalgamation.

Powers of Company Law Board/Tribunal

Question 17

What are the powers of the Company Law Board/Tribunal?

Answer

Powers of company law board/ Tribunal: *Guidance of Judicial Rulings:* The main principles that should guide the Tribunal as regards ordering meeting to be called were indicated in *re, Ruttonjee & Co. Ltd.(1968) 2 Comp. LJ 155 (1970) 40 Com. Cases 491 (Cal.):*

(i) The CLB/Tribunal would not ordinarily interfere with the domestic management of a company which should be conducted in accordance with the articles.

(ii) The discretion granted under Section 186 should be used sparingly with caution so that the CLB/Tribunal does not become either a shareholder or director of the company trying to participate in the internecine squabbles of the company.

(iii) The word impracticable means impracticable from a reasonable point of view.

(iv) The CLB/Tribunal should take a common sense view of the matter and must act as a prudent man of business.

(v) A prudent man of business has not a sensitive officious view of intervention in case of every rivalry between two groups of directors; prudence demands that the CLB/Tribunal should ordinarily keep itself aloof from participating in quarrels of rival groups of directors or shareholders.

(vi) But where the meeting can be called only by the directors and there are serious doubts and controversy as to who are directors or where these is a possibility that one or other or both the meetings called by the rival groups of directors may be invalid, the

CLB/Tribunal ought not to expose the shareholders to uncertainties and should hold a position has arisen which makes it .impracticable: to convene a meeting in any manner in which meeting of the company may be called.

(vii) Before the CLB/Tribunal exercise its discretion under Section 186, the CLB/Tribunal must be satisfied when a director or a member moves an application, that it has been made *bona fide* in the larger interests of the company for removing a deadlock otherwise irremovable.

Class Meeting

Question 18

What is a class meeting?

Answer

Class meetings: Meetings of members of a company fall into two broad divisions, namely, general meetings and class meetings. Class meetings are meeting of shareholders, holding a particular class of share which are held to pass resolution which will bind only the members of the class concerned. Only members of the class concerned may attend and vote at meeting. Usually the rules to voting apply to class meetings as they govern voting at general meetings. These class meetings must be convened whenever it is necessary to alter or change the rights or privileges of that class as provided by the articles. For effecting such changes, it is necessary that these are approved at a separate meeting of the holders of those shares and supported by a special resolution. Under Section 106, class meeting of the holders of different classes of shares shall be held if the rights attaching to these shares are to be varied. Similarly, under Section 394, where a scheme of arrangement is proposed, meeting of several classes of shareholders and creditors are required to be held.

Procedure for convening and conduct of General Meetings

Question 19

What are the requirements for the conduct of valid general meetings?

Answer

The business at a meeting is said to have been "validly transacted" if the members of the organisation or body concerned, whether or not they were present, are bound by the decision made threat. They cannot be so bound unless the meeting is validly held. The essentials of a valid meeting are that the meeting should be:

(a) *Properly convened:, i.e.* a proper notice must be sent by the proper authority to every person entitled to attend.

(b) *Properly constituted*, i.e. the proper person must be in the chair, the rules as to quorum must be observed, and the regulations governing the meeting must be complied with.

(c) *Properly conducted*, i.e. the chairman must conduct the proceeding in accordance with the law relating to general meetings as per the Companies Act 1956 (Sections 171 to 185), the Company's own Articles of Association or, where applicable, Table A (Regulations 47 to 63) or in the absence thereof in respect of any specific matter, by the common law relating to meetings.

Notice of Meeting

Question 20

Dinesh, a director in a company, gave in writing to the company that notice for any General Meeting and the Board of Directors' Meeting be sent to him at his address in India only by Registered Mail and for which he paid sufficient money. The company sent two notices to him, of such meetings, by ordinary mail, under certificate of posting. Dinesh did not receive the said notices and could not attend the meetings and the proceedings thereof on the ground of improper notice. Decide in the light of the provisions of the Companies Act, 1956:

(i) Whether the contention of Dinesh is valid?

(ii) Would you answer be still the same in case Dinesh remained outside India for two months (when such notices were given and meetings held).

Answer

Problem on notice and validity of proceedings of the meeting: The problem as asked in the question is based on the provisions of the Companies Act, 1956 as contained in Section 172 read with Section 53. Accordingly, the notice may be served personally or sent through post to the registered address of the members and, in the absence of any registered office in India, to the address, if there be any within India furnished by him to the company for the purpose of servicing notice to him. Service through post shall be deemed to have effected by correctly addressing, preparing and posting the notice. If, however, a member wants to notice to be served on him under a certificate or by registered post with or with acknowledgement due and has deposited money with the company to defray the incidental expenditure thereof, the notice must be served accordingly, otherwise service will not be deemed to have been effected.

Accordingly, the questions as asked may be answered as under:

(i) The contention of Dinesh shall be tenable, for the reason that the notice was not properly served and meetings held by the company shall be invalid.

(ii) In view of the provisions of the Companies Act, 1956, as contained in Section 172, the company is not bound to send notice to Dinesh at the address outside India. Therefore, answer in the second case shall differ from the first one.

Question 21

Dev Limited issued a notice for holding of its Annual General Meeting on 7th November, 2005. The notice was posted to the members on 16.10.2005. Some members of the company allege

that the company had not complied with the provisions of the Companies Act, 1956 with regard to the period of notice and as such the meeting was not validly called. Referring to the provisions of the Act, decide:

(i) Whether the meeting has been validly called?

(ii) If there is a short fall in the number of days by which the notice falls short of the statutory requirement, state and explain by how many days does the notice fall short of the statutory requirement?

(iii) Can the short fall, if any, be condoned?

Answer

(i) 21 Days clear notice of an AGM must be given [Section 171, Companies Act, 1956]: In case of notice by post, section 53(2) provides that the notice shall be deemed to have been received on expiry of 48 hours from the time of its posting. Besides, for working out clear 21 days, the day of the notice and the day of the meeting shall be excluded. Accordingly, 21 clear days notice has not been served (only 19 clear days notice is served) and the meeting is, therefore, not validly convened.

(ii) worked as per (i) above, notice falls short by 2 days.

(iii) according to Section 171(2), on AGM called at a notice shorter than 21 clear days shall be valid if consent is accorded thereto by all the members entitled to vote thereat. Thus, if all the members of the company approve the shorter notice, shortfall may be condoned.

Question 22

Company served a notice of General Meeting upon its members. The notice stated that a resolution to increase the share capital of the Company would be considered at such meeting. A shareholder complaints that the amount of the proposed increase was not specified in the notice. Is the notice valid?

Answer

Notice of Meeting: Section 173 of the Companies Act, 1956 requires a company to annex an explanatory statement to every notice for a meeting of company, at which some 'special business' is to be transacted. This explanatory statement is to bring to the notice of members all material facts relating to each item of special business. Section 173 further specifies that all business in case of any meeting other than the annual general meeting is regarded as special business. Thus, the objection of the shareholder is valid since the details on the item to be considered are lacking. The information about the amount is a material fact with reference to the proposed increase of share capital. The notice is, therefore, not a valid notice under Section 173 of the Companies Act, 1956.

Question 23

Who are entitled to get notice for the general meeting called by a Public Limited Company registered under the Companies Act, 1956? Does the non-receipt of a notice of the meeting by any one entitled to such notice invalidate the meeting and the resolution passed thereat? What would be your answer in case the omission to give notice to a member is only accidental omission?

Answer

Notice of meeting shall be given -

(i) to every member of the company;

(ii) to the persons entitled to a share in consequence of the death or insolvency of a member;

(iii) to a auditor or auditors [Section 172(2)] and,

The company cannot take notice of the beneficial owners of shares who are, therefore, not entitled to notice, where, however, anyone is legally entitled to represent the members, such representative is entitled to receive the notice.

The private company, which is not, a subsidiary of a public company may prescribe, by its articles, persons to whom the notice should be given.

The non-receipt of notice or accidental omission go given notice to any member shall not invalidate the proceedings in the meeting [Section 172(3)]. However, omission to serve notice of meeting on a member on the mistaken ground that he is not a shareholder cannot be said to be an accidental omission. Accidental omission means that the omission must be not only designed but also not deliberate. *[Maharaja Export Vs. Apparels Exports Promotion Council (1986)].*

Question 24

ABC Limited served a notice of a general meeting upon its members. The notice stated that a resolution to increase the Share Capital of the company would be considered at the meeting. A member complains to the company that the amount of the proposed increase was not specified in the notice. In the light of the provisions of the Companies Act, 1956, examine the validity of the notice.

Answer

Section 173 of the Companies Act, 1956 requires a company to annex an explanatory statement to every notice for a meeting of company, at which some 'special business' is to be transacted. This explanatory statement is to bring to the notice of members all material facts relating to each item of special business. Section 173 further specifies that all business in case of any meeting is regarded as special business. Thus, the objection of the shareholder is valid since the details on the item to be considered are lacking. The information about the

amount is a material fact with reference to the proposed increase of share capital. The notice is, therefore, not a valid notice under Section 173.

Question 25

M. H. Company Limited served a notice of general meeting upon its shareholders. The notice stated that the issue of sweat equity shares would be considered at such meeting. Mr. 'A', a shareholder of the M. H. Company Limited complains that the issue of sweat equity shares was not specified fully in the notice. Is the notice issued by M. H. Company Limited regarding issue of sweat equity shares valid according to the provisions of the Companies Act, 1956? Explain in detail.

Answer

Section 173 of the Companies Act, 1956 requires a company to annex an explanatory statement to every notice for a meeting of the company at which some special business is to be transacted. This explanatory statement is to bring to the notice of members all material facts relating to each item of special business. Section 173 further specifies that all business in case of any meeting other than (i) consideration and approval of the annual accounts of the company (ii) declaration of dividend (iii) appointment of directors in place of those retiring and (iv) appointment of auditors including the fixing of their remuneration is regarded as special business. Therefore, the complaint of Mr. A, the shareholder is valid, since the details on the item regarding issue of sweat equity shares to be considered is lacking. The information about the issue of sweat equity shares is a material fact. The notice given by M. H. Ltd. of the General Meeting of the shareholders is not a valid notice under Section 173 of the Companies Act, 1956.

Question 26

ABC Ltd. called its annual general meeting on 7th April, 2010. The notice of AGM was posted on 16th March, 2010. One member holding 20 shares wishes to challenge the resolutions passed at the AGM on the ground that the notice was not valid. What advise would you give to him?

Answer

According to Section 171(1) of the Companies Act, 1956 a general meeting of a company may be called by giving not less than 21 days notice in writing. Not less than 21 days means 21 clear days i.e. excluding both the date on which the notice was served and the date of the meeting. In case the notice of the general meeting is sent by post, service of notice of the meeting shall be deemed to have been effected at the expiry of 48 hours after it was posted. In the instant case, the notice was short of one day as per the section:

16th March to 7th April	23 days
Less date of service and date of meeting	2 days
	21 days

Less 48 hours of posting but 24 hours are common between date of service & date of posting	1 day
	20 days

Therefore, the meeting was invalid and the resolutions passed were invalid. However in case AGM, where all members entitled to vote consent, the meeting may be held on shorter notice.

In *Saliesh Harilal Shah v. Matushree Textiles Ltd. (1994) 2CLJ, 291,* the Bombay High Court [in contrast to the Madras High Court decision in *N. Chettair(v) the Madras Race Club (1951]* held that the requirement of the section as length of notice is directly only and not mandatory. A couple of shareholders cannot be permitted to defeat the interest of the large body of shareholders by saying that the duration of the notice was not sufficient even if the short notice does not indicate any prejudice to the complaining shareholders.

In this problem, the member may be advised to explore whether he has suffered any prejudice by the short notice before proceeding to challenge the validity of the resolutions.

Question 27

The annual general meeting for 2006-2007 and 2007-08 were convened on 7-10-2009 belatedly and with great difficulty. The notice of the meeting was published in a newspaper of Calcutta on 12-9-2009. The shareholders received the notice 22-9-2009 which was shown to have been posted on 16-9-2009. The notice was dated 9-9-2009. D sought an injunction that the resolutions passed at the meetings are not given effect to, on the ground that the notice was received by him on 22-9-2009. D held only seven shares of ₹10 in the company and was a resident of Kolkata where the meeting was to be held.

State whether the shortness of the notice invalidated the meeting?

Answer

Section 172(3) of the Companies Act, 1956 makes it abundantly that it is not a condition precedent to the holding of the annual general meeting of a company that a clear 21 days notice must be given to each and every member of the company. The accidental omission to give notice to any member or non-receipt of notice by any member shall not invalidate the proceedings at the meeting. If the contention of D was to be upheld it would mean that whereas if the notice to a shareholder was not accidentally posted at all, the proceedings at the annual general meeting of a company would be valid, but if the notice was posted accidentally less 21 days before the meeting, the proceedings at the meeting will be void even though the shareholder received the notice in good time before the meeting was held an actually attended the meeting. Hence, such a construction would lead to absurdity and should be avoided. The contention could not, therefore be accepted that a short notice served on member will invalidate meeting altogether but non-receipt of the notice by a member will not have the same effect. In view of the clear provisions of Section 172(3), it cannot be said that the requirements of Section 171 are mandatory and a short notice given to any member will render the entire meeting void and of no legal consequence even if that the member has not

suffered any prejudice in any way. On the facts of the case that the notice of the meetings was published in a newspaper in good time, the shareholder was a resident of Calcutta; advertisement was given in a newspaper having circulation in Calcutta the two annual meetings were held at Calcutta; the shareholder had not been able to make out any case of any prejudice at all; and that two annual meetings were at last held after protracted litigations, there was no reason why the resolutions passed at the annual general meeting should not given effect to merely because one shareholder having 7 shares of ₹ 10 actually each received the individual notices less than 21 days in advance. The balance of convenience did not required an order of injunction *[Calcutta Chemical Co. Ltd. Vs. Chandra Roy (1985) 58 Comp. Cas 275 (Cal)].* Further if a notice of meeting is published as a newspaper advertisement, the statement of material facts, referred to in Section 173, need not be annexed, but the fact that the statement shall be forwarded must be mentioned.

Question 28

Mr. DP, Secretary, of City Handicrafts Ltd. called an extraordinary general meeting of the company on the requisition of some members. Mr. DP, Secretary of the Company, issued notice of the meeting without the authority of the Board of Directors. Discuss on the validity of the notice issued by Mr. DP, Secretary of the City Handicrafts Ltd.

Answer

Validity of the notice of extra ordinary general meeting issued by secretary: The Annual General Meeting or Extra-ordinary General Meeting can be called only with authority of Board of Directors i.e. by passing necessary resolution in the Board Meeting or by Circular resolution. An Annual General Meeting or Extra-ordinary General Meeting cannot be called by an individual director or some of the directors or by secretary. Now, in the instant case, Mr. DP, Secretary of City Handicrafts Ltd., called an extraordinary general meeting on requisition of some members. He issued notice of the meeting without the authority of the Board of Directors. The Secretary of the company does not have the power to call the meeting by himself by issuing notices. Unless the Secretary is specifically authorized either by the board of directors or by the articles, any meeting called by him and the business done there at it would be null and void (Al Amin Seatrans Ltd. Vs. Owners and Party Interested in Vessel M V "Loyal Bird").

However, the notice of the meeting may be ratified by the Board of Directors of the company before the meeting is held to make it good (Hooper Vs. Kerr. Stuart & Co.). Thus, the notice issued by Mr. DP may be ratified by the Board of Directors of City Handicrafts Ltd., to make it valid.

Special and Ordinary Business

Question 29

Referring to the provisions of the Companies Act, 1956 state the matters relating to 'Ordinary Business' which may be transacted at the Annual General Meeting of a Company. What kinds

of resolutions need to be passed to transact the 'ordinary Business' and the 'Special Business' at the Annual General Meeting of the Company? Explain.

OR

State the ordinary business which may be transacted at an Annual General Meeting of a public limited company incorporated under the Companies Act, 1956.

Answer

Ordinary Business (Section 173): In accordance with the provision of Companies Act, 1956 as contained in Section 172, the business to be transacted at an AGM may comprise of:

(i) Ordinary Business: Which relate to the following matters:

  (a) Consideration of accounts, balance sheet and the report of the Board of Directors and auditors.

  (b) Declaration of dividend.

  (c) Appointment of Directors in place of those retiring; and

  (d) appointment of auditors and fixation of their remuneration.

(ii) Special Business: Any other business scheduled to be transacted at the meeting shall be deemed to be special business.

  Ordinary business can be passed by an ordinary resolution. However, special business may be transacted either by passing ordinary resolution or special resolution, depending upon the requirements of Companies Act, 1956.

Quorum

Question 30

State what is meant by "Quorum" and when does quorum be considered immaterial under the provisions of the Companies Act, 1956.

Answer

Quorum means the minimum number of members that must be present in order to constitute a meeting and transact business thereat. Thus quorum represents the number of members on whose presence the meeting of a company can commence its deliberations. Under the articles provide for a larger number, 5 members personally present in the case of a public company (other than a public company which became public by virtue of Section 43A, now deleted) and 2 members in case of a private company constitute the quorum for a general meeting as given in Section 174 of the Companies Act, 1956. The words 'personally present' excludes proxies. However, the representative of a body corporate appointed under Section 187 or the representative of the President or Governor of a State appointed under Section 187A is a member personally present for the purpose of counting quorum.

If all the members are present, it is immaterial that the quorum required is more than the total number of members. If for example, the articles of a private company provide that 4 members personally present shall be a quorum and the number of members is reduced to 3, the question of quorum will not arise when all the 3 members attend the meeting.

Question 31

The Articles of Association of X Ltd. require the personal presence of 7 members to constitute quorum of General Meetings. The following persons were present in the extra-ordinary meeting to consider the appointment of Managing Director:

(i) A, the representative of Governor of Madhya Pradesh.

(ii) B and C, shareholders of preference shares,

(iii) D, representing Y Ltd. and Z Ltd.

(iv) E, F, G and H as proxies of shareholders.

Can it be said that the quorum was present in the meeting?

Answer

Quorum: In this case the quorum for a general meeting is 7 members to be personally present. For the purpose of quorum, only those members are counted who are entitled to vote on resolution proposed to be passed in the meeting.

Again, only members present in person and not by proxy are to be counted. Hence, proxies whether they are members or not will have to be excluded for the purposes of quorum.

If a company is a member of another company, it may authorize a person by resolution to act as its representative at a meeting of a latter company, then such a person shall be deemed to be a member present in person and counted for the purpose of quorum (Section 187)

Where two or more companies which are members of another company, appoint a single person as their representative then each such company will be counted as quorum at a meeting of the latter company.

Again Section 187A of the Companies Act, 1956 provides that the President of India or Governor of a State, if he is a member of a company, may appoint such a person as he thinks fit, to act as its representative at any meeting of the company. A person so appointed shall be deemed to be a member of such a company and thus considered as member personally present.

In view of the above there are only three members personally present.

'A' will be included for the purpose of quorum. B & C have to be excluded for the purpose of quorum because they represent the preference shares and since the agenda being the appointment of Managing Director, their rights cannot be said to be directly affected and therefore, they shall not have voting rights. D will have two votes for the purpose of quorum as

he represents two companies ' Y Ltd.' and 'Z Ltd.' E, F, G and H are not to be included as they are not members but representing as proxies for the members.

Thus it can be said that the requirements of quorum being 7, 3 members personally present shall not constitute a valid quorum for the meeting.

Question 32

DJA Company Ltd. has only 50 preference shareholders. A meeting of the preference shareholders who called by the company for amending the terms of these shares. Mr. A, was the only preference shareholder who attended the meeting. He, however, held proxies from all other shareholders. He took the Chair, conducted the meeting and passed a resolution for amending the terms of the issue of these shares. Referring to the provisions of the Companies Act, 1956, examine the validity of the meeting and the resolution passed thereat.

Answer

This question was decided in *Sharp Vs., Dawes* case which provides that "The word meeting prima facie means coming together of more than one person." In this given case, only one shareholder present. This was not a meeting within the meaning of the Companies Act, 1956. According to Section 174 another requirement of valid meeting is the presence of a required quorum. Moreover, the section also says that "the members actually present shall be the quorum." The presence of one member may not be enough. This was not a valid meeting.

In *East Vs. Bennet Brothers Ltd. (1911)* it has been held that in case of a class meeting of all the shares of a particular class are held by one person, one person shall form the quorum. In the given case, since all the shares are not held by one person, no quorum is therefore present. The meeting and the resolution passed there shall not be valid.

Question 33

State the legal position in the following circumstances with reference to the provisions in the Companies Act, 1956.

At an adjourned extraordinary general meeting of a Public Ltd. Company adjourned for want of quorum, only 3 members are personally present.

Answer

Quorum: Quorum means the minimum number of members who must be present in order to constitute a meeting and transact business thereat. Thus the meeting cannot proceed with business in the absence of quorum unless the articles of the company provide otherwise.

As per Section 174(5) of the Companies Act, 1956, if a meeting is adjourned for want of quorum and at the adjourned meeting also quorum is not present, within half an hour from the time appointed for holding the meeting, the members present shall be quorum. Assuming here, that the adjournment of meeting is called because of absence of quorum, the above- stated provision will prevail. Accordingly, three members who are personally present can validly conduct the meeting.

But if the adjournment has taken place for any reason other than absence of quorum, the quorum as per articles or at least five members as per Section 174(1), must be present.

Question 34

The quorum for a General meeting of a public company is 15 members personally present according to the provisions of the articles of association of the company. Examine with reference to the provisions of the companies Act, 1956 whether there is proper quorum at a General meeting of the company which was attended by the following persons:

(i) 13 members personally present

(ii) 2 members represented by proxies who are not members of the company

(iii) One person representing two member companies.

Answer

Quorum: According to section 174 of the Companies Act, 1956 unless the articles of the company provide for a larger number, 5 members personally present in the case of a public company shall be the quorum for a meeting of the company.

In this case articles of the company provide for a larger number of 15, hence the quorum is 15.

The words 'personally present' exclude proxies. Hence two members represented by proxies cannot be counted for the purpose of quorum. However, the representative of a body corporate appointed under section 187 is a member 'personally present' for the purpose of counting a quorum. In case two or more corporate bodies who are members of the company are represented by single individual each of the bodies corporate will be treated as personally present by the individual representing it. In this case one person represent two member companies and his presence will be counted as two members being present in person for the purpose of quorum. Hence 15 members are personally present (13+2) and as such there is proper quorum.

Question 35

A general meeting of a public company was adjourned by the chairman for want of quorum. Fresh notice was not served for the adjourned meeting. Do you feel that notice is required for the adjourned meeting? Referring to the provisions of the Companies Act, 1956 state the minimum number of members required to be present in the adjourned meeting.

Answer

As per section 174 of the Companies Act, 1956, if within half an hour from the time appointed for holding a meeting for the company quorum is not present, the meeting, shall stand adjourned to the same day in the next week, at the same time and place unless the directors determine otherwise. No fresh notice is, therefore, required to hold the adjourned meeting. Besides, no quorum is necessary in the adjourned meeting. Thus, the adjourned meeting in question is valid.

Question 36

The articles of X & Co. Ltd provide that in the event of the quorum being not present within half-an- hour- from the time scheduled for the annual general meeting, the meeting shall stand dissolved and then quorum is not formed within half-an-hour from the time fixed therefor.

Give the answers of the following-

(a) In the above circumstance, what further steps are necessary to hold the annual general meeting?.

(b) If it is to be convened afresh, will a fresh resolution of the Board be needed?

(c) What will be the position of retiring directors-will they cease to be directors from the date on which the general meeting could not be held for want of quorum and consequently stood dissolved as per the articles as aforesaid or will they remain directors till the date of the fresh annual general meeting which was convened subsequent to the first one?

Answer

(a) By implication of Section 174(2), if the articles of the company otherwise provide, the meeting cannot be adjourned to the same day at the next week at same time and place or to such other day and at such other time and place as the Board determines. To resolve this impasse, till any judicial ruling is given, the annual general meeting should be called a new in the circumstances of the above-mentioned case.

(b) Since a resolution is taken at a Board meeting, fixing the date of the annual general meeting and since the annual general meeting will have to be convened afresh in the circumstances of the case, it seems that a fresh resolution of the Board fixing the date of the new annual general meeting would be required.

(c) If the newly convened annual general meeting is held well within the statutory period, then the rotational directors may remain in office till the date of the second meeting so held. If, however, the meeting is called on the last day of the statutory prescribed period and the meeting could not be held for want of quorum and a fresh annual general meeting is convened as a result, then the rotational directors might be allowed to retain their office till the date of the second meeting with the prior permission of the registrar of Companies.

Question 37

Whether the following persons can be counted for the purposes of quorum in a general meeting of a public company-

(a) a person representing three member companies;

(b) both the joint owners of shares or present at the meeting;

(c) a single member present at the meeting.

Answer

(a) Unless the articles of a company provide for a larger number, five members personally present in the case of a public company shall be the quorum for a meeting of the company (section 174). Personally present excludes proxies. But a representative of a body corporate appointed under Section 187 is a member personally present for purposes of counting of quorum. If one individual represents three member companies, his presence will be counted as three members being present in person for purpose of quorum [*Mac-Leod (Neil) & Sons Ltd.].*

(b) For the purpose of quorum, joint shareholders will be collectively regarded as one shareholder. However in an Australian Case *(Re. Trans-Continental Hotel Ltd.),* it has been held that two joint holders are each members and are to be counted towards a quorum as two members personally present. The Companies Act specifically provides for certain purposes e.g. under Section 3(i) (iii) and under section 399 where two or more persons hold shares jointly they shall be counted only as one member. If the articles do not provide anything to the contrary, it appears that two or more joint holders when personally present can be counted as so many members for the purpose of forming quorum.

(c) The word meeting literally means a coming of together of two or more persons and generally more than one person will be necessary to constitute a meeting *[Mac-leod (Neil) & Sons Ltd.*]. But there may be cases where the constitution of a company may be such as, for instance, where one person holds all the equity shares of a class or all the preference shares so that there can be no meeting of more than one voting shareholder or one member of a particular class of shares. In such cases, it must be presumed that the Act contemplates positions where a meeting of two or more persons will not be possible in the strict sense and the word .meeting must be taken to have been used in the sense of a function which can be performed by one person also as effectively as by two or more *(East v. Bennet Bros. Ltd.)*. Apart from these special circumstances, there is an express provision in the Companies Act where a single member will constitute a meeting. Section 167 empowers the CLB to call annual general meeting of a company. Section 186 empowers CLB to order a meeting of the company, other than an annual general meeting. In both these cases, the CLB may issue directions in relation to the calling, holding and conducting of the meeting. The directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

Question 38

Unless the Articles provide for a large number, the quorum for a General Meeting for a public limited company is:

(a) 1/3rd of the member

(b) 5 members personally present

(c) 2 members

(d) 7 members

Answer

Answer (b), Reason: As per Section 174 of the Companies Act, 1956 unless the Articles provide for a large number, the quorum for a General Meeting of a public company is 5 members personally present

Proxies

Question 39

What do you mean by Proxy? Explain the provisions relating appointment of Proxy under the Companies Act, 1956

Answer

A proxy is an instrument in writing executed by a shareholder authorizing another person to attend a meeting and to vote thereat on his behalf and in his absence. The term is also applied to the person so appointed.

According to Section 176, the appointment of proxy must be in written instrument signed by the appointer or his duly authorized attorney. The instrument of proxy must be deposited with the company 48 hours before the meeting.

Further, unless articles otherwise provide:

1. a member of a company having no share capital cannot appoint a proxy;
2. a member of a private company cannot appoint more than one proxy to attend on the same occasion;
3. a proxy shall not be entitled to vote except on a poll.

Question 40

Annual General Meeting of a Public Company was scheduled to be held on 15.12.2003. Mr. A, a shareholder, issued two Proxies in respect of the shares held by him in favour of Mr. 'X' and Mr. T. The proxy in favour of 'Y' was lodged on 12.12.2003 and the one in favour of Mr. X was lodged on 15.12.2003. The company rejected the proxy in favour of Mr. X as the proxy in favour of Mr. Y was of dated 12.12.2003 and thus in favour of Mr. X was of dated 13.12.2003. Is the rejection by the company in order?

Answer

In case more than one proxies have been appointed by a member in respect of the same meeting, one which is later time shall prevail and the earlier one shall be deemed to have been revoked. Thus, in the normal course, the proxy in favour of Mr. X, being later in time, should be upheld as valid.

But, as per Section 176 of the Companies Act, 1956, a proxy should be deposited 48 hours before the time of the meeting. In the given case, the proxies should have, therefore, been deposited on or before 13.12.2003 (the date of the meeting being 15.12.2003). X deposited the proxy on 15.12.2003. Therefore, proxy in favour of Mr. X has become invalid. Thus, rejecting the proxy in favour of Mr. Y is unsustainable. Proxy in favour of Y is valid since it is deposited in time.

Question 41

What is the concept of proxy in relation to the meetings of a Company? Decide the appointment and rights of a proxy, under the Companies Act, 1956, in the following cases:

(i) When a body corporate is a member in the company.

(ii) When a foreign company is a member in the company.

Answer

(i) A proxy is a person, being a representative of a share holder at a meeting company who may be described as his agent to carry out which the shareholder has himself decided upon. *[Cousin vs. International Brick Co, 1931].*

The appointment of a proxy must be made by a written instrument signed by the appointer or his duly authorised attorney. The instrument of proxy has to be in the prescribed form set out in Schedule IX.

Section 187 of the Companies Act, 1956 provides that where a company is a member of another company it may attend the meeting of any other company through a representative. The representative must be appointed by a resolution of the Board of directors or the other governing body, the person so appointed is entitled to exercise the same rights and powers (including the right to vote by proxy) on behalf of the company as the individual member of the company may exercise.

(ii) Foreign company can also make the use of this provision or it may by means of power of attorney. *[CEPT v. Jeevanlal Ltd., (1951)]*

Question 42

Annual General Meeting of MGR Limited is convened on 28th December, 2008. Mr. J, who is a member of the company, approaches the company on 28th December, 2008 and demands inspection of proxies lodged with the company. Explain the legal position as stated under the Companies Act, 1956 in this regard.

Answer

Every member entitled to vote at a meeting of the company or on any resolution to be moved thereat, shall be entitled during the period beginning 24 hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting, to inspect the proxies lodged, at anytime during the business hours of the company. Provided not less than 3

days' notice in writing of the intention to inspect is given to the company [Section 176(7) of the Companies Act, 1956].

In the given case, Mr. J who is a member approaches the company on 28th December and demands inspection of proxies lodged with the company. Based on the above provisions since prior notice had not been given by Mr. J to the company for inspecting the proxies, the company may refuse inspection of proxy forms.

Question 43

'S', a shareholder, after duly appointing P as his proxy for a meeting, himself attended the meeting and voted on a resolution. P thereafter claimed to exercise his vote. Examine his claim.

Answer

As per law, a shareholder has a right to revoke the proxy's authority by voting himself before the proxy has voted - but once the proxy has voted he cannot retract his authority. Therefore P's claim in the given case is invalid. This point was reiterated in *Cousins v. International Brick Co. Ltd* also.

Question 44

The Articles of Association of a public company require the instrument appointing a proxy to be received by the company 75 hours before the meeting. Is it a valid requirement? If not, what are its effect?

Answer

According to Section 176 of the Companies Act, 1956, any provision in the Articles of a public company or of a private company which is a subsidiary of a public company which requires a longer period than 48 hours before a meeting of the company for depositing a proxy, shall have effect as if a period of 48 hours had been specified for such deposit. Therefore in the given case, the answer is a 'no'.

Question 45

S, a shareholder, gives a notice for inspecting proxies, five days before the meeting is scheduled and approaches the company two days before the scheduled meeting for inspecting the same. What is the legal position relating to his actions?

Answer

S has given proper notice under Section 176(7) of the Companies Act 1956 which stipulates that not less than three days in writing of the intention to inspect has to be given to the company. But, such inspection can be undertaken only during the period beginning 24 hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting. So S can undertake the inspection only during the above mentioned period and not two days prior to the meeting.

Question 46

A General Meeting to be held on 15th April, 2010 at 4.00 P.M. As per the notice the members who are unable to attend the meeting in person can appoint a proxy and the proxy forms duly filled should be sent so as to reach at least 48 hours before the meeting. Mr. A, a member of the company appoints Mr. P as his proxy and the proxy form dated 10.4.2010 was deposited by Mr. P with the company at its Registered Office on 11.10.2005. However, Mr. A changes his mind and on 12.04.2010 gives another proxy to Mr. Q and it was deposited on the same day with the company. Similarly another member Mr. B also gives to separate proxies to two individuals named Mr. R and Mr. S. In the case of Mr. R, the proxy dated 12.04.2010 was deposited with the company on the same day and the proxy form in favour of Mr. S was deposited on 14.04.2010. All the proxies viz., P, Q, R and S were present before the meeting.

In the light of the relevant provisions of the Companies Act, who would be the persons allowed to represent at proxies for members A and B respectively?

Answer

A Proxy is an instrument in writing executed by a shareholder authorizing another person to attend a meeting and to vote thereat on his behalf and in his absence. As per, the provisions of Section 176 of the Companies Act, 1956 every shareholder who is entitled to attend and vote has a statutory right to appoint another person as his proxy and the proxy need not be a member of the company. Further, any provision in the articles of association of the company requiring instrument of proxy to be lodged with the company more than 48 hours before a meeting shall have effect as if 48 hours had been specified therein. The members has a right to revoke the proxy's authority by voting himself before the proxy has voted but once the proxy has voted the member cannot retract his authority. Where two proxy instruments by the same shareholder are lodged in respect of the same votes before the expiry of the time for lodging

The proxies, the second in time will be counted and where one is lodged before and the other after the expiry of the date fixed for lodging proxies, the former will be counted. Thus in case of Member A, the proxy Q (and not Proxy P) will be permitted to vote on his behalf. However, in the case of Member B, the proxy R (and not Proxy S) will be permitted to vote as the proxy authorizing S to vote was deposited in less than 48 hours before the meeting.

Question 47

C, a shareholder, after appointing B as his proxy at meeting of the Company, himself attended the meeting and voted on a particular resolution. B thereafter claimed to exercise his vote. Examine his claim in the light of the provisions of the Companies Act, 1956.

Answer

B's claim is invalid. Where a shareholder who having appointed a proxy, personally attends and votes at the meeting, the proxy is revoked thereby. Thus in the instant case, B's authority is revoked and he cannot exercise his vote.

Question 48

K, a member of MNO Limited, appoints L as his proxy to attend the general meeting of the company. Later he (K) also attends the meeting. Both K (the member) and L (the proxy) voted on a particular resolution in the meeting. K's vote was declared invalid by the chairman stating that since he has appointed the proxy and L's vote has been considered as valid. K objects to the decision of the Chairman. Decide, under the provisions of the Companies Act, 1956 whether K's objection shall be taxable.

Answer

The given problem is based on *Cousins vs International Brick Company Limited.* In above case the court held that a proxy is appointed to attend a meeting on an implied condition that he will attend if the person appointing the proxy is himself unable to attend the meeting. But if the person appointing also attends the meeting and casts the vote the proxy's stand will be cancelled.

Hence, in the given problem, the decision of chairman is invalid. Here K's vote was valid, L's vote was invalid. Therefore K's objection is taxable,

Resolution

Question 49

Outline some eight matters for which an ordinary resolution would suffice.

Answer

Subject to the articles, an ordinary resolution is sufficient, for inter alia any of the following matters:

(a) To authorise an issue of shares at a discount (Section 79);

(b) To increase the share capital if authorised by the articles, or otherwise alter the share capital apart from its reduction (Section 94,100);

(c) To appoint auditors [Section 224(1)]; but in the case of a company in which not less than 25 percent of the subscribed share capital is held, whether singly or in any combination, by a public financial institution or a Government company or Central or any State Government, or a nationalised bank or an insurance company carrying a general insurance business, the appointment of auditors requires a special resolution (Section 224A);

(d) To appoint directors;

(e) To adopt annual accounts;

(f) To declare dividends;

(g) To wind up voluntarily when the period, if any, fixed for the duration of the company by the articles has expired, or the event, if any , has occurred, on the occurrence of which the articles provided that the company is to be dissolved [Section 484(1)];

(h) To appoint liquidators in a members 'voluntary winding-up and to fix their remuneration (Section 490);

(i) To register an unlimited company as a limited company (Section 32); and generally to do all things for which a special resolution is not specifically required either by the Act or the company's articles.

Question 50

Mention any ten acts for which a special resolution is required.

Answer

Acts for which special resolutions are required: Some matters may be so important and outside the ordinary course of the company's business, such as any important constitutional changes, that safeguards should be imposed to ensure that a larger majority than a simple majority of the members approve of them before they are given effect to. The Act requires that the following matters, *inter alia*, have to be resolved by the company, by a special resolution:

(1) To alter any provision contained in the memorandum, which could lawfully have been contained in the articles instead of the memorandum (Section 16);

(2) To alter the objects or the place of registered office of a company (Section 17);

(3) To change the name of the company (Section 21);

(4) To alter the articles of association (Section 31);

(5) To create a reserve liability, that is, to determine that a portion of the uncalled capital shall not be capable of being called up, except in the event of a winding up (Section 99);

(6) To reduce the share capital (Section 100);

(7) To move the company's registered office within the same State but outside the local limits of the city, town or village where such office is situated [Section 146(2)];

(8) To commence any new business which is not germane to the business the company is carrying on , though covered by the objects clause of the memorandum [Section 149(2A)];

(9) To pay interest on shares out of capital (Section 208);

(10) To appoint auditors, if not less than 25 per cent of the company's subscribed capital is held, whether singly or in any combination, by the Central or any State Government, Government companies, financial institutions, nationalized banks, etc. (Section 224A).

Question 51

State with reason, whether the following statement is correct or incorrect, according to the Companies Act, 1956.

A special resolution is one to pass, where the votes cast in favors must be twice the votes cast against it.

Answer

Incorrect. A resolution shall be a special resolution when the votes cast in favour of the resolution by members (whether on a show of hands, or on a poll , or by proxy), are not less than three times the number of votes, if any, cast against the resolution.

Question 52

Which one of the following required ordinary resolution?

1. *to change the name of the company*
2. *to alter the articles of association*
3. *to reduce the share capital*
4. *to declare dividends.*

Answer

To declare dividends; Reason: The Companies Act, 1956 requires that the following matters, inter alia, have to be resolved by the company by a special resolution: (i) to change the name of the company (Section 21) (ii) to alter the articles of association (Section 31) and (iii) to reduce the share capital (Section 100). While for declaration of dividends ordinary resolution is sufficient.

Question 53

At a General meeting of a company, a matter was to be passed by a special resolution. Out of 40 members present, 20 voted in favour of the resolution, 5 voted against it and 5 votes were found invalid. The remaining 10 members abstained from voting. The Chairman of the meeting declared the resolution as passed.

With reference to the provisions of the Companies Act, 1956, examine the validity of the Chairman's declaration.

Answer

Under Section 189(2) of the Companies Act, 1956, for a valid special resolution, the following conditions need to be satisfied:

(i) The intention to propose the resolution, as a special resolution must have been specified in the notice calling the general meeting or other intimation given to the members;

(ii) The notice required under the Companies Act must have been duly given of the general meeting;

(iii) The votes cast in favour of the resolution (whether by show of hands or on poll) by members present in person or by proxy are not less than 3 times the number of votes, if any, cast against the resolution.

Thus, in terms of the requisite majority, votes cast in favour have to be compared with votes cast against the resolution. Abstentions or in valued, if any, are not to be taken into account. Accordingly, in the given problem, the votes cast in favour (20) being more than 3 times of the votes cast against (5), if other conditions of Section 189(2) are satisfied, the decision of the Chairman is in order.

Question 54

Explain the provisions of the Companies Act, 1956 relating to 'Resolutions requiring Special Notice'. State the resolutions that require 'Special Notice' under the Act.

Answer

Special Notice (Section 190): Section 190 of the Companies Act, 1956 deals with resolutions requiring special notice. Accordingly the section provides that where under any provision contained the Company Act or in the Acts, special notice is required to be given of any resolution, notice of intention to move the resolution should be given to the company, not less than 14 days before the meeting at which it is to be moved.

Special notice is required to move, besides the resolution mentioned in the Articles, the following resolutions:

(i) a resolution appointing an auditor other than the retiring one. (Section 225)

(ii) a resolution providing expressly that the retiring auditor shall not be reappointed. (Section 225)

(iii) a resolution purporting to remove a director before the expiry of his period of office. (Section 284).

(iv) a resolution to appoint another director in place of the removed director. (Section 284).

Question 55

At the annual general meeting of a company a resolution is proposed to be moved to the effect that the retiring auditors shall not be re-appointed. What would be the duty of the company and the right of the auditor in the circumstances?

Answer

As per Section 225 of the Companies Act, 1956, the duty of the company may be summed up as follows:

(i) On the receipt of the special notice, the company must forthwith send a copy thereof to the retiring auditor [Section 225(2)].

(ii) Where the retiring auditor makes a written representation, not exceeding a reasonable length, to the company and requests the company to notify such representation to the members, the company is bound to state in any notice of the resolution given to the members, the fact of the representation having been made and send a copy of the representation to every member to whom notice of the meeting is sent-whether before or after a receipt of the representation by the company. Moreover, the company is bound by this duty if the representation has not been received too late. If the representation has been received too late, the company will be relieved of this duty. But in such a case, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting.

The auditor's right to get the copies of the presentation sent out to members or read out at the meeting is hedged in by the provision that if the Court is satisfied, on the application of the company or any other aggrieved person, that the right is being abused to secure needless publicity for a defamatory matter, the Court may order that the representation may not be circularised or read out. The Court may further order that the company's costs on such an application should be paid by the auditor, in whole or any part even though he is not a party to the application [Section 225(3)].

The rights of the auditor in this context are as follows:

(1) It follows from paragraph (ii) above that the auditor has the right to make representation to the company and to request it to the members.

(2) The auditor has also right to be heard orally at the meeting of the shareholders.

(3) Where a copy of the representation has not been despatched as aforesaid because it was received too late or because of the company's default, the auditor may without prejudice to his right to be heard orally, require that the representation be read out at the meeting.

Passing of Resolution by Postal Ballot [Section 192A]

Question 56

State the procedure for passing a resolution by Postal Ballot.

Answer

A listed public company and in case of resolutions relating to such business as the Central Government may, by notification, declare to be conducted only by postal ballot, shall get any resolution passed by means of a postal ballot, instead of transacting the business in general meeting of the company. The procedure laid down in Section 192A is as under:

(i) Where a company decides to pass any resolution by resorting to postal ballot, it shall send a notice to all the shareholders, along with a draft resolution explaining the reasons therefore and requesting them to send their assent within a period of 30 days from the date of posting of the letter;

(ii) The notice shall be sent by registered post acknowledgement due or by any other method as may be prescribed by the Central Government in this behalf, and shall be annexed with the notice a postage pre-paid envelope for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period;

(iii) The board of directors shall appoint one scrutinizer, who is not in employment of the company, may be a retired judge or any person of repute, who, in the opinion of the board can conduct the postal ballot voting process in a fair and transparent manner;

(iv) The scrutinizer will be in position for 35 days (excluding holidays) from the date of issue of notice for annual general meeting. He is required to submit his final report on or before the said period.

(v) If a resolution is assented to by a requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been passed at a general meeting convened in that behalf.

For this purpose the scrutinizer willing to be appointed is available at the registered office of the company for ascertaining the requisite majority.

(vi) If a shareholder sends his assent or dissent in writing on a postal ballot and thereafter any person fraudulently defences or destroys the ballot paper or declaration of the identity of shareholder, such person shall be punishable with imprisonment for a term which may extend to six months or with fine or both;

(vii) The scrutinizer shall maintain a register to record the consent received, including electronic media, mentioning the particulars of name, address, folio number, number of shares, nominal value of shares, whether the shares have voting, differential voting or non-rights and the scrutinizer shall also maintain record for postal ballot which are received in defaced or mutilated form. The postal ballot and all other papers relating to postal ballot will be under the safe custody of the scrutinizer till the Chairman considers, approves and signs the minutes of the meeting. Thereafter, the scrutinizer shall return the ballot papers and other related papers/register to the company so as to preserve such ballot papers and other related papers/registers safely till the resolution is given effect to.

As per the Explanation, 'Postal Ballot' includes voting by electronic mode.

Question 57

Explain the provisions of the Companies Act, 1956 relating to the procedure to be followed for transacting business of the general meeting of members of a company through postal ballot.

Answer

Procedure for transacting business of the General Meeting through Postal Ballot: The new section 192(A) of the Companies Act, 1956, provides for procedures to be followed by the company for ascertaining the views of the members by postal ballot.

Procedure to be followed for conducting business through postal ballot is as under:

(i) The company may make a note below the notice of general meeting for understanding of members that the transactions at serial number requires consent of shareholders through postal ballot.

(ii) The board of directors shall appoint one scrutinizer, who is not in employment of the company, may be a retired judge or any person of repute who, in the opinion of the board can conduct the postal ballot voting process in a fair and transparent manner.

(iii) The scrutinizer will be in a position for 35 days (excluding holidays) from the date of the issue of notice for annual general meeting. He has to summit his final report on or before the said period.

(iv) The scrutinizer will be willing to be appointed and he is available at the registered office of the company for the purpose of ascertaining the requisite majority.

(v) The scrutinizer shall maintain a register to record to consent or otherwise received, including electronic media, mentioning the particulars of name, address, folio number, number of share, nominal value of shares, whether the shares have voting, differential voting or non-voting rights and the scrutinizer shall also maintain record for postal ballot which are received in defaced or mutilated form. The postal ballot and all other papers relating to postal ballot will be under the safe custody of the scrutinizer till the chairman considers, approves and signs the minutes of the meeting. Thereafter, the scrutinizer shall return the ballot papers and other related papers/registers safely till the resolution is given effect to:

(vi) Consent or otherwise relating to issue mentioned in notice for annual general meeting received after 35 days from the date of issue will be strictly treated as if the reply from the member has not been received. [Companies (Passing of the resolution by Postal Ballot) Rules, 2001 vide Notification No. G.S.R. 337 (E), dated 10th May, 2001].

Minutes

Question 58

In a General Meeting of PQR Limited, the Chairman directed to exclude certain matters detrimental to the interest of the company from the minutes. M, a shareholder contended that the minutes of the meeting must contain fair and correct summary of the proceedings thereat. Decide, whether the contention of M/s is maintainable under the provisions of the Companies Act, 1956?

Or

The minutes of the meeting must contain fair and correct summary of the proceedings thereat. Can the Chairman direct exclusion of any matter from the minutes? Some of the shareholders insist on inclusion of certain matters which are regarded as defamatory of a Director of the company. The Chairman declines to do so. State how the matter can be resolved.

Answer

Under Section 193 (5) of the Companies Act, 1956 any matter which in the opinion of the Chairman of the meeting:

(i) is or could reasonably be regarded as defamatory of any person;

(ii) is irrelevant or immaterial to the proceeding; or

(iii) is detrimental to the interests of the company;

The chairman shall have the discretion in regard to the inclusion or non inclusion of any matter in the minutes on the grounds specified above.

The Chairman enjoys an absolute discretion in the regard.

Hence, the contention of M, a shareholder of PQR Limited is not valid because the Chairman has discretion on the inclusion or exclusion of any matter in the minutes for aforesaid reasons.

Question 59

State the procedure for inspection of Minutes Book of General Meetings of a company, by the members.

Answer

Inspection of Minutes Books of General Meetings: Following are the provisions relating to the procedure for inspection of minutes books of general meetings of a company by the members:

(1) The books containing the Minutes of the proceedings of any general meeting of a company shall-

(a) be kept at the registered office of the company, and

(b) be open, during business hours, to the inspection of any member without charge, subject to such reasonable restrictions as the company may, by its articles or in general meeting impose, so however that not less than two hours in each day are allowed for inspection.

(2) Any member shall be entitled to be furnished, within seven days after he has made a requisition in that behalf to the company, with a copy of any minutes referred to in sub-section (1), on payment of such sum as may be prescribed for every one hundred words or fractional part thereof required to be copied.

(3) If any inspection required under sub-section (1) is refused, or if any copy required under sub-section (2) is not furnished within the time specified therein, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to five thousand rupees in respect of each offence.

(4) In the case of any such refusal or default, the Central Government may, by order, compel on immediate inspection of the Minute books or direct that the copy required shall forthwith be sent to the person requiring it.

Question 60

XYZ Limited held its Annual General Meeting on September 15, 2006. The meeting was presided over by Mr. V, the Chairman of the Company's Board of Directors. On September 17, 2006, Mr. V, the Chairman, without signing the minutes of the meeting, left India to look after his father who fell sick in London. Referring to the provisions of the Companies Act, 1956, state the manner in which the minutes of the above meeting are to be signed in the absence of Mr. V and by whom.

Answer

By virtue of Section 193 (1A) (b) of the Companies Act, 1956, minutes of proceeding of general meeting can be signed and dated within a period of 30 days, by a director duly authorized by the board for the purpose. In the circumstances contemplated by the question, therefore, a Board meeting has to be convened and one of the directors present thereat be authorized to sign and date the minutes of the annual general meeting

Question 61

The last General Meeting was conducted by the Chairman on 12th August, 2008. Thereafter, on 19th August, 2008, the Chairman died, before the minutes of the said meeting could be signed. In such an eventuality, how are the minutes book to be dated and signed? Discuss in terms of the provisions of the Companies Act, 1956.

Answer

According to Section 193 (1) of the Companies Act, 1956, minutes of the proceedings of a General Meeting are required to be signed and dated by the chairman of the same meeting

within 30 days from the holding of that meeting Further, in the event of death or inability of the chairman within the specified period to authenticate and date the same, a director can be authorized by the Board to sign and date the same. Thus in the circumstance contemplated by the question, therefore, a Board Meeting has to be convened and one of the Directors present thereat be authorized to sign and date the minute of the Annual General Meeting.

Meeting of the Debenture Holders

Question 62

The Board of Directors of Alltronix Ltd, have passed resolution to the effect that no member who is indulging in activities detrimental to the interest of the company be permitted to examine the records or obtain certified copies thereof. A member of the Company, considered by the Company to be acting against the interests of the Company, demands inspection of the register of members and minutes of General Meeting and certified true copies thereof. The Company refuses the inspection etc. on the strength of the resolution referred to above. Examine the correctness of the refusal by the Company referring to the provisions of the Companies Act, 1956.

Answer

According to the provisions contained in Section 16 of the Companies Act, 1956, every member of the Company is entitled to inspect the Register of Members without payment of any fee. They can also ask for copies of extracts from the Register of Members on payment of the prescribed fee. Similarly, as per Section 196 of the Companies Act,1956, the minutes book of the General Meetings are also to be made available for inspection of the members of the company without any charge.Applying these provisions to the given case, Attronix Ltd., have no right to refuse the inspection of the Register of Members and minutes book of General Meeting . The resolution passed by the said Company is not valid as it cannot go beyond the provisions of the Act.

Company Law in a computerized Environment

Question 63

What is E filing? List at least five advantages of E filing under MCA 21.

Answer

The term E-filing indicates the process of getting services electronically with a comprehensive on-line portal. The advantages are:

1. Instant registration of companies;
2. Simplified and more facile method of filing documents;
3. Total transparency;
4. Easier and better compliance of regulations;
5. Utmost customer care

6. Authentic and reliable filling of forms / returns through professionals;
7. Centralised database management;
8. Better service availability;
9. Filing of and inspection of documents anywhere and anytime.
10. Quick redressal of investor grievances
11. Supervisor and monitoring of compliance made easier.

Question 64

Explain the 'MCA 21 Program' introduced by the Government of India to develop computerized environment for company law. How does it serve the interest of all the stakeholders of a company, corporate professionals and the public at large?

Answer

MCA 21 project is an innovative project and initiative of the Ministry of Corporate Affairs carried out under the national e-governance programme of the Government with a comprehensive online portal to enable e-filing. This project covers all the services provided by the Registrar of Companies (ROC) starting from the incorporation of a new company. The project would provide e-services including names and registration of new companies, filing of various return and statutory documents under the Companies Act, 1956. The system would also enable for e-filing and access for statutory documents like Memorandum of Association, Articles of Association, Certificate of Incorporation etc.

The project serves the interest of all the key stakeholders, corporate professionals and the public at large as follows:

- Expeditious incorporation of companies
- Simplified and ease of convenience in filing of Forms/Returns/Statutory documents
- Better compliance management
- total transparency through e-Governance
- Customer centric approach
- Increased usage of professional certificate for ensuring authenticity and reliability of the Forms/Returns.
- Building up a centralized database repository of corporate operatings enhanced service level fulfillment.
- Inspection of public documents of companies anytime from anywhere.
- Registration as well as verification of charges anytime from anywhere

- Timely redressal of investor grievance and to get easy access to relevant records by the public.
- Availability of more time for MCA employees for monitoring and supervision.

Professionals need no longer to visit the officers of ROC and would be able to interact with the Ministry using MCA 21 portal from their offices or home. They are able to provide efficient services to their client companies. Financial Institutions may easily find charges registration and verification. Proactive and effective compliance of relevant laws and corporate governance by the employees.

Question 65

What are the steps for offline eFiling?

Answer

1. Select a category to download an eForm from the My MCA portal (with or with out the instruction kit.
2. At any time, you can read the related instruction kit to familiarise yourself with the procedures (you can download the instruction kit with eform or view it under Help menu).
3. You have to fill the downloaded e-Form.
4. You have to attach the necessary documents as attachments.
5. You can use the Prefill button in eForm to populate the greyed out portion by connecting to the Internet.
6. The applicant or a representative of the applicant needs to sign the document using a digital signature.
7. You need to click the Check Form button available in the eForm. System will check the mandatory fields, mandatory attachment(s) and digital signature(s).
8. You need to upload the eForm for pre-scrutiny. The pre-scrutiny service is available under the Services tab or under the eForms tab by clicking the Upload eForm button. The system will verify (pre-scrutinise) the documents. In case of any inadequacies, the user will be asked to rectify the mistakes before getting the document ready for execution (signature).
9. The system will calculate the fee, including late payment fees based on the due date of filing, if applicable.
10. Payments will have to be made through appropriate mechanisms - electronic (credit card, Internet banking) or traditional means (at the bank counter through challan).
    (a) Electronic payments can be made at the Virtual Front Office (VFO)or at PFO

(b) If the user selects the traditional payment option, the system will generate 3 copies of pre-filled challan in the prescribed format. Traditional payments through cash, cheques can be done at the designated network of banks using the system generated challan. There will be five banks with estimated 200 branches authorised for accepting challan payments.

11. The payment will be exclusively confirmed for all online (Internet) payment transactions using payment gateways.

12. Acceptance or rejection of any transaction will be explicitly communicated to the applicant (including facility to print a receipt for successful transactions).

13. MCA 21 will provide a unique transaction number, the Service Request Number (SRN) which can be used by the applicant for enquiring the status pertaining to that transaction.

14. Filing will be complete only when the necessary payments are made.

15. In case of a rejection, helpful remedial tips will be provided to the applicant.

16. The applicants will be provided an acknowledgement through e-mail or alternatively they can check the MCA portal.

EXERCISE

1. *C, a member of LS & Co. Ltd., holding some shares in his own name on which Final call money has not been paid, is denied by the company voting right at a general meeting on the ground that the articles of association do not permit a member to vote if he has not paid the calls on the shares held by him.*

   With reference to the provisions of the Companies Act, 1956, examine the validity of company's denial to C of his voting right.

   [Hints: The company's restriction on C against his voting right is valid, as per section 181 of the Companies Act, 1956]

2. *For a special resolution in a Company's general meeting, 10 voted in favour, 2 against and 4 abstained. The chairman declared the resolution as passed. Is it a valid resolution as per the provisions of the Companies Act, 1956.*

   [Hints: Yes, as per Section 189(2)(c) of the Companies Act,1956]

3. *The Chairman of the meeting of a company received a Proxy 54 hours before the time fixed for the start of the meeting. He refused to accept the Proxy on the ground that the Articles of the company provided that a Proxy must be filed 60 hours before the start of the meeting. Decide, under the provisions of the Companies Act, 1956 whether the Proxy holder can compel the Chairman to admit the Proxy?*

   [Hints: Yes, the holder of proxy can compel the chairman as per the Section 176(3) of the Companies Act, 1956]

4. *State whether the following statements are correct or incorrect. Give reasons:*

(i) *A company should file its annual return within six month of the close of the financial year.*

(ii) *The shareholder of the company is general meeting can increase the rate of dividend recommended by the Board of Directors.*

[Hints: (I) Incorrect, as per Section 159 of the Companies Act, 1956 (ii) Incorrect as shareholders can decrease the rate but cannot increase the rate of the dividend]

5. *Board of Directors of ABC Ltd., called for EGM on 14th January, 2010. Mr. M who is newly appointed as Company Secretary is confused over the issue of sending notices to joint shareholders of the company. Advise Mr. M by referring to the provisions of Companies Act, 1956.*

[Hints*:* In the case of joint shareholders, notices will be deemed to be properly served if the service is effected on the first named of the joint holders as entered in the register of members according to the provision given under Section 53(4) of the Companies Act, 1956].

6. *Annual General Meeting of a Public Company was scheduled to be held on 15.12.2009. Mr. A, a shareholder, issued two Proxies in respect of the shares held by him in favour of Mr. 'X' and Mr. 'Y'. The proxy in favour of 'Y' was lodged on 12.12.2009 and the one in favour of Mr. X was lodged on 15.12.2009. The company rejected the proxy in favour of Mr. Y as the proxy in favour of Mr. Y was of dated 12.12.2009 and thus in favour of Mr. X was of dated 13.12.2009. Is the rejection by the company in order ?*

[Hints: Proxy in favour of Y is valid since it is deposited in time as given section 176 of the Companies Act, 1956]

7. (i) *An annual general meeting of a company was convened in November, 2008. It was adjourned and the adjourned meeting was held in March, 2009. The next general meeting was held in March, 2010. The company was held liable for an irregularity in holding the AGMs. Decide.*

(ii) *Reliance Industries Ltd. has its registered office at Mumbai. The company desires to hold an extraordinary general meeting in New Delhi. Examine the validity of the company's desire with reference to the relevant provisions of the Companies Act, 1956.*

[Hints: (i) The company is guilty of violation of Section 166.

(ii) The company may hold the EGM at any place as per section172 (1), dealing with EGMs, contains no reference to any particular place for meeting.]