

CORPORATE LAWS AND COMPLIANCE

FINAL

STUDY NOTES



The Institute of Cost Accountants of India

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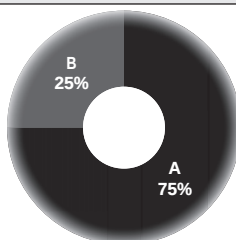
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Syllabus

Syllabus Structure

A	Corporate Laws	75%
B	Corporate Governance and Responsibilities	25%



ASSESSMENT STRATEGY

There will be written examination paper of three hours

OBJECTIVES

To gain an expert knowledge of Corporate functions in the context of Companies Act & related Corporate Laws. To be able to assess whether strategies and the organization is in compliance with established regulatory framework.

Learning Aims

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

- Understand the principles of Corporate Laws relevant for compliance and decision-making
- Analyze and interpret the impact of allied laws
- Evaluate the essence of Corporate Governance for effective implementation
- Demonstrate the role of a Corporate in socio-economic development

Skill set required

Level C: Requiring skill levels of knowledge, comprehension, application, analysis, synthesis and evaluation.

Section A : Corporate Laws	75%
1. The Companies Act, 1956 (as amended from time to time) – rules, regulations prescribed there under with special reference to: (a) Company formation and conversion (b) Procedure for alteration of Memorandum and Articles (c) Procedure for Issue of Shares and Securities (d) Investment and loans (e) Audits under Companies Act (f) Dividends (g) Board of Directors (h) Board Meetings and Procedures (i) Inspection and investigation (j) Prevention of oppression and mismanagement (k) Revival and rehabilitation of sick industrial companies (l) Corporate winding up and dissolution (m) Companies incorporated outside India (n) Offences and penalties (o) E-governance	

2. Laws and Procedures for Corporate Restructuring	
3. SEBI Laws and Regulations	
4. The Competition Act, 2002 and its role in Corporate Governance	
5. Laws related to Banking Sector	
6. Laws related to Insurance Sector	
7. Laws related to Power Sector	
Section B : Corporate Governance and Responsibilities	25%
8. Corporate Governance	
9. Social, Environmental and Economic Responsibilities of Business	

SECTION A: CORPORATE LAWS [75 MARKS]

1. The Companies Act, 1956 (as amended from time to time) – rules, regulations prescribed there under with special reference to:

- (a) Company formation and conversion
 - (i) Incorporation of private companies, public companies, company limited by guarantee and unlimited companies and their conversions/reconversion/re-registration
 - (ii) Nidhi Companies, Mutual Benefit Funds and Producer Companies – concept, formation, membership, functioning, dissolution
 - (iii) Formation of “Not-for-Profit” making companies
 - (iv) Procedure relating to Foreign Companies Carrying on Business in India
- (b) Procedure for alteration of Memorandum and Articles
 - (i) Alteration of various clauses of memorandum
 - (ii) Effects of alteration
- (c) Procedure for Issue of Shares and Securities
 - (i) Shares – public issue, Rights Issue, Bonus Shares, Issue of Shares at Par / Premium / Discount; issue of shares on preferential or private placement basis
 - (ii) Issue of Sweat Equity Shares, Employees Stock Option Scheme (ESOPs), Employees Stock Purchase Scheme (ESPS), Shares with differential voting rights
 - (iii) Issue and redemption of preference shares
 - (iv) Alteration of share capital – forfeiture of shares, reissue of forfeited shares, increase, consolidation, conversion and re-conversion into stock, subdivision, cancellation and surrender of shares
 - (v) Buy back of shares
 - (vi) Reduction of share capital
 - (vii) Issue of debentures and bonds, creation of security and debenture redemption reserve, redemption of debentures, conversion of debentures into shares
 - (viii) Transfer and transmission
- (d) Investment and loans
 - (i) Procedure for inter-corporate loans, investments, giving off guarantee and security
 - (ii) Acceptance of deposits, renewal, repayment, default and remedies
- (e) Audits under Companies Act
 - (i) CARO
 - (ii) Statutory Cost Auditor's and Statutory Financial Auditors – appointment, resignation, removal, qualification, disqualification, rights, duties and liabilities
 - (iii) Companies (Cost Accounting Record) Rules, 2011 and Companies (Cost Audit Report) Rules, 2011
- (f) Dividends
 - (i) Profits and ascertainment of divisible profits
 - (ii) Declaration and payment of dividend
 - (iii) Unpaid and unclaimed dividend – treatment and transfer to Investor Education and Protection Fund
- (g) Board of Directors
 - (i) Directors and Managerial Personnel – appointment, reappointment, resignation, removal
 - (ii) Payment of remuneration to Directors and managerial personnel and disclosures thereof
 - (iii) Power, Managerial remuneration
 - (iv) Obtaining DIN

- (v) Compensation for loss of office
- (vi) Waiver of recovery of remuneration
- (vii) Making loans to Directors, Disclosure of interest of a Director, Holding of Office or Place of Profit by a Director/relative
- (viii) Interested Directors
- (h) Board Meetings and Procedures
 - (i) Board Meetings, Minutes and Registers
 - (ii) Powers of the Board
 - (iii) Corporate Governance & Audit Committee
 - (iv) Duties and Liabilities of Directors
 - (iv) Powers related to – political contributions, sole selling agent, loans to Directors, Interested Directors, Office or Place of Profit
- (i) Inspection and investigation
- (j) Prevention of oppression and mismanagement
 - (i) Majority Rule but Minority Protection
 - (ii) Prevention of Oppression and Mismanagement
- (k) Revival and rehabilitation of sick industrial companies
- (l) Corporate winding up and dissolution – issues related to winding up, powers of the Court, Official Liquidator
 - (i) Reconstruction under Members' Voluntary Winding up [Sec. 494]
 - (ii) Reconstruction under Creditors' Voluntary Winding up [Sec. 507]
 - (iii) Reconstruction by arranging with Creditors in Voluntary Winding up [Sec. 517]
- (m) Companies incorporated outside India
- (n) Offences and penalties
- (o) E-governance

2. Laws and Procedures of Corporate Restructuring leading to:

- (a) Mergers; Amalgamations, Takeovers / Acquisitions, Joint Ventures, LLPs, Corporate restructure, Demerger, Reorganization through compromise or an arrangement
- (b) Reconstruction Vs. Amalgamation
- (c) Sale of undertaking of the Company [Sec. 391-394]
- (d) Acquiring Shares in another company [Sec. 395]
- (e) Compulsory Amalgamation in public interest [Sec. 396]

3. SEBI Laws and Regulations:

- (a) The Securities and Exchange Board of India Act,1992 – Rules, Regulations and Guidelines issued there under
- (b) The Securities Contracts (Regulation) Act,1956
- (c) SEBI (Issue of Capital and Disclosure Regulations), 2009
- (d) Clause 49
- (e) Substantial Acquisition of Shares and Takeover Regulations

4. The Competition Act, 2002 and its role in Corporate Governance

- (a) Competition – Meaning, objectives, extent and applicability
- (b) Competition Commission of India
- (c) Areas affecting competition
- (d) MRTP Act vs. Competition Act
- (e) Other matters
- (f) Competition Act, 2002 and Corporate Governance

5. Laws related to Banking Sector:

- (a) The Banking Regulation Act, 1949;
- (b) The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
- (c) The Prevention of Money Laundering Act, 2002 – Role of Cost Accountants in Anti-Money Laundering (AML) Audits to check tax evasion and transfer of funds.
- (d) The Foreign Exchange Management Act, 1999

6. Laws related to Insurance Sector:

- (a) The Insurance Act, 1938;
- (b) The Insurance Regulatory and Development Authority Act, 1999

7. Laws related to Power Sector:

- (a) The Indian Electricity Act, 1910
- (b) Role of Central Electricity Regulatory Commission (CERC)

SECTION B: CORPORATE GOVERNANCE AND RESPONSIBILITIES [25 MARKS]

8. Corporate Governance

- (a) Overview-Issues and Concepts
- (b) Corporate Governance Practices/Codes in India, UK, Japan, Germany and USA
- (c) Corporate governance in family business
- (d) Corporate governance in state-owned business – the MOU system

9. Social, Environmental and Economic Responsibilities of Business.

- (a) National Voluntary Guidelines on Social, environmental and Economic Responsibilities of Business
- (b) Corporate Social Responsibility – Nature of activities; Evaluation of CSR projects
- (c) Whole life costing- assessment of socio-economic impact of strategic and operational decisions of business.

Content

CORPORATE LAWS AND COMPLIANCE

Study Note 1 : The Companies Act, 1956

1.1	Company Formation and Conversion	1.1
1.2	Procedure for Alteration of Memorandum and Articles of Association	1.57
1.3	Procedure for Issue of Shares and Securities	1.69
1.4	Investments, Loans	1.136
1.5	Audits under Companies Act, 1956	1.155
1.6	Dividends	1.184
1.7	Board of Directors	1.202
1.8	Board Meetings And Procedures	1.258
1.9	Inspection and Investigation	1.299
1.10.	Prevention of Oppression and Mismanagement	1.313
1.11	Revival and Rehabilitation of Sick Industrial Companies	1.350
1.12.	Issues related to Winding Up and Dissolution	1.362
1.13.	Companies Incorporated outside India	1.416
1.14.	Offences and Penalties	1.426
1.15.	E - Governance	1.434

Study Note 2 : Laws and Procedures for Corporate Restructuring

2.1	Amalgamation/Merger	2.1
2.2.	Reconstruction Vs. Amalgamation	2.113
2.3.	Sale of undertaking of the Company [Sec.391-394]	2.114
2.4.	Acquiring Shares in another company [Sec. 395]	2.117
2.5.	Compulsory Amalgamation in public interest [Sec. 396]	2.117

Study Note 3 : SEBI Laws and Regulations

3.1	The Securities and Exchange Board of India Act, 1992	3.1
3.2	The Securities Contracts (Regulation) Act, 1956	3.24
3.3	Sebi (Issue Of Capital And Disclosure Requirements)	3.49
3.4	Clause 49- Corporate Governance	3.107
3.5	Sebi (Substantial Acquisition Of Shares And Takeovers) Regulations, 2011	3.121

Study Note 4 : The Competition Act, 2002 and its Role in Corporate Governance

4.1	Preliminary	4.1
4.2	Prohibition of Certain Agreements, Abuse of Dominant Position and Regulation of Combinations	4.4
4.3	Competition Commission Of India	4.9
4.4	Duties, Powers And Functions Of Commission	4.12
4.5	Duties Of Director General	4.22
4.6	Penalties	4.22
4.7	Competition Advocacy	4.24
4.8	Finance, Accounts And Audit	4.25
4.9	Competition Appellate Tribunal	4.26
4.10	Miscellaneous	4.32
4.11	MRTI Act, 1969 & Competition Act, 2002	4.39
4.12	Competition Act, 2002 And Corporate Governance	4.40

Study Note 5 : Laws Related to Banking Sector

5.1	The Banking Regulation Act, 1949	5.1
5.2	The Securitisation And Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002	5.81
5.3	The Prevention of Money Laundering Act, 2002	5.102
5.4	The Foreign Exchange Management Act, 1999	5.114

Study Note 6 : Laws Related to Insurance Sector

6.1	The Insurance Act, 1938	6.1
6.2	The Insurance Regulatory and Development Authority Act, 1999	6.131

Study Note 7 : Laws Related to Power Sector

7.1	The Indian Electricity Act 1910	7.1

Study Note 8 : Corporate Governance

8.1	Overview-Issues and Concepts	8.1
8.2	Corporate Governance Practices/Codes in - UK, Germany, Japan, India and USA	8.3
8.3	Corporate Governance in Family Business	8.28
8.4	Corporate Governance in State-owned Business - the MOU System	8.35

Study Note 9 : Social, Environmental and Economic Responsibilities of Business

9.1	Corporate Social Responsibility: Towards a Sustainable Future	9.1
9.2	CSR: A Commonly Misunderstood Concept	9.4
9.3	Corporate Social Responsibility– Perspectives and Best Practices	9.12
9.4	Corporate Social Responsibility Voluntary Guidelines 2009 from Ministry of Corporate Affairs, Government of India	9.35
9.5	Whole Life Costing - Assessment of Socio-economic impact of Strategic and Operational Decisions of Business	9.39

Study Note - 1

THE COMPANIES ACT, 1956



This Study Note includes

- 1.1 Company Formation and Conversion**
- 1.2 Procedure for Alteration of Memorandum and Articles of Association**
- 1.3 Procedure for Issue of Shares and Securities**
- 1.4 Investments, Loans**
- 1.5 Audits under Companies Act, 1956**
- 1.6 Dividends**
- 1.7 Board of Directors**
- 1.8 Board Meetings and Procedures**
- 1.9 Inspection and Investigation**
- 1.10. Prevention of Oppression and Mismanagement**
- 1.12. Issues related to Winding Up and Dissolution**
- 1.13. Companies Incorporated outside India**
- 1.14. Offences and Penalties**
- 1.15. E - Governance**

1.1 Company Formation and Conversion

The Companies Act, 1956 – Historical Background

- The Companies Act 1956 was enacted on the recommendations of the Bhaba Committee set up in 1950 with the object to consolidate the existing corporate laws and to provide a new basis for corporate operation in independent India. With enactment of this legislation in 1956, the Companies Act 1913 was repealed.
- The Companies Act, 1956, has since provided the legal framework for corporate entities in India. The need for streamlining this Act was felt from time to time as the corporate sector grew in pace with the Indian economy, with as many as 24 amendments taking place since 1956. Major amendments to the Act were made through Companies (Amendment) Act, 1988 after considering the recommendations of the Sachar Committee, and then again in 1998, 2000 and finally in 2002 through the Companies (Second Amendment) Act 2002, consequent to the report of the Eradi Committee.
- Many countries faced with the task of economic restructuring in response to the realities of a changing economic environment, have undertaken comprehensive revisions of their respective corporate laws. UK Companies Act was revised during the 1980s. Subsequently, many countries whose legal systems were derived from UK, such as Australia, New Zealand, Canada etc also undertook reviews of their corporate laws and brought about several comprehensive reforms. It is widely accepted that reform and updation of the basic legal framework for corporate entities is essential to enable sustainable economic reform.
- After a hesitant beginning in the 1980s, India took up its economic reforms programme in the 1990s. Equally, a need was felt for a comprehensive review of the Companies Act, 1956. Unsuccessful

attempts were made in 1993 and 1997 to replace the present Act with a new law. Companies (Amendment) Bill, 2003; containing important provisions relating to corporate governance was also introduced, the consideration of which has been held back in anticipation of the comprehensive review of the Company Law. While piecemeal reform continued through amendments, it has not yet been possible to bring about comprehensive, new legislation to replace the existing Act.

- In the current national and international context, there is a requirement for simplifying corporate laws so that they are amenable to clear interpretation and provide a framework that would facilitate faster economic growth. It is also increasingly being recognized that the framework for regulation of corporate entities has to be in tune with the emerging economic scenario, encourage good corporate governance and enable protection of the interests of the investors and other stakeholders. In the competitive and technology driven business environment, while corporates require greater autonomy of operation and opportunity for self-regulation with optimum compliance costs, there is a need to bring about transparency through better disclosures and greater responsibility on the part of corporate owners and managements for improved compliance.
- It is appreciated that the Government has taken up this fresh exercise for a comprehensive revision of the Companies Act 1956 on the basis of a broad based consultative exercise. As a the first step in this consultative process, a Concept Paper on Company Law drawn up in the legislative format was exposed for viewing on the electronic media so that all interested may not only express their opinions on the concepts involved but may also suggest formulations on various aspects of Company Law. This was a laudable step and has evoked considerable response. Comments and suggestions from a large number of organizations, professional bodies and individuals have been received. This consultative process will not only allow ideas, comments and suggestions to flow in from all quarters, but will also enable the Government to work out appropriate legislative proposals to meet the requirements of India's growing economy in the years to come.
- The Government, therefore, felt it appropriate that the proposals contained in the Concept Paper and suggestions received thereon be put to merit evaluation by an independent Expert Committee. The present Committee was constituted on 2nd December, 2004 under the chairmanship of Dr. J J Irani, Director, Tata Sons, with the task of advising the Government on the proposed revisions to the Companies Act, 1956. The objective of this exercise is perceived as the desire on the part of the Government to have a simplified compact law that will be able to address the changes taking place in the national and international scenario, enable adoption of internationally accepted best practices as well as provide adequate flexibility for timely evolution of new arrangements in response to the requirements of ever-changing business models. It is a welcome attempt to provide India with a modern Company Law to meet the requirements of a competitive economy.
- The Expert Committee consists of 13 members and 6 special invitees drawn from various disciplines and fields including trade and industry, chambers of commerce, professional institutes, representatives of Banks and Financial Institutions, Sr. Advocates etc. Government Ministries as well as regulatory bodies concerned with the subject were represented through special invitees. The Committee thus brings to bear a wide range of expertise and experience on the issues before it. In the exercise taken up by it, the Committee took the Companies Act, 1956, as amended, as the base and adopted the following approach:
 - Taking note of the Concept Paper and suggestions/objections and comments on the same received from various quarters, to enable synthesis of opinion on the desirable features of the new law;
 - Identifying the essential ingredients to be addressed by the new law, retaining desirable features of the existing framework, segregating substantive law from the procedures to enable a clear framework for good corporate governance that addresses the concerns of all stakeholders equitably.



- Making recommendations to enable easy and unambiguous interpretation by recasting the provisions of the law so as to enable easy understanding and interpretation;
- Enabling greater flexibility in procedural aspects through rule making, so that with the change of time the legal framework may adapt without amendment of the substantive enactment, which would be a time consuming process;
- Addressing the concerns arising out of the experience of the stock market scams of the 1990s, the phenomenon of vanishing companies and recommendations made by Joint Parliamentary Committee on Stock Market Scam;
- Enabling measures to protect the interests of stakeholders and investors, including small investors, through legal basis for sound corporate governance practices.
- Providing a framework for responsible self-regulation through determination of corporate matters through decisions by shareholders, in the background of clear accountability for such decisions, obviating the need for a regime based on Government approvals;
- Recognizing the relevance of a climate that encourages people to set up businesses and make them grow, addresses the practical concerns of small businesses so that people may deal with and invest in companies with confidence, promotes international competitiveness of Indian businesses and provides it the flexibility to meet the challenges of the global economy.

Definition of a Company

As per Section 3(1)(i) of the Companies Act, 1956, “

a “company” means a company formed and registered under this Act or an existing company as defined in clause 3(1)(ii)”.

Section 3(1)(ii) states as follows:

(ii) “existing company” means a company formed and registered under any of the previous companies laws.

Company - Classification

The Companies Act, 1956 provides for a variety of companies that may be promoted and registered under the Act. The two common types of companies which may be registered under the Act are:—

- (a) Private companies
- (b) Public companies

These companies may be incorporated either as limited liability companies or as unlimited liability companies.

Private company

By virtue of section 3(1)(iii) [as amended by the Companies (Amendment) Act, 2000], 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 :—
 - (i) persons who are in the employment of the company, and
 - (ii) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased; and

where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of membership, be treated as a single member.

- (c) prohibits 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.

In view of the aforesaid definition, a private company must, in its articles, incorporate the said restrictions, limitations and prohibitions. Sub-section (3) of section 27 further endorses this point by stating that a private company limited by shares must have articles containing restrictions, limitations and prohibitions required by section 3(1)(iii) and other private companies (i.e., not having share capital) must have in its articles the limitations and prohibitions contained in clauses (b), (c) and (d) of section 3(1)(iii).

Other requirements relating to a Private Company:

1. There should be at least two persons to form a private company. As per section 12, for forming a private company, two or more persons are required to subscribe their names to a Memorandum of Association. The subscribers to the Memorandum may, however, be nominees of a single person and subscribing their names may be merely a formality.

Any person who is competent to contract can be a subscriber. A company being a legal person can subscribe but a partnership firm cannot do so.

A minor cannot be a signatory to the Memorandum since he is not competent to contract. The guardian of a minor who subscribes to a memorandum on behalf of the minor will be deemed to have subscribed in his personal capacity.

Again, a Joint Hindu Family, being not a person, cannot be a subscriber. A 'Karta' or manager of the Joint Hindu Family may however sign on its behalf.

In the case of an illiterate subscriber, the thumb impression or mark duly attested by the person writing for him may be given.

2. The words 'private limited' or any acceptable abbreviation thereof, such as 'Pvt. Ltd.' must be added at the end of the name of a private limited company.

Public company [Section 3(i)(iv)]

A public company, as per the Companies (Amendment) Act, 2000 means a company which:

- (a) is not a private company;
- (b) has a minimum paid-up capital of ₹ 5 lakhs or such higher paid-up capital, as may be prescribed;
- (c) is a private company which is a subsidiary of a company which is not a private company.

Procedure for Incorporation/Registration of a Company

Pre- Registration Requirements

The directors must have a valid Director Identification Number (DIN), allotted by the Ministry of Corporate Affairs. DIN is a unique identification number for an existing director or a person intending to become a director of a company. As per a recent amendment to the Companies Act 1956, DIN has become mandatory for all the directors. DIN is unique and specific to an individual therefore only one DIN is allotted per individual even if the individual serves as director at multiple companies. Application for the allotment of Director Identification Number (DIN) can be obtained online on MCA's website. Duly completed DIN Application Form must be mailed to MCA DIN Cell, along with a proof of identity and a proof of residence with coloured photo. The photo affixed on the form and the proofs attached must be certified by a Public Notary or Gazetted Officer or any certified professionals.



At least one of the directors should have a valid Digital Signature Certificate issued by the Certifying Authorities (CA) and approved by the Ministry of Corporate Affairs. The Information Technology Act, 2000 provides for use of Digital Signatures on the documents submitted in electronic forms, in order to ensure the security and authenticity of the documents filed electronically. Every document prescribed under the Companies Act, 1956, is required to be filed with the digital signature of the managing director or director or manager or secretary of the company. Therefore at least one of directors must have a digital signature. Any person may make an application to the Certifying Authority for the issue of a Digital Signature in such form as may be prescribed by the Central Government. Digital Signatures are typically issued with one year validity and two year validity. The issuance cost varies depending on the CA. Digital Signatures can be obtained within an hour.

Name Approval

The first step in the process of formation is the application for MCA's approval of the desired name for the proposed company. Once, Company name is allotted, company registration documents are filed with respective ROC for registration. Application for name approval can be made online via MCA's portal MCA 21.

The following particulars are required to complete the form:-

Name of the Proposed Company
Location of the Registered office of the proposed Company
Main objectives of the business of the Company
Names of Subscribers of to the Memorandum of Association
Proposed Authorized Share Capital of the Company
DIN (Directors Identification Number) & DSC (Digital Signature Certificate)

Select, at least four names (a maximum of Six names can be listed), and indicate the order of preference. Ensure that the company name is in accordance to the guidelines of the MCA, and also ensure the name is unique and does not resemble the name of any existing company in India. The company name must end with the words 'Private Limited' or 'PVT Ltd'. In order to have specific key words in the name such as corporation, International, Hindustan, Industries, India etc., the proposed company should satisfy a minimum authorized capital criteria. Duly completed Form 1A for name approval must be submitted to the concerned ROC along with a fee of ₹500.

As per the amended rule 4A, upon due receipt of the application in Form 1A, the ROC shall examine whether the proposed name is undesirable within the meaning of section 20 of the Act. If it is not found to be undesirable, the ROC will intimate the applicants for the company about approval and availability of the proposed name and shall allow sixty days time from the date of approval of the name for registration of the company. In case the applicants fail to act within aforesaid time period,

they may seek extension of the period by another thirty days, with half the fee originally paid, before the expiry of the first sixty days. If within the extended period the applicants fail to act on the approved name, the same shall lapse. In the event, the ROC finds the name proposed in the initial application as undesirable, hence cannot be approved, shall intimate his finding to the applicants ordinarily within three days of receipt of the application and ask for either any further information that he may need in the matter or for resubmission of the application with new name.

Corporate Identity number-ROC is to allot a CIN to each company registered on or after November 1, 2000. Vide Circular No. 12/2000, dated 25-10-2000.

Preparation of Documents

After obtaining name approval from the ROC the following documents must be prepared to incorporate the company:

Memorandum of Association

Articles of Association

Form 1 - providing statutory declaration regarding compliance of all the incorporation requirements

Form 18 - providing details of registered office of the company

Form 29 - providing consent in writing to act as a director (in case of a public company having a share capital)

Form 32 - providing details of Directors of the Company

The Memorandum of Association is a document that sets out the constitution of the company. It contains, amongst others, the objectives and the scope of activity of the company and also describes the relationship of the company with the outside world.

The Articles of Association contain the rules and regulations of the company for the management of its internal affairs. While the Memorandum specifies the objectives and purposes for which the Company has been formed, the Articles lay down the rules and regulations for achieving those objectives and purposes. It also states the authorized share capital of the proposed company and the names of its first / permanent directors.

Professional help is to be sought in the drafting of the MOA and AOA, as it contains the governing policies, rules and by-laws of the proposed venture. The draft must be carefully vetted by the promoters before printing and stamping.

The MOA and AOA must be signed by at least two subscribers in his own hand, along with father's name, occupation, address and the number of shares subscribed for and witnessed by at least one person, who shall attest the signature and shall likewise add his address, description and occupation, if any.

Then the MOA and AOA are required to be stamped & filed with the ROC. A stamp duty is required to be paid on the MOA and on the AOA. The stamp duty depends on the authorized share capital and varies between states as per the Stamp Act applicable to the State where the company is incorporated.



Submission of Documents

The following documents are to be submitted to the office of Registrar of Companies(ROC) with the filing fee and the registration fee:

- 1 •The Stamped and Signed MOA and AOA (3 copies)
- 2 •Form 1, 18 , 29 & 32 (in duplicate)
- 3 •Any agreement referred to in the Memorandum of Association & Articles of Association
- 4 •Any agreement proposed to be entered into with any individual for appointment as Managing Director or Whole-time Director
- 5 •Declaration of Compliance by an Advocate or Company Secretary or Chartered Accountant or Director, Manager or Secretary of the Company
- 6 •Name Availability Letter issued by ROC
- 7 •Power of Attorney authorizing a person, on behalf of Subscribers, any documents and papers filed for registration. The Power of Attorney should be given on Non-Judicial Stamp paper of appropriate value and submitted to the Registrar

Payment of Registration Fees

The fees payable to the Registrar at the time of registration of a new company varies according to the authorized capital of a company proposed to be registered. The amount of registration fee and filing fee payable are given in Schedule X to the Companies Act.

Obtaining Certificate of Incorporation

The ROC will issue a Certificate of Incorporation after careful review of documents submitted. Section 34(1) cast an obligation on the Registrar to issue a Certificate of Incorporation, normally within 7 days of the receipt of documents. A Private Limited Company or a Company having no share capital may commence its business and exercise its powers immediately after it is incorporated.

The Public Company having share capital, on the other hand, in addition to the steps followed by a Private Limited Company has to obtain a certificate of Commencement of Business before they can commence the business or exercise its borrowing powers.

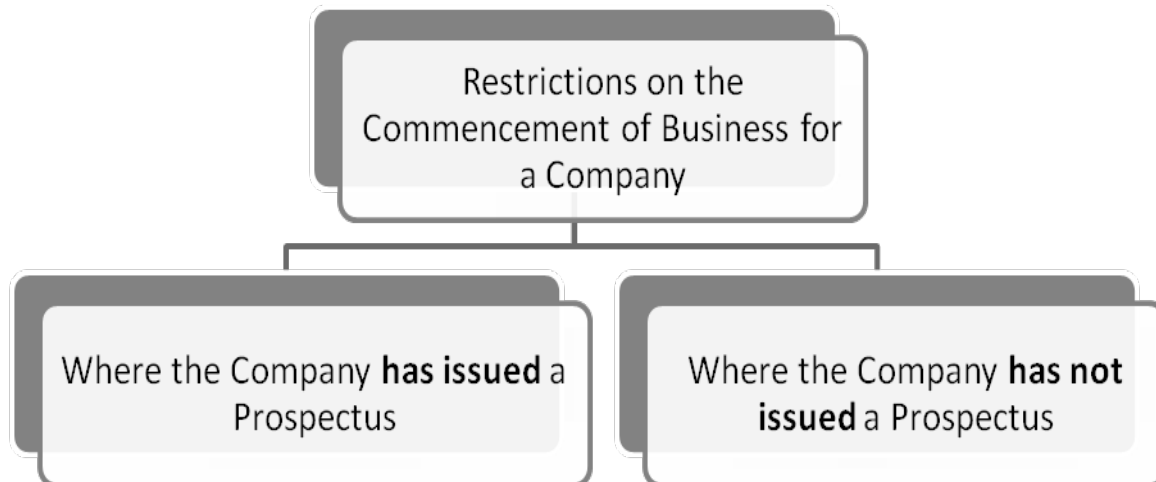
In order to obtain this certificate, the company must comply with the provisions of section 149 of the Companies Act and has to:

- File a declaration of compliance with the provisions of Section 149(2)(b) of the Act in Form No.20 and attach the statement in lieu of the prospectus(schedule III)

OR

- File a declaration of compliance with the provisions of Section 149 (1)(a),(b),(c) of the Act in Form No.19 and attach the prospectus (Schedule II) to it.

Section 149 of the Act, states the Restrictions on the commencement of Business:-



Where the company has issued a prospectus-Section 149(1) provides that if a company having a share capital has issued a prospectus, it shall not commence any business or exercise any borrowing powers, unless -

- (a) shares up to the amount of the minimum subscription have been allotted by the company;
- (b) every director of the company has paid to the company, on each of the shares taken or contracted to be taken by him and for which he is liable to pay in cash, the same proportion as is payable on application and allotment on the shares, offered for public subscription;
- (c) no money is, or may become, liable to be repaid to applicants for any shares or debentures offered for public subscription, for failure to obtain permission for the shares to be dealt in on any recognized stock exchange.

Where the company has not issued a prospectus-Section 149(2) requires that if a public company having share capital has not issued a prospectus, it shall not commence business or exercise any borrowing powers unless every director of the company has paid to the company, on each of the shares taken or contracted to be taken by him and for which he is liable to pay in cash, a proportion equal to the proportion payable on application and allotment on the shares payable in cash.

Registration of Companies without share capital

The Act provides for registration of companies which need not have share capital. However, with the requirement of minimum paid-up share capital for a public company and a private company, the concept of companies without share capital has become redundant. No doubt, in terms of sub-section (6) of section 3 the minimum paid-up capital requirement is not applicable to a company registered under section 25 of the Act which belongs to the category of the companies not having share capital.

Limited liability companies

The discussion on limited liability companies may be divided under the following three heads:—

- (i) Companies limited by shares;
- (ii) Companies limited by guarantee;
- (iii) Companies limited by guarantee having share capital.



- (i) **Companies limited by shares** - A company having the liability of its members limited by the memorandum, to the amount, if any, unpaid on the shares respectively held by them is termed "a company limited by shares" [Sec. 12(2)(a)]. Such a company is commonly called limited liability company although the liability of the company is never limited, it is the liability of its members which is limited. The liability of members can be enforced at any time during the existence and also during the winding-up of the company. Such a company must have share capital as the extent of liability is determined by the face value of shares. However, except where the articles otherwise provide, there is no liability to pay any balance amount due on the shares, except in pursuance of calls duly made in accordance with law and the articles while the company is a going concern or of calls made in the event of winding up of the company.
- (ii) **Companies limited by guarantee** - A company limited by guarantee may be defined as a company having 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 [Section 12(2)(b)]. The liability of a member in the case of a company limited by guarantee, where the company has no share capital, is limited to the amount which he has undertaken by the memorandum of association to contribute to the assets of the company in the event of its being wound up.
- (iii) **Companies limited by guarantee having share capital**- The liability of member of a guarantee company having share capital is not merely limited to the amount guaranteed; he may be called upon to also contribute to the extent of any sums remaining unpaid on the shares held by him [Sec. 426(2)]. Such companies have been exempted from minimum paid-up share capital requirement introduced vide Companies (Amendment) Act, 2000.

Unlimited Liability Company

A company having no limit on the liability of its members is an unlimited company [Sec. 12(2)(c)]. Thus, in the case of an unlimited liability company, the liability of each member extends to the whole amount of the company's debts and liabilities. It may be seen that the liability of members of an unlimited company is similar to that of the partners but unlike the liability of partners, the members of the company cannot be directly proceeded against. Company being a separate legal entity, the claims can be enforced only against the company. Thus, creditors shall have to institute proceedings for winding-up of the company for their claims. But the official liquidator may call upon the members to discharge the debts and liabilities without limit.

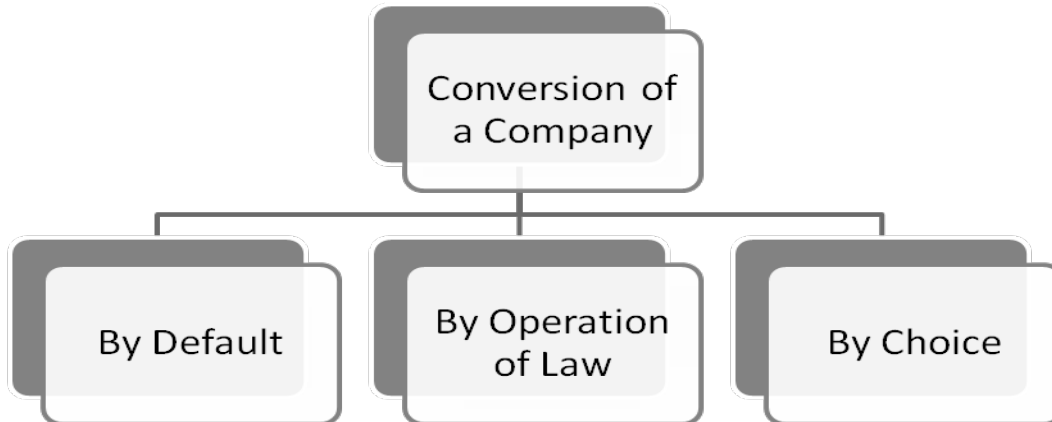
An unlimited company may or may not have share capital. The articles of association of an unlimited company must state the number of members with which the company is to be registered and, if the company has share capital, the amount of share capital with which the company is to be registered [Sec. 27(1)].

As the capital, if any, is stated in the articles and not in the memorandum, it may be varied, increased or reduced, by passing a special resolution.

An unlimited company is not subjected to any restrictions regarding purchase of its own shares [Sec. 77]. Accordingly, such a company may purchase its own shares or advance monies to any person to purchase its shares. Under section 32, a company registered as an unlimited company may subsequently convert itself into a limited liability company, subject to the provision that any debt, liabilities, applications or contracts in regard to or entered into, by or on behalf of the unlimited liability company before such conversion are not affected by such conversion.

Conversion of a Private company into a Public company

The discussion on conversion of a private company into a public company may be grouped under the following heads :—



1. **Conversion by default [Sec. 43]**- Where a private company makes a default in compliance with the statutory requirement as laid down in sec. 3(1)(iii) of the Act (i.e., if its membership exceeds 50 or it permits free transferability of shares or extends invitation to public to subscribe to shares or debentures or to make deposit), it becomes a public company automatically. As a consequence, the company shall cease to enjoy the privileges and exemptions conferred on a private company and the provisions of the Companies Act shall apply to it as if it were a public company. However, the Company Law Board (now Central Government¹) on being satisfied that the failure to comply with the conditions was accidental or due to inadvertence or to some other sufficient cause, may grant relief from such consequence as aforesaid. The relief may be granted on grounds which the Company Law Board (now Central Government¹) feels are just and equitable.

It may be noted that the provisions of section 43 are very general. A departure from the conditions of section 3(1)(iii) invites such penalty as may be applicable to a public company for contravention of the provisions of the Companies Act. The section does not fix any time limit or impose any special penalty.

Petition praying for relief is required to be made in Form No. 1 of Annexure II to the CLB Regulations, 1991 along with prescribed application fee accompanied by the following documents:

1. Copy of memorandum and articles of association;
 2. Copy of document showing that the default has been committed in complying with the conditions laid down in sec. 3(1)(iii);
 3. Affidavit verifying the petition;
 4. Bank draft evidencing the payment of prescribed fee;
 5. Memorandum of appearance.
2. **Conversion by operation of law (Deemed Public Company) [Sec. 43A]**- Section 43A was introduced in 1960 (and was further amended in 1965, 1974 and 1988) to check misuse of private company status. Since private companies were conferred certain privileges and exemptions under the Companies Act, 1956, certain managements incorporated their companies as private companies but employed substantial public funds. Section 43A introduced certain criteria² according to which such private companies were treated as 'deemed public companies'. The Companies (Amendment) Act, 2000 has, by introducing sub-section (11) to section 43A, made the section inoperative except sub-section (2A) [again added by the Companies (Amendment) Act, 2000]. The effect of introduction of sub-section (11) is that, on and after commencement of



the Companies (Amendment) Act, 2000, a private company will not automatically become a public company on account of shareholding or turnover. Acceptance of deposit criterion has been shifted to section 3(1)(iii) whereby a private company accepting deposits from public shall become a public company.

Sub-section (2A) allows an existing deemed public company to opt to become a private company by complying with the (new) requirements of section 3(1)(iii). In such a case, the sub-section requires the company to inform the Registrar that it has become a private company and thereupon the Registrar shall substitute the words "private company" for the words "public company" in the name of the company upon the register and shall also make the necessary alterations in the certificate of incorporation issued to the company and in its memorandum of association within four weeks from the date of application made by the company.*

Note:

1. Vide Companies (Second Amendment) Act, 2002.
2. According to section 43A, before amendment, a private company was deemed to be a public company in the following cases:
 - (i) If 25% or more of its paid-up share capital is held by a public company or a deemed public company except where the said percentage is held by a banking company as a trustee or executor/administrator for any individual(s).
 - (ii) If its average annual turnover for last three financial years is ₹ 25 crores or more,
 - (iii) If it holds 25% or more of the paid-up share capital of a public company,
 - (iv) If it invites, accept or renews deposits from public.

'No time limit has, however, been set for the company to inform the Registrar. Accordingly, the company shall continue to be treated as a public company till the said information to the Registrar.

The Department of Company Affairs, vide its Circular No. 3/2002, dated 24-7-2002, has stated that fixing of time limit for getting conversion by deemed public company to private limited company under section 43A(2A) may not be feasible. If a private company which became a deemed public company under section 43A when it was in force does not approach for reconversion, it is deemed to have chosen to remain as a public company.

3. Conversion by choice [Sec. 44] - A private company may, of its own choice, become a public company.

The following steps are necessary for this purpose:

- (i) Special Resolution - A private company desiring to become public company must pass a special resolution deleting from its articles the requirements of section 3(1)(iii). A copy of the special resolution so passed must be filed with the Registrar of Companies within 30 days thereof;
- (ii) Increase in membership- If the number of members is less than seven, it must be raised to not less than seven (Sec. 12).
- (iii) Increase in number of directors - If the number of directors is less than three, it must be raised to not less than three (Sec. 252).
- (iv) Raising of paid-up capital to the minimum prescribed for public companies (presently, ₹ 5 lakhs).
- (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 [Sec. 44(1)(b)].

Every prospectus filed under sub-section (1) shall state the matters specified in Part I of Schedule II and set out the reports specified in Part II of that Schedule [Sec. 44(2)(a)].

Every statement in lieu of prospectus filed shall be in the form and contain particulars set out in Schedule IV [Sec. 44(2)(b)].

If default is made in complying with sub-section (1) or (2), the company, and every officer of the company who is in default, shall be punishable with fine, which may extend to five thousand rupees for every day during which the default continues.

Where any prospectus or statement in lieu of prospectus filed under this section includes any untrue statement, any person who authorised the filing of such prospectus or statement shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to fifty thousand rupees, or with both, unless he proves either that the statement was immaterial or that he had reasonable ground to believe, and did up to the time of filing of the prospectus or statement believe, that the statement was true.

Fact of a company becoming a public limited company is of no consequence insofar as rights and obligations of company are concerned, nor does it render defective any legal proceedings by or against it - *Wasava Tyres v. Printers (Mysore) Ltd.* [2008] 86 SCL171(Kar.).

Where by passing resolutions a final decision had been taken by the company to convert itself into a public company with immediate effect; Form No. 23 had been filed along with said resolutions and statement in lieu of prospectus, which is required to be filed by a private company when it has converted itself into a public company, had been filed on behalf of the company, it was sufficient for the purpose of arriving at a prima facie conclusion that the company had altered its status and had become a public company even though the necessary alterations had not been effected in the records of the Registrar of Companies - *Ram Purshotam Mittal v. Hillcrest Realty Sdn. Bhd.*, [2009] 94 SCL 120 (SC).

Conversion of a public company into a private company

No express provision exists in the Companies Act except the reference in the proviso to sec. 31 (1) and (2 A) for converting a public company into a private company.

Conversion of a public company into a private company will require:

- (i) Passing of a special resolution authorising the conversion and altering the articles so as to contain the matters specified in sec. 3(1)(iii).
- (ii) Changing the name of the company by omitting the word 'Private'. As per section 21, it does not require special resolution to be passed,
- (ii) Obtaining the approval of the Central Government as required by section 31: Proviso to section 31(1) provides that no alteration made in the articles which has the effect of converting a public company into a private company shall have effect unless such alteration has been approved by the Central Government.
- (iv) Filing of printed copy of the articles as altered within one month of the receipt of the approval of the Central Government [Sec. 31(2A)].

RE-REGISTRATION

Is it possible to re-register a private limited company to a public limited company and then back to a private limited company? Are there any restrictions?

Unlike the restriction imposed when a limited company intends to re-register as an unlimited company, [see Sections 102-104 of the Companies Act 2006 (the Act)], there are no restrictions in law as to the number of times a private limited company can re-register as a public company and then re-register back to a private company.



However, the commercial justification for undertaking multiple re-registrations is something the board should consider very carefully. Depending on the number of shareholders in the company one may find it difficult to re-register on multiple occasions.

The intention to re-register as a public company may be to offer shares to the public and obtain a Listing or admission to trading on AIM or PLUS. Or it might be to gain a perceived degree of commercial respectability by having the status of a public company.

Re-registration back to a private company may be required if the company is acquired by another company or the directors feel there is no benefit in remaining a public company. There may also be legal reasons, for example if, following a court order confirming a reduction of capital, the nominal value of the allotted share capital falls below the authorised minimum (Sec.650). Re-registration can also be used to circumvent some of the more onerous obligations imposed on public companies. The cost implications involved in multiple re-registrations should be considered. For example, in preparing balance sheets and obtaining unqualified audit reports as required by Sec.92 of the Act when re-registering from private to public.

1.1.2. Nidhi Companies, Mutual Benefit Funds and Producer Companies

Nidhi Companies

For over a century Nidhis, with the objective of cultivating the habit of thrift, were promoted by public spirited men drawn from affluent local persons, lawyers and professionals like auditors, educationists, etc., including retired persons. The area of operation was local – within municipalities and panchayats. Some Nidhis on account of their financial and administrative strength opened branches within the respective revenue district and even outside. The principle of mutual benefit was fundamental – to get savings from members and lend only to members and never have dealing with Non-members.

The primary object of Nidhis has been to carry on the business of accepting deposits and lending money to member-borrowers only against jewels, etc., and mortgage of property. Nidhis were not expected to engage themselves in the business of Chit Fund, hire purchase, insurance or in any other business including investments in shares or debentures. As stated these Nidhis do their business only with Members. Such Members are only individuals. Bodies Corporate or Trusts are never to be admitted as Members.

In the history of Nidhis, there have been some failures but what hit the headlines recently is the failure of leading Nidhis involving crores of rupees and lakhs of depositors, caused by imprudent lending and mismanagement by those in control. On account of these startling failures there is a tendency to condemn Nidhis as a whole. The facts, are that a large number of Nidhis, many of them 100 years old, have been functioning without giving room for any complaint and their financial resources mobilisation and service oriented practices have been commendable. Nidhis play a very useful role in helping middle and lower middle classes by providing quick financial services with minimum formalities and should, therefore, be allowed to grow with supervision.

Nidhi is a company governed by the provisions of the Companies Act, the MCA has all along taken into consideration the objective of the Nidhi and has, therefore, sanctioned concessions by way of exempting the Nidhis from certain provisions of the Companies Act.

Nidhi according to Section 620A of Companies Act 1956 means:

1. In this section, "Nidhi " or " Mutual Benefit Society " means a company which the Central Government may, by notification in the Official Gazette, declare to be a Nidhi or Mutual Benefit Society, as the case may be.
2. The Central Government may, by notification in the Official Gazette, direct that any of the provisions of this Act specified in the notification 356

- a) Shall not apply to any Nidhi or Mutual Benefit Society, or
 - b) Shall apply to any Nidhi or Mutual Benefit Society with such exceptions, modifications and adaptations as may be specified in the notification.
3. A copy of every notification issued under sub-section (1) shall be laid as soon as may be after it is issued, before each House of Parliament.

Procedure for Incorporation of Nidhis

1. At the outset it would be pertinent to mention that there is no Government Notification defining the word 'Nidhi'. The companies doing Nidhi business, viz. borrowing from members and lending to members only against security, go under different names such as Nidhi, Permanent Fund, Benefit Funds, Mutual Benefit Funds and Mutual Benefit Company. In view of the above situation the Committee feels that it is imperative that a precise definition and meaning should be given to the word Nidhi. Taking into consideration the manner of functioning of Nidhis at present and the recommendations of the Committee in this report and also to prevent unscrupulous persons using the word 'Nidhi' in their name without being incorporated by Department of Company Affairs and yet doing Nidhi business, the Committee suggests the following definition:

"Nidhi is a company formed with the exclusive object of cultivating the habit of thrift, savings and functioning for the mutual benefit of members by receiving deposits only from individuals enrolled as members and by lending only to individuals, also enrolled as members, and which functions as per Notification and Guidelines prescribed by the DCA. The word Nidhi shall not form part of the name of any company, firm or individual engaged in borrowing and lending money without incorporation by DCA and such contravention will attract penal action."
2. The Committee also recommends that any company desirous of doing Nidhi business as defined above should have the word 'Nidhi' added to the company's name. In so far as the existing companies functioning as Nidhis, they should be required to add the word 'Nidhi' after their name within a period of three months.

The present procedure to incorporate a Nidhi company is as follows:

- **Name of the Company:-** To get approval of the name by which the company will be known. The promoters propose three names to ROC. After verification the ROC is able to either identify one name or else calls for a panel of fresh names. Following this exercise a name is finally allotted by ROC to the promoters which will be used as the name of the company. But the word 'Nidhi' cannot be used as a part of the name at this stage.
- **Submission of MOA & AOA:-** The promoters submit the Memorandum and Articles of Association to ROC who after examination registers the company and issues a Certificate of Incorporation.
- **Submission of other documents:-** The company submits to the ROC documents such as a Statement in lieu of Prospectus, declaration by the promoters etc., specified under Section 149 of the Companies Act. ROC registers these documents after corrections if any and issues a Certificate of Commencement of Business.

At this stage there is no stipulation as to the membership strength of the company nor any restriction regarding capital for doing business. The company can receive deposits and lend without any restriction on rates of interest and for any period of time. Consequently, the functioning of such companies is not restricted or supervised by the authorities. During this period authorities are expected to know the functioning of this type of companies and place restrictions on receipt of deposits.

Nidhi Companies are Companies notified by the Central Government as such under Section 620A of the Companies Act, 1956. These Companies mainly engage in the business of collecting deposits in the form of Savings Deposit, Recurring Deposit etc. And also lend the same to the members of the Company. One of the important feature of a Nidhi Company is that it deals only with members (share holders). Thus if you want to deposit any amount in a Nidhi Company or want to avail a loan from



a Nidhi Company, first you have to become a member by subscribing to shares of the Company.

Moreover, Nidhi Companies can open SB Accounts for its members. Moreover, there are certain restrictions like a Director can hold office for a continuous period of 10 years only and an Auditor for a period of 5 years.

Nidhi is a company formed with the exclusive object of cultivating the habit of thrift, savings and functioning for the mutual benefit of members by receiving deposits only from individuals enrolled as members and by lending only to individuals, also enrolled as members, and which functions as per Notification and Guidelines prescribed by the DCA. The word Nidhi shall not form part of the name of any company, firm or individual engaged in borrowing and lending money without incorporation by DCA and such contravention will attract penal action. First you have to register your company under the Companies Act, 1956. Then you have to get approval from Registrar of Chits for Chits company incorporation. For NBFC you have to get prior approval from RBI to commence business.

MUTUAL BENEFIT FUNDS

Introduction

Out of the different investment avenues are available to investors. Mutual funds also offer good investment opportunities to the investors. Like all investments, they also carry certain risks. The investors should compare the risks and expected yields after adjustment of tax on various instruments while taking investment decisions. The investors may seek advice from experts and consultants including agents and distributors of mutual funds schemes while making investment decisions.

Mutual Fund

Mutual fund is a mechanism for pooling the resources by issuing units to the investors and investing funds in securities in accordance with objectives as disclosed in offer document.

Investments in securities are spread across a wide cross-section of industries and sectors and thus the risk is reduced. Diversification reduces the risk because all stocks may not move in the same direction in the same proportion at the same time. Mutual fund issues units to the investors in accordance with quantum of money invested by them. Investors of mutual funds are known as unit holders.

The profits or losses are shared by the investors in proportion to their investments. The mutual funds normally come out with a number of schemes with different investment objectives which are launched from time to time. A mutual fund is required to be registered with Securities and Exchange Board of India (SEBI) which regulates securities markets before it can collect funds from the public.

History of Mutual Funds in India and role of SEBI in mutual funds industry

Unit Trust of India was the first mutual fund set up in India in the year 1963. In early 1990s, Government allowed public sector banks and institutions to set up mutual funds.

In the year 1992, Securities and exchange Board of India (SEBI) Act was passed. The objectives of SEBI are – to protect the interest of investors in securities and to promote the development of and to regulate the securities market.

As far as mutual funds are concerned, SEBI formulates policies and regulates the mutual funds to protect the interest of the investors. SEBI notified regulations for the mutual funds in 1993. Thereafter, mutual funds sponsored by private sector entities were allowed to enter the capital market. The regulations were fully revised in 1996 and have been amended thereafter from time to time. SEBI has also issued guidelines to the mutual funds from time to time to protect the interests of investors.

All mutual funds whether promoted by public sector or private sector entities including those promoted by foreign entities are governed by the same set of Regulations. There is no distinction in regulatory requirements for these mutual funds and all are subject to monitoring and inspections by SEBI. The risks associated with the schemes launched by the mutual funds sponsored by these entities are of similar type.

Set up of Mutual Funds

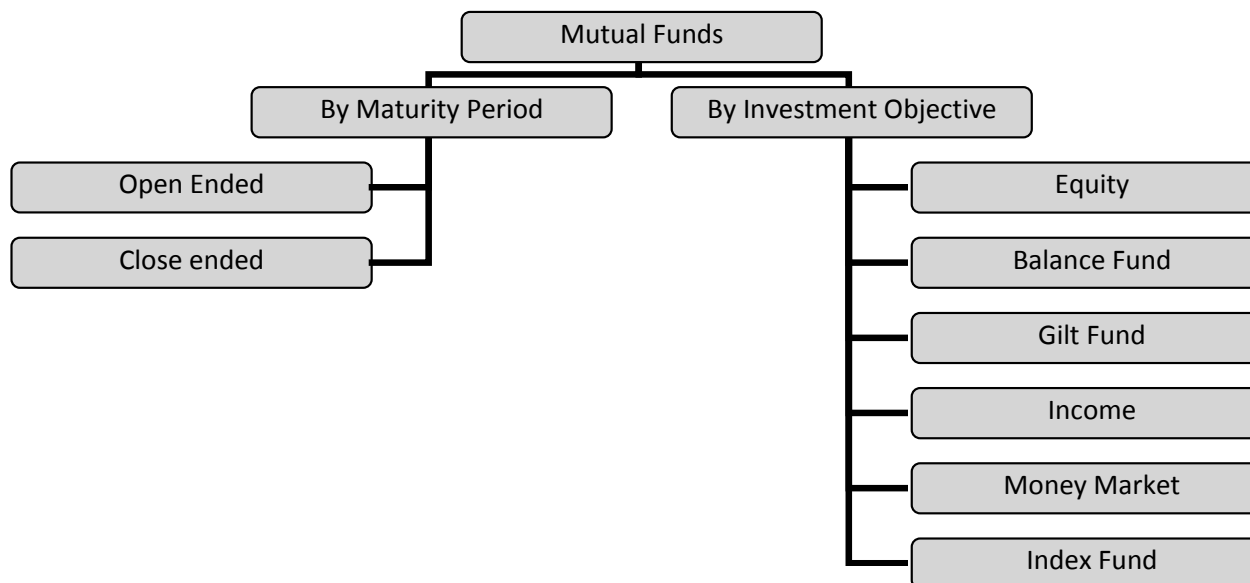
A mutual fund is set up in the form of a trust, which has sponsor, trustees, asset management company (AMC) and custodian. The trust is established by a sponsor or more than one sponsor who is like promoter of a company. The trustees of the mutual fund hold its property for the benefit of the unit holders. Asset Management Company (AMC) approved by SEBI manages the funds by making investments in various types of securities. Custodian, who is registered with SEBI, holds the securities of various schemes of the fund in its custody. The trustees are vested with the general power of superintendence and direction over AMC. They monitor the performance and compliance of SEBI Regulations by the mutual fund.

SEBI Regulations require that at least two thirds of the directors of trustee company or board of trustees must be independent i.e. they should not be associated with the sponsors. Also, 50% of the directors of AMC must be independent. All mutual funds are required to be registered with SEBI before they launch any scheme.

NAV of Scheme

The performance of a particular scheme of a mutual fund is denoted by Net Asset Value (NAV). Mutual funds invest the money collected from the investors in securities markets. In simple words, Net Asset Value is the market value of the securities held by the scheme. Since market value of securities changes every day, NAV of a scheme also varies on day to day basis. The NAV per unit is the market value of securities of a scheme divided by the total number of units of the scheme on any particular date. For example, if the market value of securities of a mutual fund scheme is ₹ 200 lakhs and the mutual fund has issued 10 lakhs units of ₹ 10 each to the investors, then the NAV per unit of the fund is ₹ 20. NAV is required to be disclosed by the mutual funds on a regular basis - daily or weekly - depending on the type of scheme.

Different types of Mutual Fund Schemes



The different schemes are detailed hereunder:

Schemes according to Maturity Period:

A mutual fund scheme can be classified into open-ended scheme or close-ended scheme depending on its maturity period.



Open-ended Fund/ Scheme

An open-ended fund or scheme is one that is available for subscription and repurchase on a continuous basis. These schemes do not have a fixed maturity period. Investors can conveniently buy and sell units at Net Asset Value (NAV) related prices which are declared on a daily basis. The key feature of open-end schemes is liquidity.

Close-ended Fund/ Scheme

A close-ended fund or scheme has a stipulated maturity period e.g. 5-7 years. The fund is open for subscription only during a specified period at the time of launch of the scheme. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchanges where the units are listed. In order to provide an exit route to the investors, some close-ended funds give an option of selling back the units to the mutual fund through periodic repurchase at NAV related prices. SEBI Regulations stipulate that at least one of the two exit routes is provided to the investor i.e. either repurchase facility or through listing on stock exchanges. These mutual funds schemes disclose NAV generally on weekly basis.

Schemes according to Investment Objective:

A scheme can also be classified as growth scheme, income scheme, or balanced scheme considering its investment objective. Such schemes may be open-ended or close-ended schemes as described earlier. Such schemes may be classified mainly as follows:

Growth / Equity Oriented Scheme

The aim of growth funds is to provide capital appreciation over the medium to long-term. Such schemes normally invest a major part of their corpus in equities. Such funds have comparatively high risks. These schemes provide different options to the investors like dividend option, capital appreciation, etc. and the investors may choose an option depending on their preferences. The investors must indicate the option in the application form. The mutual funds also allow the investors to change the options at a later date. Growth schemes are good for investors having a long-term outlook seeking appreciation over a period of time.

Income / Debt Oriented Scheme

The aim of income funds is to provide regular and steady income to investors. Such schemes generally invest in fixed income securities such as bonds, corporate debentures, Government securities and money market instruments. Such funds are less risky compared to equity schemes. These funds are not affected because of fluctuations in equity markets. However, opportunities of capital appreciation are also limited in such funds. The NAVs of such funds are affected because of change in interest rates in the country. If the interest rates fall, NAVs of such funds are likely to increase in the short run and vice versa. However, long term investors may not bother about these fluctuations.

Balanced Fund

The aim of balanced funds is to provide both growth and regular income as such schemes invest both in equities and fixed income securities in the proportion indicated in their offer documents. These are appropriate for investors looking for moderate growth. They generally invest 40-60% in equity and debt instruments. These funds are also affected because of fluctuations in share prices in the stock markets. However, NAVs of such funds are likely to be less volatile compared to pure equity funds.

Money Market or Liquid Fund

These funds are also income funds and their aim is to provide easy liquidity, preservation of capital and moderate income. These schemes invest exclusively in safer short-term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money, government securities, etc. Returns on these schemes fluctuate much less compared to other funds. These funds are appropriate for corporate and individual investors as a means to park their surplus funds for short periods.

Gilt Fund

These funds invest exclusively in government securities. Government securities have no default risk. NAVs of these schemes also fluctuate due to change in interest rates and other economic factors as is the case with income or debt oriented schemes.

Index Funds

Index Funds replicate the portfolio of a particular index such as the BSE Sensitive index, S&P NSE 50 index (Nifty), etc. These schemes invest in the securities in the same weightage comprising of an index. NAVs of such schemes would rise or fall in accordance with the rise or fall in the index, though not exactly by the same percentage due to some factors known as "tracking error" in technical terms. Necessary disclosures in this regard are made in the offer document of the mutual fund scheme.

There are also exchange traded index funds launched by the mutual funds which are traded on the stock exchanges.

Sector specific funds/schemes

These are the funds/schemes which invest in the securities of only those sectors or industries as specified in the offer documents. e.g. Pharmaceuticals, Software, Fast Moving Consumer Goods (FMCG), Petroleum stocks, etc. The returns in these funds are dependent on the performance of the respective sectors/industries. While these funds may give higher returns, they are more risky compared to diversified funds. Investors need to keep a watch on the performance of those sectors/industries and must exit at an appropriate time. They may also seek advice of an expert.

Tax Saving Schemes

These schemes offer tax rebates to the investors under specific provisions of the Income Tax Act, 1961 as the Government offers tax incentives for investment in specified avenues. e.g. Equity Linked Savings Schemes (ELSS). Pension schemes launched by the mutual funds also offer tax benefits. These schemes are growth oriented and invest pre-dominantly in equities. Their growth opportunities and risks associated are like any equity-oriented scheme.

Fund of Funds (FoF) scheme

A scheme that invests primarily in other schemes of the same mutual fund or other mutual funds is known as a FoF scheme. An FoF scheme enables the investors to achieve greater diversification through one scheme. It spreads risks across a greater universe.

Load or no-load Fund

A Load Fund is one that charges a percentage of NAV for entry or exit. That is, each time one buys or sells units in the fund, a charge will be payable. This charge is used by the mutual fund for marketing and distribution expenses. Suppose the NAV per unit is ₹ 10. If the entry as well as exit load charged is 1%, then the investors who buy would be required to pay ₹ 10.10 and those who offer their units for repurchase to the mutual fund will get only ₹ 9.90 per unit. The investors should take the loads into consideration while making investment as these affect their yields/returns. However, the investors should also consider the performance track record and service standards of the mutual fund which are more important. Efficient funds may give higher returns in spite of loads.

A no-load fund is one that does not charge for entry or exit. It means the investors can enter the fund/scheme at NAV and no additional charges are payable on purchase or sale of units.

Sales or repurchase/redemption price

The price or NAV a unit holder is charged while investing in an open-ended scheme is called sales price. It may include sales load, if applicable.



Repurchase or redemption price is the price or NAV at which an open-ended scheme purchases or redeems its units from the unit holders. It may include exit load, if applicable.

Assured return scheme

Assured return schemes are those schemes that assure a specific return to the unit holders irrespective of performance of the scheme.

A scheme cannot promise returns unless such returns are fully guaranteed by the sponsor or AMC and this is required to be disclosed in the offer document.

Investors should carefully read the offer document whether return is assured for the entire period of the scheme or only for a certain period. Some schemes assure returns one year at a time and they review and change it at the beginning of the next year.

Change in asset allocation while deploying funds of investors

Considering the market trends, any prudent fund managers can change the asset allocation i.e. he can invest higher or lower percentage of the fund in equity or debt instruments compared to what is disclosed in the offer document. It can be done on a short term basis on defensive considerations i.e. to protect the NAV. Hence the fund managers are allowed certain flexibility in altering the asset allocation considering the interest of the investors. In case the mutual fund wants to change the asset allocation on a permanent basis, they are required to inform the unit holders and giving them option to exit the scheme at prevailing NAV without any load.

Procedure to invest in a scheme of a mutual fund

Mutual funds normally come out with an advertisement in newspapers publishing the date of launch of the new schemes. Investors can also contact the agents and distributors of mutual funds who are spread all over the country for necessary information and application forms. Forms can be deposited with mutual funds through the agents and distributors who provide such services. Presently, even, the post offices and banks also distribute the units of mutual funds. However, the investors may please note that the mutual funds schemes being marketed by banks and post offices should not be taken as their own schemes and no assurance of returns is given by them. The only role of banks and post offices is to help in distribution of mutual funds schemes to the investors.

Investors should not be carried away by commission/gifts given by agents/distributors for investing in a particular scheme. On the other hand they must consider the track record of the mutual fund and should take objective decisions.

Investment by Non-resident Indians (NRIs) in mutual funds

Non-resident Indians can also invest in mutual funds. Necessary details in this respect are given in the offer documents of the schemes.

Quantum one should invest in debt or equity oriented schemes

An investor should take into account his risk taking capacity, age factor, financial position, etc. As already mentioned, the schemes invest in different type of securities as disclosed in the offer documents and offer different returns and risks. Investors may also consult financial experts before taking decisions. Agents and distributors may also help in this regard.

Filling up of application form of Mutual Funds

An investor must mention clearly his name, address, number of units applied for and such other information as required in the application form. He must give his bank account number so as to avoid any fraudulent encashment of any cheque/draft issued by the mutual fund at a later date for the purpose of dividend or repurchase. Any changes in the address, bank account number, etc at a later date should be informed to the mutual fund immediately.

Contents of Offer Document

An abridged offer document, which contains very useful information, is required to be given to the prospective investor by the mutual fund. The application form for subscription to a scheme is an integral part of the offer document. SEBI has prescribed minimum disclosures in the offer document. An investor, before investing in a scheme, should carefully read the offer document. Due care must be given to portions relating to main features of the scheme, risk factors, initial issue expenses and recurring expenses to be charged to the scheme, entry or exit loads, sponsor's track record, educational qualification and work experience of key personnel including fund managers, performance of other schemes launched by the mutual fund in the past, pending litigations and penalties imposed, etc.

Time within which the investor gets certificate or statement of account after investing in a mutual fund

Mutual funds are required to dispatch certificates or statements of accounts within six weeks from the date of closure of the initial subscription of the scheme. In case of close-ended schemes, the investors would get either a Demat Account Statement or unit certificates as these are traded in the stock exchanges. In case of open-ended schemes, a statement of account is issued by the mutual fund within 30 days from the date of closure of initial public offer of the scheme. The procedure of repurchase is mentioned in the offer document.

Duration for transfer of units after purchase from stock markets in case of close-ended schemes

According to SEBI Regulations, transfer of units is required to be done within thirty days from the date of lodgment of certificates with the mutual fund.

As a unitholder, time taken to receive dividends/repurchase proceeds

A mutual fund is required to dispatch to the unit holders the dividend warrants within 30 days of the declaration of the dividend and the redemption or repurchase proceeds within 10 working days from the date of redemption or repurchase request made by the unit holder.

In case of failures to dispatch the redemption/repurchase proceeds within the stipulated time period, Asset Management Company is liable to pay interest as specified by SEBI from time to time (15% at present).

Change in the nature of the scheme from the one specified in the offer document

A mutual fund can change the nature of the scheme from the one specified in the offer document. However, no change in the nature or terms of the scheme, known as fundamental attributes of the scheme e.g., structure, investment pattern, etc. can be carried out unless a written communication is sent to each unitholder and an advertisement is given in one English daily having nationwide circulation and in a newspaper published in the language of the region where the head office of the mutual fund is situated. Apart from it, many mutual funds send quarterly newsletters to their investors. The unitholders have the right to exit the scheme at the prevailing NAV without any exit load if they do not want to continue with the scheme. The mutual funds are also required to follow similar procedure while converting the scheme from close-ended to open-ended scheme and in case of change in sponsor.

At present, offer documents are required to be revised and updated at least once in two years. In the meantime, new investors are informed about the material changes by way of addendum to the offer document till the time offer document is revised and reprinted.

Performance of a Mutual Fund Scheme

The performance of a scheme is reflected in its net asset value (NAV) which is disclosed on daily basis in case of open-ended schemes and on weekly basis in case of close-ended schemes. The NAVs of mutual funds are required to be published in newspapers. The NAVs are also available on the web sites of mutual funds. All mutual funds are also required to put their NAVs on the web site of Association of Mutual Funds in India (AMFI) and thus the investors can access NAVs of all mutual funds at one place



The mutual funds are also required to publish their performance in the form of half-yearly results which also include their returns/yields over a period of time i.e. last six months, 1 year, 3 years, 5 years and since inception of schemes. Investors can also look into other details like percentage of expenses of total assets as these have an affect on the yield and other useful information in the same half-yearly format.

The mutual funds are also required to send annual report or abridged annual report to the unitholders at the end of the year.

Various studies on mutual fund schemes including yields of different schemes are being published by the financial newspapers on a weekly basis. Apart from these, many research agencies also publish research reports on performance of mutual funds including the ranking of various schemes in terms of their performance. Investors should study these reports and keep themselves informed about the performance of various schemes of different mutual funds.

Investors can compare the performance of their schemes with those of other mutual funds under the same category. They can also compare the performance of equity oriented schemes with the benchmarks like BSE Sensitive Index, S&P CNX Nifty, etc.

On the basis of performance of the mutual funds, the investors should decide when to enter or exit from a mutual fund scheme.

Disclosure as to how mutual fund scheme has invested money mobilised from the investors

The mutual funds are required to disclose full portfolios of all of their schemes on half-yearly basis which are published in the newspapers. Some mutual funds send the portfolios to their unitholders.

The scheme portfolio shows investment made in each security i.e. equity, debentures, money market instruments, government securities, etc. and their quantity, market value and % to NAV. These portfolio statements also required to disclose illiquid securities in the portfolio, investment made in rated and unrated debt securities, non-performing assets (NPAs), etc.

Some of the mutual funds send newsletters to the unitholders on quarterly basis which also contain portfolios of the schemes.

Difference between investing in a mutual fund and in an initial public offering (IPO) of a company

IPOs of companies may open at lower or higher price than the issue price depending on market sentiment and perception of investors. However, in the case of mutual funds, the par value of the units may not rise or fall immediately after allotment. A mutual fund scheme takes some time to make investment in securities. NAV of the scheme depends on the value of securities in which the funds have been deployed.

Choosing a scheme if schemes in the same category of different mutual funds are available

Some of the investors have the tendency to prefer a scheme that is available at lower NAV compared to the one available at higher NAV. Sometimes, they prefer a new scheme which is issuing units at ₹ 10 whereas the existing schemes in the same category are available at much higher NAVs. Investors may please note that in case of mutual funds schemes, lower or higher NAVs of similar type schemes of different mutual funds have no relevance. On the other hand, investors should choose a scheme based on its merit considering performance track record of the mutual fund, service standards, professional management, etc. This is explained in an example given below.

Suppose scheme A is available at a NAV of ₹ 15 and another scheme B at ₹ 90. Both schemes are diversified equity oriented schemes. Investor has put ₹ 9,000 in each of the two schemes. He would get 600 units ($9000/15$) in scheme A and 100 units ($9000/90$) in scheme B. Assuming that the markets go up by 10 per cent and both the schemes perform equally good and it is reflected in their NAVs. NAV of scheme A would go up to ₹ 16.50 and that of scheme B to ₹ 99. Thus, the market value of investments would be ₹ 9,900 (600×16.50) in scheme A and it would be the same amount of ₹ 9900 in scheme B (100×99).

The investor would get the same return of 10% on his investment in each of the schemes. Thus, lower or higher NAV of the schemes and allotment of higher or lower number of units within the amount an investor is willing to invest, should not be the factors for making investment decision. Likewise, if a new equity oriented scheme is being offered at ₹ 10 and an existing scheme is available for ₹ 90, should not be a factor for decision making by the investor. Similar is the case with income or debt-oriented schemes.

On the other hand, it is likely that the better managed scheme with higher NAV may give higher returns compared to a scheme which is available at lower NAV but is not managed efficiently. Similar is the case of fall in NAVs. Efficiently managed scheme at higher NAV may not fall as much as inefficiently managed scheme with lower NAV. Therefore, the investor should give more weightage to the professional management of a scheme instead of lower NAV of any scheme. He may get much higher number of units at lower NAV, but the scheme may not give higher returns if it is not managed efficiently.

Choosing a scheme for investment from a number of schemes available

As already mentioned, the investors must read the offer document of the mutual fund scheme very carefully. They may also look into the past track record of performance of the scheme or other schemes of the same mutual fund. They may also compare the performance with other schemes having similar investment objectives. Though past performance of a scheme is not an indicator of its future performance and good performance in the past may or may not be sustained in the future, this is one of the important factors for making investment decision. In case of debt oriented schemes, apart from looking into past returns, the investors should also see the quality of debt instruments which is reflected in their rating. A scheme with lower rate of return but having investments in better rated instruments may be safer. Similarly, in equities schemes also, investors may look for quality of portfolio. They may also seek advice of experts.

Companies having names like mutual benefit vis-a-vis mutual funds schemes

Investors should not assume some companies having the name “mutual benefit” as mutual funds. These companies do not come under the purview of SEBI. On the other hand, mutual funds can mobilise funds from the investors by launching schemes only after getting registered with SEBI as mutual funds.

Higher net worth of the sponsor a guarantee for better returns

In the offer document of any mutual fund scheme, financial performance including the net worth of the sponsor for a period of three years is required to be given. The only purpose is that the investors should know the track record of the company which has sponsored the mutual fund. However, higher net worth of the sponsor does not mean that the scheme would give better returns or the sponsor would compensate in case the NAV falls.

Information on mutual funds

Almost all the mutual funds have their own web sites. Investors can also access the NAVs, half-yearly results and portfolios of all mutual funds at the web site of Association of mutual funds in India (AMFI). AMFI has also published useful literature for the investors.

Investors can log on to the web site of SEBI and go to “Mutual Funds” section for information on SEBI regulations and guidelines, data on mutual funds, draft offer documents filed by mutual funds, addresses of mutual funds, etc. Also, in the annual reports of SEBI available on the web site, a lot of information on mutual funds is given.

There are a number of other web sites which give a lot of information of various schemes of mutual funds including yields over a period of time. Many newspapers also publish useful information on mutual funds on daily and weekly basis. Investors may approach their agents and distributors to guide them in this regard.



Appointment of a nominee for investment in units of a mutual fund

The nomination can be made by individuals applying for / holding units on their own behalf singly or jointly. Non-individuals including society, trust, body corporate, partnership firm, Karta of Hindu Undivided Family, holder of Power of Attorney cannot nominate.

Winding up of scheme

In case of winding up of a scheme, the mutual funds pay a sum based on prevailing NAV after adjustment of expenses. Unitholders are entitled to receive a report on winding up from the mutual funds which gives all necessary details.

Redressal of complaints

Investors would find the name of contact person in the offer document of the mutual fund scheme whom they may approach in case of any query, complaints or grievances. Trustees of a mutual fund monitor the activities of the mutual fund. The names of the directors of asset management company and trustees are also given in the offer documents. Investors should approach the concerned Mutual Fund / Investor Service Centre of the Mutual Fund with their complaints,

If the complaints remain unresolved, the investors may approach SEBI for facilitating redressal of their complaints. On receipt of complaints, SEBI takes up the matter with the concerned mutual fund and follows up with it regularly. Investors may send their complaints to:

Securities and Exchange Board of India

Office of Investor Assistance and Education (OIAE)

Plot No.C4-A , “G” Block, 1st Floor,

Bandra-Kurla Complex,

Bandra (E), Mumbai – 400 051.

Phone: 26449199-88-77

Procedure for registering a Mutual Fund with SEBI

An applicant proposing to sponsor a mutual fund in India must submit an application in Form A along with a fee of ₹ 25,000. The application is examined and once the sponsor satisfies certain conditions such as being in the financial services business and possessing positive net worth for the last five years, having net profit in three out of the last five years and possessing the general reputation of fairness and integrity in all business transactions, it is required to complete the remaining formalities for setting up a mutual fund. These include inter alia, executing the trust deed and investment management agreement, setting up a trustee company/board of trustees comprising two- thirds independent trustees, incorporating the asset management company (AMC), contributing to at least 40% of the net worth of the AMC and appointing a custodian. Upon satisfying these conditions, the registration certificate is issued subject to the payment of registration fees of ₹ 25.00 lacs.

Producer Companies

Part IX A dealing with Producer Companies has been added to the Companies, Act, 1956 by the Companies (Amendment) Act, 2002 and the provisions of this part have become operative w.e.f. 6th February, 2003 (vide Notification No. S.O. 135(E) dated 5th February, 2003 issued by the D.C.A.). Through this Amendment Act a new class of companies has been created in the Act with special provisions in this regard. This part of the Companies Act, 1956 is unique in character - it provides a self-contained set of legal provisions in the matter of Producer Companies and is exclusively devoted to Producer Companies. The necessity to bring in this class of companies under the discipline of the Companies Act, though has not been spelt out in the Part, seems to provide a regulated platform for development of entities engaged in activities that a producer company may engage in sections 581A to 581ZT of the Act spread on twelve chapters comprise this Part.

The pattern and contents of the chapters appear to suggest that this Amendment Act is an Act within an Act and most of the distinctive features of the Companies Act, 1956 are there. It can further be noted that this Amendment Act has principal focus on multi-State co-operative societies.

Recognising inherent limitations of the co-operative form of economic organization and primarily to bring the multi-State co-operative societies in the main-stream economic activity but not giving-up the co-operative principle of mutual assistance, Part IX A has been enacted and included in the Companies Act, 1956. This Part IXA has been so framed as to bring inducement for earning profit by emphasizing on active membership, distribution of patronage bonus and other direct benefits to members. Further, the scheme of activity has been devised for bringing discernible corporate culture by creating position for C.E.O and emphasizing on marketing, research, technical services, training, etc.

Overview of the provisions- Part IXA as introduced enable incorporation of co-operatives as companies and conversion of existing co-operatives into companies, on optional basis. Unique elements of co-operative business are accommodated within a regulatory framework similar to that of companies. The salient features are - (i) to offer a statutory and regulatory framework that creates the potential for producer-owned enterprises to compete with other enterprises on a competitive footing, (ii) to provide for the formation and registration of producer companies which include the mutual assistance and co-operative principles within the more liberal regulatory framework afforded by the Company Law with suitable adaptations, (iii) to provide an opportunity to co-operative institutions to voluntarily transform themselves into the new form of producer companies, (iv) conversion of a co-operatives to producer companies is purely voluntary, (v) member's equity may not be publicly traded, but may only be transferred, with the approval of the producer company's Board of Directors. Producer companies would not be vulnerable to the takeover by multinationals or other companies, (vi) the conversion option by cooperative society to producer company can be exercised only if two-thirds of the members of the concerned society vote in favour of a resolution to that effect, (vii) the new form of company is designated as 'producer company' to indicate that only certain categories of persons can participate in the ownership of such companies. The members of the Producer Company have necessarily to be 'primary producers' that is persons engaged in an activity connected with, or relatable to, primary produce, (viii) the objects of a producer company have been defined to include, among other things production, processing, manufacture and sale of primary produce as well as allied matters.

Incorporation of Producer Companies - Section 581B to section 581N deal with matters connected with incorporation of producer companies. Section 581B(i) specifies the objects with which a producer company can be incorporated under the Act. The nucleus of all the objects stated in the aforesaid section seems to be 'primary produce' and this expression has been defined in section 581A(J) meaning—

- (i) produce of farmers arising from agriculture [including animal husbandry, horticulture, floriculture, pisciculture (raising fish), viticulture (growing grapes), forestry, forest products, re-vegetation, bee raising and farming plantation products], or from any other primary activity or service which promoted the interest of farmers or consumers;
- (ii) produce of persons engaged in handloom, handicraft and other cottage industries;
- (iii) any product resulting from any of the above activities, including by-products of such products;
- (iv) any product resulting from an ancillary activity that would assist or promote any of the aforesaid activities or anything ancillary thereto;
- (v) any activity which is intended to increase the production of anything referred to in (i) to (iv) above or improve the quality thereof. Broadly, the definition covers activities of and related to agriculture (of various forms) and handloom, handicraft and other cottage industries. Till now these activities had been the concern of co-operative societies. Part IXA has not defined the word 'Produce'. Therefore, this word has to be construed as to its natural meaning.

However, services also come within the definition by virtue of clause (v) above.



Objects of a Producer Company - The objects with which a producer company can be incorporated are as under:

- (a) production, harvesting, procurement, grading, pooling, handling, marketing, selling and export of primary produce of the members or import of goods or services for their benefit; any of these activities can be carried on by the company being incorporated or through other institution on behalf of the company;
- (b) processing including preserving, drying, distilling, brewing, vinting, canning and packaging of produce of its members;
- (c) manufacture, sale or supply of machinery, equipment or consumables mainly to its members; [in other words, a producer company can as well be a normal manufacturing or trading company provided it produces requirements of the farming sector and handicrafts, handloom and cottage industries, provided further that the company's members are the main buyers and users of these products];
- (d) providing education on the mutual assistance principles to its members and others; [Le., it can be an institution imparting education to the members of the company as also others, owning the institution on principles of 'mutual assistance'. The expression 'mutual assistance principle' has been defined in section 581A(f) read with section 581B(2) of the Act];
- (e) rendering technical services, consultancy services, training, research and development and all other activities for the promotion of interests of its members [i.e., it can be a service rendering company acting as a catalyst for improved quality of production or for development of products by research or allied activities of its members;]
- (f) generation, transmission and distribution of power, revitalization of land and water resources, their use, conservation and communications relatable to primary produce; i.e., it can be a power generating, transmitting and distributing company or a company developing/improving land and water resources including their conservation, all of which should be relatable to primary produce. Here, a company promoted with this object does not need to have as buyers/users of its output restricted to its members;
- (g) insurance of producers or their primary produce (i.e., it can be an insurance company insuring producers or their primary produce);
- (h) promoting techniques of mutuality and mutual assistance;
- (i) welfare measures or facilities for the benefit of members as may be decided by the Board;
- (j) any other activity, ancillary or incidental to any of the activities referred in (a) to (i) above or other activities which may promote the principles of mutuality and mutual assistance amongst the members in any manner;
- (k) financing of procurement, processing, marketing or other activities specified in clauses (a) to (j) above.

A producer company can be incorporated with all or any of the above objects.

Formation of Producer Company and its registration [Section 581C]- The following categories of people or entities will be entitled to form a producer company:

- (i) any ten or more individuals each of whom will be a producer;.
- (ii) any two or more producer institutions;
- (iii) a combination of ten or more individuals and producer institutions.

A 'producer' has been defined in section 581A(k) as "any person engaged in any activity connected with or relatable to any primary produce" and a 'producer company' has been defined by clause (l) of

section 581A as “a body corporate having objects or activities specified in section 581B and registered as ‘producer company’ under the Act.” A ‘producer institution’ has been defined in the next clause of section 581A as a producer company or any other institution having only producer or producers or producer company or producer companies as its member whether incorporated or not having any of the objects referred to in section 581B and which agrees to make use of the services of the producer company or producer companies as provided in its articles. The definitions of ‘producer’ and ‘producer company’ do not need much elaboration except that ‘a producer’ is not necessarily an individual and it can be any entity which in law can be considered as ‘person’ e.g. a company or a co-operative society. In other words, a producer can be an individual, a producer company or a co-operative or other society with only condition that such body must be engaged in any activity connected with or relatable to any primary produce. A ‘producer company’ can have as its members, co-operative societies or other legal entities apart from individuals. The definition of ‘producer institution’, however, is a bit complex. The term ‘institution’ in this context does not bear any special meaning and as such it can be an organisation or establishment devoted to the promotion of a particular object and in this case the object has to be any or all the objects with which a producer company can be registered, (the objects mentioned in section 581B). A producer institution cannot be an individual; it is to be a collective entity composed of members who may be individual or producer company. It is important to note that a producer institution, not itself being a producer company, has to have as its members only producer(s) and/or producer company(ies). A producer company itself also can be a producer institution. A producer institution, other than a producer company, can be either an incorporated body or a non-incorporated body. The only further condition to be fulfilled is that it has to have object or objects mentioned in section 581B. It seems, therefore, that even a partnership firm, a joint Hindu family, or an Association of persons or a Trust can as well be a producer institution, provided its object(s) is confined to the objects mentioned in section 581B. Also a section 25 company under the Act can be a producer company or a producer institution. If any existing section 25 company has as its objects any or all the objects in section 581B, it will automatically become a producer company or a producer institution and would be governed by the requirements of Part IXA of the Act as well with the exception that it cannot have distribution of profit earned amongst its members.

Ordinarily, the term “institution” is associated with a ‘no-profit’ motive, but in case of producer institution, that is not the case. No provision of this part bars a producer institution from earning profit and distributing the same to its members. A further issue needs consideration; a producer company can be a producer institution apart from any other body that qualify to be a producer institution. What would then be distinguishing feature of a producer company becoming a producer institution? It seems that any producer company which has other producer companies as members will only qualify to be called producer institution. However, if such a company has any other body or individual as member(s), it will remain as producer company only.

The promoting individuals /bodies of a producer company must express the desire to form such a company with object(s) specified in section 581B. They will also have to comply with the requirements of Part IXA of the Act and provisions of the Act in respect of registration of companies. Under provisions of sections 581F and 581G, the promoters of a producer company will have to prepare the memorandum of association and articles of association, special to producer companies. The requirements are as under:

Memorandum of Association of a Producer Company shall state : -

- (i) the name of the company with “Producer Company Limited” as last words of the name of such company;
- (if) the state in which the registered office of the Producer Company is to situate (in case the objects of the producer company are to extend beyond the state of registration, the State(s) to which the objects will extend will have to be stated);



- (iii) the main objects of the producer company shall be one or more of the objects specified in section 581B;
- (iv) the names and addresses of the persons who have subscribed to the memorandum ('Persons' mean individuals and Producers institutions);
- (v) the amount of share capital with which the producer company is to be registered and division thereof into shares of fixed amounts;
- (vi) the name, address and occupation of the subscribers being producers, who shall act as the first directors of the producer company [a reference to section 581J(2) has been made in this context which seems to be inappropriate. It should be section 581R(2);]
- (vii) that the liability of its members is limited;
- (viii) the number of shares each subscriber takes is mentioned opposite to the name of respective subscriber. No subscriber shall take less than one share.

Directors - It seems that the first directors of the producer company will be only from producers who are individuals and producer institution as such cannot be a director. Where, however, a producer company is being promoted only by producer institutions, the possible recourse would be to have required individuals acting for and on behalf of promoting producer institutions as nominee holders of shares to act as first directors. In case of an incorporated body this is already an accepted procedure but if the promoting producer institution is a non-incorporated body, the process of nomination as subscriber cum first director shall have to be determined by reference to its constituting document.

Subscription to the memorandum by non-incorporated body of producer institution - Since a non-incorporated body also can be producer institution, a mechanism needs to be evolved by reference to the constituting document of that body to sign as subscriber to the memorandum.

Status of a Producer Company - As per section 581C(5), a producer company on registration as such, will be treated as a private limited company under this Act, to which Part IXA will apply even though it is not required to add the word "private" in its name or to restrict its membership to the number (i.e., fifty) specified for other Private Limited Companies or to be subjected to the general requirement of a minimum of two members. So far minimum strength of members criterion is concerned, it needs to have at least two producer institutions or ten producers or a total of ten producers and producer institutions as minimum number of members to form a producer company and to carry on its activities. A producer company shall have liability of its members limited by the Memorandum to the amount, if any, unpaid on the shares respectively held by them. It will be a company limited by Shares [Section 581C(3)]. A producer company shall not be a public company under this Act. (Nor shall it be a guarantee company or unlimited company)

A member means a person or producer institution admitted as a member of a Producer company and who retains the qualifications necessary for continuance as such.

Articles of Association [Section 581G]- The distinctive feature of the Articles of Association of a producer company is that the Articles have to contain certain "mutual assistance principles", apart from other relevant regulatory provisions. "Mutual assistance Principles" have been defined in clause (f) of section 581A as the principles set out in sub-section (2) of section 581G and they are as under:

- (i) the membership shall be voluntary and available to all eligible persons who, can participate or avail of the facilities or services of the Producer Company, and are willing to accept the duties of membership;
- (ii) each member shall, save as otherwise provided in Part IXA of the Act, have a single vote irrespective of the shareholding;
- (iii) the Producer Company shall be administered by a Board consisting of persons elected or appointed as directors in the manner consistent with the provisions of Part IXA of the Act and the Board shall be accountable to the members;

- (iv) there shall be limited return (the maximum dividend as may be stated in the Articles) on share capital except for circumstances provided in Part IXA of the Act;
- (v) the surplus arising out of the operations of the producer company shall be distributed in an equitable manner by—
 - (a) providing for the development of the business of the producer company;
 - (b) providing for common facilities; and
 - (c) distributing amongst the members, as may be admissible, in proportion to their respective participation in the business;
- (vi) provision for education of members, employees and others, on the principles of mutuality and techniques of mutual assistance shall be made;
- (vii) the producer company shall actively co-operate with other producer companies (and other organisation following similar principles) at local, national or international level so as to best serve the interests of its members and the communities it purports to serve.

The Articles shall also contain the following provisions in terms of sub-section (3) of section 581G of the Act:

- (1) the qualifications for membership, the condition for continuance or cancellation of membership and the terms, conditions and procedure for transfer of shares;
- (2) the manner of ascertaining the patronage and voting right based on patronage;
- (3) the manner of constitution of the Board, its powers and duties, the minimum and maximum number of directors, manner of election and appointment of directors and retirement by rotation, qualifications for being elected or continuance as such and the terms of office of the said directors, their powers and duties, conditions for election or co-option of directors, method of removal of directors and the filling up of vacancies on the Board, and the manner and the terms of appointment of the Chief Executive (as stipulated in section 581W). [When an inter-State co-operative society transforms itself as a producer company, all its directors at the time of transformation shall become and continue as directors of the producer company concerned for a period of one year from the date of the transformation. However, their rights, duties, etc. as directors will then be according to the provisions of the Companies Act, 1956];
- (4) the election of the chairman, term of office of directors and the chairman, manner of voting at the general or special meetings of members, procedure for voting by directors at meetings of the Board, powers of the chairman and the circumstances under which the chairman may exercise a casting vote;
- (5) the circumstances under which and the manner in which, the 'withheld price' is to be determined and distributed ['withheld price' means part of the price due and payable for goods supplied by any member to the producer company and as withheld by the producer company for payment on a subsequent date -Section 581A(n)].

Note: Since a producer company can engage in providing service also, [vide section 581A(J) (v)], it seems that no part of service charge can be withheld by a producer company. Right to withhold is confined to 'price of goods supplied';

- (6) the manner of disbursement of patronage bonus in cash or by issue of equity shares or both; (A producer company can have only equity share capital - vide section 581ZB of the Act);

'Patronage bonus' means payments made by a producer company out of its surplus income to the members in proportion to their respective patronage. The word "patronage", in turn, means the use of services offered by the producer company to its members by participation in its business activities [vide clauses (h) and (i) of section 581 A];



- (7) the contribution to the shared and related matters [in the event of a producer company not being in a position to transfer requisite sum(s) to the reserves (including the general reserve) as may be specified in the Articles, the shortfall will have to be shared by the members in proportion to their patronage in the business of the producer company of that year. This sharing is the “contribution”];
- (8) the matters relating to the issue of bonus shares out of general reserve of the producer company;
- (9) the basis and manner of allotment of shares of the producer company in lieu of the whole or part of sale proceeds of produce or products supplied by the members;
- (10) the amount of reserves, sources from which funds may be raised, limitation on raising of funds, restriction on the use of such funds and the extent of debt that may be contracted and the conditions thereof;
- (11) the credit, loans or advances which may be granted to a member and the conditions for the grant of the same;
- (12) the right of any member to obtain information relating to general business of the company;
- (13) the basis and manner of distribution and disposal of funds available after meeting- liabilities in the event of dissolution or liquidation of the producer company;
- (14) the authorization for division, amalgamation, merger, creation of subsidiaries and the entering into joint ventures and other matters connected therewith;
- (15) laying of the Memorandum of Association and Articles of Association of the Producer Company before a special general meeting to be held within ninety days of its registration; and
- (16) any other provision, which the members may, by special resolution recommend to be included in articles, e.g., members’ or others’ right of inspection of books, registers and records, etc.

Registration of Producer Company - The registration of a producer company requires compliance not only with those specified in this Part IXA of the Act but also other applicable provisions of the Act not dealt with by this Part of the Act. It is evident from the language used in section 581C of the Act. For example, provisions of sections 15 and 30 of the Act dealing with printing and signature of memorandum and articles of association will require compliance. Similarly, section 33 of the Act requiring registration of memorandum and articles will also apply to a producer company. Section 20 concerns approval of name of a company and producer company is no exception to that section. Upon receipt of the memorandum and the articles along with any other relevant document of the producer company for registration and after examining their contents if the Registrar is satisfied that all the requirements of the Companies Act have been complied with in respect of registration of the producer company, including matters precedent and incidental thereto, he shall, within thirty days of the receipt of the documents lodged for registration, register the memorandum, the articles and other documents, if any, and issue a certificate of incorporation to the producer company. Sections 34(2) and 35 of the Act regarding conferring of the ‘body corporate’ status and conclusiveness of the Certificate of incorporation will then apply to the producer company. On incorporation, the producer company may reimburse to its promoters all the direct costs associated with promotion and registration of the company. These costs include registration fees, legal fees and the cost of printing of the memorandum and the articles. This reimbursement can be made only with the approval of the first general meeting of the producer company.

Amendment of Memorandum and Articles of Association of a producer company- Sections 581H and 581-I contain requirements to be fulfilled for amending memorandum and articles of the producer company. A producer company may, by special resolution, not inconsistent with section 581B (objects of a producer company), alter its objects specified in the memorandum. A copy of the memorandum as amended, together with a copy of the special resolution duly certified by two directors, shall be

filed with the Registrar within thirty days from the date of adoption of the resolution. With a view to alter the Memorandum so as to change the address of the producer company, from the jurisdiction of one Registrar to the jurisdiction of another Registrar, a special resolution will have to be passed and copies of the special resolution certified by two directors of the producer company shall be filed with both the Registrars, presumably with copies of the altered memorandum within thirty days. Each Registrar will record the same and thereafter it will be the responsibility of the Registrar from whose jurisdiction the address (the place) has been shifted to forthwith forward to the other Registrar all the documents with him relating to the producer company concerned. In case the change involves shifting of the producer company from one state to another, the confirmation of the Company Law Board is necessary.

Unlike the process of amendment of the memorandum, section 581-I requires a proposal by either at least two-third of the elected directors or at least one-third of the members of the producer company to amend any clause of the Articles of the company. The proposal as above has to be approved by a special resolution of the members. A copy of the amended Articles together with the copy of the special resolution, duly certified by two directors, is required to be filed with the Registrar within thirty days from the date of its adoption.

Benefits to Members [Section 581E]

- (i) Every member shall initially receive only such value for the produce or products supplied and pooled as the Board of the producer company may determine. This determination shall have to be made in accordance with the provision made in the Articles in this behalf. The price not paid then (withheld price) may later be disbursed in cash or in kind or by allotment of equity shares, in proportion to the produce supplied to the producer company during the financial year. The extent of the payment or settlement of the withheld price shall be decided by the Board along with the manner and condition thereof. This provision implies that the Board of the Producer Company may not pay the full withheld price.
- (ii) On the share capital, the members are entitled to only a limited return as provided in the Articles.
- (iii) Members may receive bonus shares of the producer company in accordance with the provisions of section 581ZJ. Necessary clause in this regard need to be in the Articles. Section 581ZJ authorises a producer company to issue bonus shares by capitalisation of amounts from general reserve, in proportion to the shares held by the members on the date of the issue. However, the issue of the bonus shares as above should be approved by members in a general meeting, provided the Board has made a recommendation to that effect. The Articles may provide for the type of resolution needed for this purpose. However, if the Articles do not contain any clause on issue of bonus shares, the Articles have to be first amended before passing the appropriate resolution.
- (iv) Patronage bonus may be paid to the members by the producer company out of any surplus left after making provision for payment of limited return and creation of any reserves mandated by section 581ZI. If the company decides to pay patronage bonus to members, it should be in proportion to their participation in the business of the producer company and may be paid either in cash or by way of allotment of shares, or both as may be decided by the members in the general meeting. Here again, the Articles must have clause enabling the producer company to pay patronage bonus.

Voting rights of members of a producer company - Section 581D specifies that:

- (i) Where membership consists of individual producers only every member shall have a single vote, irrespective of his shareholding or patronage.
- (ii) Where membership comprises of only producer institutions, such members shall enjoy voting rights on the basis of their participation in the business of the producer company in the previous year, as may be specified in the Articles. However, when the producer company did not exist in the previous year i.e., in the first year of its operation, the voting rights of these members shall be determined on the basis of their respective shareholding.



- (iii) Where membership comprises of both individual producers and producer institutions, the voting rights shall be computed on the basis of a single vote for every member irrespective of whether he/it is an individual or institution.
- (iv) The Articles of the producer company may provide for the conditions, subject to which, a member may continue to retain his/its membership as also the manner in which voting rights shall be exercised by the members.
- (v) Subject to authorization by the Articles, a producer company may restrict the voting rights to 'active members' only in the general or special meeting of members. An 'active member' has been defined in clause (a) of section 581A as "a member who fulfils the quantum and period of patronage of the producer company as may be required by the Articles". This means that if the articles so provide any member whether an individual or an institution can be denied voting rights altogether, if he/it fails to fulfill the criteria of "active member".

Therefore, though perhaps not intended to be the shares with differential rights as to dividend, voting or otherwise as included in section 86 of the Act, it is clear that a Producer Company may render certain shares as non-voting shares through its articles.

Membership and conflicting business interest - No person, who has any business interest which is in conflict with business of the producer company, can become a member of that company. Further, if he acquires any conflicting business interest after becoming member of a producer company, he will cease to continue as such member and be removed from membership in accordance with the Articles of the company.

Inter-State Cooperative Societies can become Producer Company [Sections 581J-581N]- Section 581C provides the basic mechanism for formation of producer company in which ten individual producers or two producer institutions or a combination of them numbering not less than ten can form a producer company. However, provisions of section 581J enable an inter-State cooperative society (hereinafter "society") also to become a producer company. Clause (e) of section 581A defines "inter-State cooperative societies" as "a multi-State cooperative society" as defined in clause (k) of section 3 of the Multi-State Cooperative Societies Act, 1984 and includes any cooperative society registered under any other law for the time being in force, which has, subsequent to its formation, extended any of its objects to more than one State by enlisting the participation of persons of by extending any of its activities outside the State, whether directly or indirectly or through an institution of which it is a constituent. Clause (k) of section 3 of the Multi-State Cooperative Societies Act, 1984 defines a multi-State cooperative society as under:

"It means a society registered or deemed to be registered under this Act and includes a national cooperative society."

Any inter-State cooperative society with objects not confined to a single state make an application to the Registrar of Companies (RoC) for registration as a producer company. The application has to accompany the following:

- (a) a copy of special resolution (at least 2/3rd of the total number of members of the cooperative society voting for it) approving for its incorporation as a producer company under the Companies Act, 1956;
- (b) statements showing/containing/indicating- (i) names and addresses or (should be 'and') the occupation of the directors and Chief Executive Officer, if any, by whatever name called, (ii) list of members of the cooperative society concerned, and (iii) that the inter-State cooperative society is engaged in any one or more of the objects specified for a producer company in section 581B of the Act; and
- (c) a declaration by two or more directors of the society concerned certifying that particulars given in (a) and (b) above are correct.

Upon registration as a producer company, the society shall have to have its name with "Producer Company Limited" as last words. It may retain its old name without the words implying cooperative society. It may also evolve any word or expression to precede the words "producer company limited" that would identify itself to its earlier co-operative status. The Registrar, within thirty days of the receipt of application for registration, complete in all respects, and having found it in compliance with the laid down requirements, shall certify under his hand that the applicant inter-State cooperative society has been incorporated as a producer company under Part IXA of the Companies Act, 1956. Apart from an inter-State cooperative society, a cooperative society formed by (i) Producers, (ii) by Federation or Union of cooperative societies of producers, (iii) co-operatives of producers, registered under any law for the time being in force which has extended its objects outside the State, either directly or through a union or Federation of cooperatives of which it is a constituent, or (iv) any Federation of Unions of such cooperatives, which has extended its object or activity outside the State, shall be eligible to make application for registration as a producer company [clause (5) of section 581J]. Therefore, this facility of registration as a producer company, though basically is available to producers or producer institutions, has been extended to (a) inter-State cooperative societies and (b) cooperative societies formed by producers or cooperative societies formed by union or Federation of cooperative societies of producers or existing cooperative societies of producers or any Federation of Unions of such cooperative society provided they are registered cooperative societies in the cases of cooperative society and have extended their objects and activities beyond the geographical boundary of their state of registration. The key-points to be noted in this regard is that the applicant has to be a registered cooperative society or a Federation of Unions of cooperative societies, its primary constituent or members must be 'producer' as defined in this Part and it must have extended its objects and activities outside the state of its registration/location as such society or Federation. Section 581J as such does not require filing of any memorandum or articles of association by the transforming inter-state cooperative society. However, following section 581ZQ, it would not be incorrect to hold that the basic requirements of section 33 of the Act have not been expressly excluded and, therefore, the general requirements of filing memorandum and articles for registration and 'declaration' by a professional [vide section 33(2)] also apply in case of transformation of an inter-state cooperative society into a Producer Company.

Transformation of inter-State cooperative society into Producer Company - An inter-State cooperative society, upon registration as a producer company shall automatically, by operation of law, become a producer company. As such producer company, it shall be governed by the provisions of this part of the Companies Act, 1956 (Part IXA) in exclusion of the law to which it was earlier subjected. However, anything done or omitted to be done before its registration as a producer company will have to be followed up or done under the earlier law. For example, if a dividend declaration was made as a cooperative society (where it was possible to make the declaration), the same has to be paid in accordance of the provisions of the concerned cooperative law including the bye-laws thereunder. No person shall have any claim against the cooperative so transformed or against the producer company that came into being because of the transformation, based on the fact of the transformation [clause (6) of section 581J]. The Registrar of Companies who registered the inter-State cooperative society as a producer company shall forthwith intimate the concerned Registrar of cooperative societies with whom the erstwhile cooperative society was registered, the fact of the registration of the producer company to enable the latter Registrar make appropriate deletion of the name of the cooperative society from his register [clause (7) of section 581J]. The clauses (6) and (7) as above, specify the inter-State cooperative society as the subject of transformation. The categories of cooperative societies mentioned in clause (5), appear to be covered by this clause as they also become inter-State cooperative societies by virtue of the fact that they also have extended their objects/activities beyond their State of registration. However, when a Federation of Unions of cooperative societies apply for registration of a producer company, whether that Federation ceases to exist after the registration of the related producer company, is not clear.

Under section 581K, every shareholder of the inter-State cooperative society immediately before the date of registration of the producer company (i.e., the transformation date) shall be deemed to be



registered shareholder of the producer company to the extent of the face value of the shares held by such shareholder in the cooperative society. It seems that the applicant cooperative society will not be able to admit any new member or effect any transfer of its shares after making the application to become a producer company as such act may bring complications of deeming the initial members of the producer company.

Section 581L deals with further consequences that follow on transformation of an inter-State cooperative society into a producer company. On the transformation date—

- (i) all properties and assets, movable and immovable, of, or belonging to the transforming cooperative society shall vest in the producer company;
- (ii) all the rights, debts, liabilities, interests, privileges and obligations of the society shall stand transferred to, and be the corresponding rights, liabilities etc. (as above) of the producer company;
- (iii) all debts, liabilities and obligations incurred, all contracts entered into and all matters and things engaged to be done by, with or for the society as on the transformation date for or in connection with their purposes, shall be deemed to have been incurred or entered into, or engaged to be done by with or for the producer company;
- (iv) all sums of money due to the society immediately before the transformation date shall be deemed to be due to the producer company;
- (v) every organisation which was being managed by the society immediately before the transformation date shall be managed by the producer company, for such period, to such extent and in such manner, as the circumstances may require;
- (vi) every organisation which was getting financial, managerial or technical assistance from the society immediately before the transformation date, may continue to be given the same assistance by the producer company, for such period, to such extent and in such manner, as the company may deem fit;
- (vii) the amount representing the capital of the erstwhile society shall form part of the capital of the producer company;
- (viii) any reference to the inter-State cooperative society (the society) in any law other than the Companies Act, 1956 or in any contract or other instrument, shall be deemed to be reference to the producer company; and
- (ix) any pending legal suit, arbitration, appeal or other legal proceedings of whatever nature by or against the society, shall not get abated, or discontinued, or anyway prejudicially affected by reason of incorporation of and consequent transformation into producer company, and the same may be continued/prosecuted and enforced by or against the producer company in the same manner and to the same extent as it would have or may have been continued, prosecuted and enforced by or against the society, as if the provisions contained in this Part (Part IXA) of the Companies Act, 1956 had not come into force.

It may be noted that the consequences (i) to (ix) above, except (v) and (vi) are absolute in their very nature. Though the responsibilities of the society contained in (v) and (vi) devolve upon the producer company immediately on transformation, the producer company has been given the flexibility to determine the duration of the responsibility, extent of the responsibility and the manner of discharging the responsibility on such devolution. In other words, the producer company has to take stock of these responsibilities taken by the society keeping in view its own position and limitations. It cannot bind itself indefinitely to the responsibilities. However, determination shall be done on a fair and reasonable basis.

Officers and other employees of the society [Section 581N] - On and from the transformation date all the serving employees and officers of the society shall become employees and officers of the corresponding producer company.

These officers (excluding directors) and other employees shall retain all the rights, privileges, obligations, benefits, tenure etc. as were with them in the society immediately before the transformation date. These include remuneration, other terms and conditions of employment, right to leave and leave travel concession, welfare measures, medical benefit schemes, insurance, provident fund, other funds, retirement, voluntary retirement, gratuity and duties. Any unrevoked contract or agreement with the officers and employees of the society on the date of transformation shall also survive including a situation where certain benefits are to be extended on a future date. Any officer (excluding directors) or employee may opt out from becoming officer or employee of the corresponding producer company and such persons shall be deemed to have resigned. This transformation, notwithstanding anything contained in the Industrial Disputes Act, 1947 or any other law then in force, will not give such officers or employee any right to compensation on their services being transferred to the corresponding producer company. No court of law or tribunal or other Authority shall entertain any such claim. However, employees or officers of the society who had retired from the services of the society before the transformation date will retain their rights, benefits, etc. e.g. pension or gratuity, and the corresponding producer company will take the position of the society in discharging these obligations. Similarly, any trust created by the society for provident fund or gratuity or other similar benefit and any other bodies created for welfare of the employees and officers of the society, shall continue to exist and discharge functions assigned to them under the umbrella of the producer company. Any tax exemption enjoyed by the Provident Fund or the Gratuity Fund will also survive under the producer company. Any officer of the society (including any director) entrusted to manage the whole or substantial part of business and affairs of the society under any law or the regulations governing the society will be entitled to any compensation from the society or the corresponding producer company for loss of office or the premature termination of contract of management, if any takes place, as a result of the transformation.

Directors of the society - Under section 581N, discussed above, all the employees and officers including directors of the erstwhile society, on the date of transformation get transferred in the corresponding position in the resulting producer company. So far directors are concerned, this will prevail inspite of the substantive provisions of section 581-0. Section 581-0 provides for floor and ceiling in respect of number of directors in a corresponding producer company. The minimum and maximum numbers are five and fifteen respectively. However, if a society which gets transformed into a producer company, had more than fifteen directors on the transformation date, the corresponding producer company, inspite of the aforesaid requirement, shall have all the directors on its Board (i.e., exceeding the number of 15) for a period of one year from the date of incorporation of the producer company. This is also a beneficial provision and allows the newly incorporated Producer Company time to adjust its position suitably so that on expiry of aforesaid one year, the number of directors can be brought within the limits set by section 581-0. Neither this section nor any other section provides for a situation where the society had less than five directors immediately before transformation. In such a situation, obviously, those who were then directors of the society will become directors of the producer company and to meet the shortfall in number the Board may co-opt one or more expert directors or additional director(s) as may be necessary and for such period as the Board would then determine, subject to the Articles. This right of co-option is available in all situations and is not necessarily restricted to a situation to meet the shortfall. Ordinarily, however, the number of directors co-opted as above cannot exceed one fifth of the pre-co-option strength of the Board. The co-opted directors shall not have any vote in the matter of the election of the Chairman of the Board. Nevertheless, they are eligible to be elected to the office of the chairman if so allowed by the Articles.

Transfer of existing benefits, etc. on transformation - A further favourable consequence of transformation is contained in section 581M which provides for transfer of all the existing benefits, fiscal and other concessions, licences, privileges and exemptions with the society to the corresponding producer company with effect from the transformation date. These benefits, concessions, etc. should relate to the affairs and business of the society and should have been granted under any law, which was then in force.

Appointment of Directors and their tenure (Section 581P) - Except the case of transformation of an



inter-State cooperative society into a producer company, the members of the society who sign the Memorandum and Articles of the producer company may designate therein the Board of directors comprised of not less than five members, (obviously not exceeding fifteen members) to govern the affairs of the producer company until the directors are elected. The election of directors shall be conducted within a period of ninety days of the registration of the producer company. (In case of transformation of a society into registered company this period is one year i.e., 365 days). Every director so elected shall hold office for a period of not less than one year and not more than five years, as may be specified in the Articles. Every director who retires in accordance with the provisions in the Articles shall be eligible for re-appointment as a director. Except the case of election of directors for the interim period i.e., within ninety days as stated above, the directors of the Board shall be regularly elected or appointed by the members in the annual general meeting.

Vacation of office by directors of a producer company [Section 581Q]- This section is corresponding to section 283 of the Act, which applies to other companies. However, the grounds for vacation of office in the two situations are not similar. In case of a producer company a director vacates his office if any of the following happens—

- (a) He is convicted by a Court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months. This ground is same as given in section 283(1)(e).
- (b) The producer company in which he is a director has made a default in repayment of any advances or loans taken from any company or institution or any other person and such default continues for ninety days. This ground appears to be a serious one for the producer company concerned. By virtue of the provision all the directors will vacate the office at a time (and vacation of office is always automatic) and there will not be any Board, on happening of this default; no safeguard seems to have been provided in this respect in Part IXA of the Act (section 283 does not contain a same or similar clause).
- (c) He has made a default in respect of any advances or loans taken from the producer company in which he is a director [no such provision appears in section 283, although a default in payment of call is a ground for vacation of office under section 283(1)(f)].
- (d) The producer company, in which he is a director has—
 - (i) not filed the annual accounts and annual return for any continuous three financial years commencing on or after the first day of April, 2002, or
 - (ii) failed to, repay its deposit or withheld price or patronage bonus or interest thereon, on due date, or pay dividend and such failure continues for one year or more; (this clause is similar but not same to the disqualification clause for a director in section 274(1)(g); also a director who incurs the disqualification arising out of failure of the company concerned does not vacate his office under section 283); like (b) above this one also results into all the directors of the producer company vacating their respective offices and thereby making the Board non-existent.
- (e) Default is made in holding election for the office of director in the producer company concerned, in accordance with the provisions of this Act and the Articles (section 283 does not contain any such ground); same observation as has been made in respect of (b) and (d) above, will apply in this case also. [It is important to note that the word 'default' as has been used, is not confined to non-holding of election alone but covers even holding the election but not following the requirements of the Companies Act and the Articles.]
- (f) The annual general meeting or extraordinary general meeting of the producer company concerned, is not called in accordance with the provisions of the Act except due to natural calamity or such other reason (same observation as regards vacation resulting into non-existence of the Board will apply). Here the incidence is with reference to 'non-calling' and not 'non-

holding'. Apart from the clear case of non-calling of these meetings, even a defect in calling these meetings may attract this clause).

These grounds are also applicable to the directors of a producer institution which is a member of the producer company concerned. More specifically, defaults of the company mentioned in (b), (d), (e) and (f) above will result in vertical incidence on the directors of the member producer institution, rendering the institution director less. However, sub-section (2) of this section under which directors of the member producer institution get hit contains the words "as far as may be" implying that there will not be unqualified incidence of vacation. But what that will be can be known only from clarification/judicial interpretation.

Powers and functions of the Board [Section 581R]- The general powers of the Board of a producer company are similar to the general powers of the Board of other companies as provisions of section 581R and section 291 of the Act are broadly similar. Section 581R(2) has specified certain powers for exercise by the Board. The Board of a producer company shall exercise all the powers (general and specific) it has for and on behalf of the company only in meetings of the Board.

The specific powers are as under:

- (i) determination of the dividend payable and quantum of withheld price;
- (ii) recommendation of patronage bonus for consideration and approval in general meeting;
- (iii) admission of new members;
- (iv) formulation and pursuing of the organizational policy and objectives including specific long term and annual objectives;
- (v) approval of corporate strategies and financial plans;
- (vi) appointment of a Chief Executive Officer (CEO) and such other officers as may be specified in the Articles;
- (vii) exercising of superintendence, direction and control over CEO and other officers appointed by it (for the producer company);
- (viii) causing proper books of account to be maintained, preparation of annual accounts to be placed before the annual general meeting with the auditor's report thereon and the replies to the auditor's qualifications, if any, in the report;
- (ix) acquisition or disposal of property of the producer company and investment of the funds of the producer company, in the ordinary course of business;
- (x) sanctioning any loan or advance, in connection with business activities of the producer company, to any member of the producer company, who is not a director of the producer company or his relative (since the word 'relative' has not been defined for the purpose of Part IXA of the Act, the definition of 'relative' as appears in Sch. 1A of the Act will apply); [it seems, making loans and advances for business of the producer company to anybody other than a member of the producer company is not permissible in the normal context. Section 292 of the Companies Act specifically empowers the Board of other companies to make loans. Here such specific empowerment is absent.]; and
- (xi) taking such other measures or to do such other acts as may be required in the discharge of its functions or exercise of its powers.

Persons who are not validly holding the position of directors of a producer company, acting individually or as a group (read Board) cannot exercise any of the powers of the Board.

Committee of Directors [Section 581U] - The Board of a producer company may constitute such number of committees as it may deem fit for the purpose of assisting the Board in the efficient discharge of its functions. However, it cannot delegate any of its powers to any committee it constitutes. Similarly, the



Board cannot assign any of powers of the CEO to any of its Committee.

A committee constituted as above, may with the approval of the Board, co-opt such number of persons as it deems fit as members of the committee. It appears that the CEO may be a member of the committee apart from other directors. It is not clear from the provisions of section 581U, whether a co-optee to a committee can be anybody other than the directors or the CEO.

A committee once formed shall function under the general superintendence, direction and control of the Board, for such duration and in such manner as the Board may direct. It seems, therefore, the committees will have tenures as may be decided by the Board and there will be no standing committee. The fee and allowances of the members of the committee shall also be prescribed by the Board. The minutes of the meetings of the committee(s) will have to be placed before the meeting of the Board held next.

Meetings of the Board and Quorum [Section 581V] - At least one Board meeting shall be held in a period of three months and at least four such meetings shall * be held in one year.

Notice for the Board meeting shall be given in writing to every director of the producer company including those for the time being in India, at his usual address in India. In other words, if any director is not ordinarily residing in India, he would be given the notice only when he is in India to the knowledge of the producer company.

The responsibility of issuing the notice rests with the CEO. He is to issue the notice at least seven days prior to the date of the meeting. In case of failure to issue the notice, he is punishable with fine which may extend to rupees one thousand. Convening a Board meeting at a notice shorter than seven days may be possible provided the reasons for the same are recorded in writing by the Board. It is possible that in a meeting of the Board, a decision is taken and recorded in the minutes of that meeting for calling the next Board meeting at a shorter notice. Alternatively, even the Board may ratify a Board meeting called at a shorter notice in the meeting itself and record the same in the minutes.

Quorum for a Board meeting, shall be one-third of the total strength of the Board, subject to a minimum of three directors. The directors including the co-opted director, if any, may be paid such fees and allowances for attendance at the Board meetings, as may be decided by the members in the general meeting.

These provisions are similar to the provisions contained in sections 285, 286 and 287 of the Companies Act applicable to other companies with such modifications as are called for a producer company e.g. the notice for Board meeting is to be issued by the CEO (a designated officer in Part IXA of the Act), and the minimum number to form the quorum is three for producer company as against two in cases of other private companies.

Liability of directors [Section 581T]- Any resolution passed or anything done by the directors in contravention of the provisions of this Act, or any other law for the time being in force or of the Articles, invites liability to such directors who passed the resolutions or who acted in aforesaid manner. These directors will be jointly and severally liable to make good to the producer company any loss or damage suffered by it in consequence of such resolution or action. More specifically the producer company has the right of recovery against its director(s) where he or they have made personal profit as a result of the resolution or action as aforesaid, the amount of the profit. In a situation where the producer company has suffered any loss or damage (irrespective of whether there was personal profit for directors) as a result of the contravention, the amount of the loss or damage is recoverable by the company from its contravening directors. This liability of the directors of a producer company is in addition to and not in derogation of the liability imposed on a director under the Companies Act or any other law for the time being in force.

Chief Executive Officer (CEO) and functions [Section 581W] – Every producer company is required to have one full time executive officer to manage and carry on the activities of the company. While the designation Executive officer has been stipulated by the Act, he may have any designation provided

his responsibilities and functions are those which are provided in the Act. He, who will have to be a non-member, would be appointed by the Board of the producer company concerned. The CEO shall be ex-officio director of the producer company and will not retire by rotation.* The articles of the producer company may specify the qualifications, experience and the terms and conditions of the service of the CEO. In the absence of any such provision in the Articles, the Board of the producer company shall fix these specifications. The CEO shall be entrusted by the Board with substantial power of management, as may be determined by it. Within the ambit of this, the CEO may exercise the powers and discharge the functions as are provided by section 581 W(5). They are as under:

- (a) administrative acts of a routine nature including management of day-to-day affairs of the company;
- (b) operation of bank accounts or entrusting this job to any other person (obviously in employment of the company), subject to the general or special approval of the Board;
- (c) arrangement for safe custody of cash and other assets of the producer company;
- (d) signing such documents as may be authorized by the Board, for and on behalf of the company;
- (e) maintaining proper books of account and preparation of annual accounts of the company and getting these audited;
- (f) placing the audited annual accounts before the Board and the members in general meeting;
(It is not expected that the CEO will do the auditing as there is an inherent conflict of interest situation. Unfortunately the language used in the law does not bring out the possible intention);
- (g) furnishing the members with periodic information to apprise them of the operation and functions of the company;
- (h) making appointments of officers and employees for the company in accordance with powers delegated by the Board;
- (i) assisting the Board in the formulation of goals, objectives, strategies, plans and policies;
- (j) advising the Board with respect to legal and regulatory matters relating to proposed and on-going activities of the company and taking necessary action thereon;
- (k) exercising the powers as may be necessary in the normal course of business;
- (l) discharging such other functions and exercising such other powers, as may be delegated by the Board.

The CEO shall manage the affairs of the producer company under the general superintendence, direction and control of the Board and shall be accountable for the performance of the producer company.

Secretary of Producer Company [Section 581X]- Every producer company having an average annual turnover exceeding rupees five crore in each of the three consecutive financial years shall appoint a whole-time secretary.

The incumbent to the position of the whole-time secretary of a producer company shall have to be a member of the Institute of Company Secretaries of India.

General Meetings [Sections 581ZA, 581S, 581Y and 581Z]- The provisions relating to general meetings of a producer company broadly conform to the corresponding provisions in the Act as regards other companies. However, departures are there where they are needed in the context of a producer company.

Annual General Meeting (AGM) - Conforming to the language used in section 166 of the Act, this new provision (Section 581ZA) has been drafted. Every producer company shall, in each year hold, in



addition to any other meetings, a general meeting, as its AGM and shall specify the meeting as such in the notice calling it. Not more than fifteen months shall elapse between the date of one AGM and the next. Registrar (ROC), may, for any special reason, permit extension of this time by a period not exceeding three months except for the first AGM. A producer, company shall hold its first AGM within a period of ninety days from the date of its incorporation. It may be noted that other companies are allowed time upto eighteen months instead of three months (90 days). Section 581P(2) in the context of directors, allows a period of ninety days, for the first Board of the producer company and before expiry of ninety days (i.e., first ninety days after incorporation), the regular Board has to be elected (by the members). Section 581P(2) has a three hundred sixty five days time frame for the first Board of a company which was formed by transforming an inter-state cooperative society into a producer company. It seems that the requirement to hold the first AGM of a producer company within ninety days of its incorporation follows the requirement of section 581P(2). However, no separate mention of the first AGM of a transformed producer company has been mentioned in section 581ZA. As such, though such a company will hold its first AGM within ninety days of its transformation, it will not be required to elect a regular Board in that meeting. It will have to constitute a regular Board within one year of its transformation by a process of election in the next AGM, which has to be held within one year of its transformation. In other words, for a transformed producer company the time gap between the first and the second AGMs will be not more than two hundred and seventy five days.

Sub-section (3) of section 581ZA requires the members to adopt the Articles of the company and appoint the members of the Board in the AGM (presumably refers to first AGM although appointment of directors will thereafter be recurring feature of subsequent AGMs). This requirement about appointment of directors will not apply to a transformed producer company as it has a period of 365 days for the purpose.

Section 581S specifies certain matters to be transacted at a general meeting to give necessary powers to the Board. They are—

- (a) approval of budget and adoption of annual accounts of the producer company;
- (b) approval of patronage bonus;
- (c) issuing of bonus shares;
- (d) declaration of limited return and distribution of patronage;
- (e) specifying the condition and limits of loans that may be sanctioned by the Board to any director; and
- (f) approval of any transaction of the nature as is to be reserved in the Articles for approval of members.

None of these except (e) and (f) and approval of budget can figure in the agenda of the first AGM.

Notice of the AGM- The notice calling the AGM shall be accompanied by the following documents—

- (i) agenda of the AGM;
- (ii) minutes of the previous AGM or the EGM, if any held;
- (iii) the names of the candidates for election, if any, to the office of the director including a statement of qualifications in respect of each candidate (Part IXA does not specify any qualification except share qualification for the office of the director of a producer company. Therefore, this statement is expected to contain the normal matters like academic qualification, experience, etc.);
- (iv) the audited balance sheet and profit and loss account of the producer company and its subsidiary, if there be any, together with a report of the Board, with respect to :
 - (a) state of affairs of the producer company; (b) amount proposed to be carried to reserve(s);

- (c) amount to be paid as limited return on share capital;
- (d) amount proposed as patronage bonus;
- (e) material changes and commitments, if any, affecting the financial position of the producer company and its subsidiary, if any, which have occurred between the dates of annual accounts of the producer company and the date of the report of the Board (i.e. subsequent event of material nature);
- (f) any other matter of importance relating to energy conservation, environmental protection, expenditure or earnings in foreign exchanges; and
- (g) any other matter which is required to be, or may be, specified by the Board,

It may be observed that salient features of the sections 210, 212 and 217 of the Act applicable to other companies are present here;

- (v) the text of the draft resolution for appointment of auditors; and
- (vi) the text of the draft resolution proposing amendment to the Memorandum or Articles to be considered at the general meeting, along with recommendation of the Board.

Every AGM shall be called, for a time during business hours, on a day that is not a public holiday and shall be held at the registered office of the producer company or at some other place within the city, town or village in which the registered office of the company is situated. [This is same as section 166(2) minus the proviso].

Period of Notice - Not less than fourteen days notice in writing is required to convene a general meeting including the AGM (contrast this with section 171 of the Act requiring 21 days' notice).

Contents of the Notice and Circulation of the notice - The notice of the general meeting indicating the date, time and place of the meeting shall be sent to every member and auditor of the producer company.

Quorum and Voting Rights - Unless the Articles provide for a larger number, one-fourth of the total number of members, shall be the quorum for the AGM of a producer company as well as of any other general meeting (vide section 581Y). Section 581Z states that subject to the provisions of sub-sections (1) and (3) of section 581D, every member shall have one vote and in the case of equality of votes, the chairman or the person presiding shall have a casting vote except in the case of election of the chairman. As regards the voting rights we may note : (1) where individual is a member of the producer company, he has one vote irrespective of the size of his holding, (2) where both individuals and producer institutions are members - single vote for every member, (3) where membership is confined to producer institutions only, in the first year of registration of the company the voting rights shall be based on the size of the shareholdings of the member institutions and in the following years it will be based on participation by the respective institutions in the business of the producer company in the previous year (as may be specified in the Articles), (4) a producer company, may, if authorized by Articles, restrict the voting rights to active members of the producer company, and (5) casting vote can be cast by the presiding member (chairman) in case of equality of votes on any resolution (except for election of the Chairman).

Filing of documents following AGM with ROC [sub-section (10) of section 581ZA]- The proceedings of every AGM shall be filed by the producer company with the ROC within sixty days of the date of holding the AGM along with—

- (1) Director's report,
- (2) Audited balance sheet and the profit and loss account, and
- (3) The annual return.

Applicable fee for the filing should accompany the documents.



Producer institution as member - A producer institution which is a member of the producer company shall be represented by its chairman or the CEO in the general meeting. However, such a person must be competent to act as such. This means that the concerned institution must have authorized that person in writing so to attend and represent. The producer institution will forfeit this right if the producer company concerned in which the institution is a member has made defaults mentioned in clauses (d) to (f) of section 581Q(1) discussed earlier. This forfeiture of right appears to be acting in opposite direction. While efforts should be there to strengthen the company so that defaults are cured, it will act to make things more difficult.

Extraordinary General Meeting on Requisition [Section 581ZA(5)] - A producer company has the right to convene general meetings between two AGMs as and when the Board of the company feels necessity for the same. However, the company's Board shall, on the requisition made in writing and duly signed by one-third of members entitled to vote in the general meetings, proceed to call an extraordinary general meeting in accordance with provisions of sections 169-186 of the Act (applicable to other companies*). The requisitioning members have to set out the matters for consideration at that meeting. In other words, all requirements for holding a general meeting as contained in sections 171 to 186 shall apply for holding the requisitioned general meeting. It seems to be a case of drafting confusion as section 581ZA(7) requires fourteen days notice for holding every general meeting of the producer company, while section 171 provides for twenty one days' notice for every other company. Section 173 requires providing explanatory statement. There is no similar provision specially for producer company. As the law has been drafted, it may be inferred that the intention was to make all the provisions from section 171 to section 186 applicable to any general meeting of the producer company by excluding the provision for notice period or quorum etc. for which specific provisions have been made in Part IXA of the Act. Then again arises the question as regards rules to govern the general meetings of the producer company for which no provision has been made in Part IXA. A simple interpretation, howsoever unworkable it may be, would be that provisions of sections 169-186 will apply only to requisitioned EGM's, except for those provisions which explicitly appear in Part IXA. Important aspects of a general meeting like proxy, poll, etc., and power of CLB to order meeting to be called remain in limbo. This also needs clarifications.

Share capital, special rights, bonus shares, transfer and transmission (Sections 581ZB to 581ZD and 581ZJ) - As has been mentioned earlier, a producer company can issue equity shares only to raise its share capital. Shares shall be issued, as far as practicable, to the members in proportion to their patronage of the producer company concerned. Beside equity shares, a producer company, if allowed by its Articles, may issue instruments embodying 'special rights', to its active members. The special rights instrument issued to an active member is transferable to another active member, subject to prior approval of the Board. The expression 'special rights' means any right relating to supply of additional produce by the active member, or any other right relating to his produce, conferred upon him by the Board. This may take the form of higher consideration for the produce supplied or a right of priority to make the supply to the producer company.

The shares of a producer company has limited transferability - A member may transfer whole or part of his share holding, along with special rights, if any, to only an active member at par value, with prior approval of the Board. No other means of transfer is available to a member of the producer company. However, the nominee of a deceased member, shall become entitled to all the rights in the shares of the deceased and the Board of the producer company shall transfer such shares to the nominee appointed by the member concerned. Every member of a producer company is required to nominate a person to whom his share shall vest in the event of his death. This nomination has to be made within three months of a person becoming member of the producer company, in the manner specified in the Articles. In case the nominee is not a producer, then the Board of the producer company shall direct the nominee to surrender the shares along with special rights, if any, to the company, at par value or such other value as may be determined by the Board. The Board of a producer company can require the surrender of shares along with special rights, if any, from any member of the company, by serving on him a written notice and giving him an opportunity of being heard. The Board can exercise the right

where it is satisfied that the concerned member has ceased to be a primary producer or has failed to retain his qualifications for becoming a member, in terms of the Articles of ' the company.

Issue of Bonus Shares - On the basis of recommendation of the Board and by passing a resolution in the general meeting, a producer company may issue bonus shares by capitalization of amounts lying in general reserves, in proportion to the respective shareholding of the members on the date of the issue.

Finance, Accounts and Audit (Sections 581ZE to 581ZI) - Every producer company shall keep at its registered office proper books of account with respect to—

- (a) all sums of money received and expended by the producer company and the matters in respect of which the receipts and expenditure take place;
- (b) all sales and purchases of goods by the producer company;
- (c) the instruments of liability executed by or on behalf of the producer company;
- (d) the assets and liabilities of the producer company; and
- (e) in case the producer company is engaged in production, processing and manufacturing, the particulars relating to utilization of materials or labour or other items of costs.

The above broadly conforms to the provisions of section 209 in the matter of 'Proper books of account' that any other company is required to keep. So far cost records are concerned, mining activity has not been envisaged for a producer company.

The balance sheet and the profit and loss account shall be prepared by the producer company (based on the books of account maintained), in accordance with the provisions of section 211 of the Companies Act, 1956, as far as practicable. As such, the balance sheet and the profit and loss account should show a true and fair view and the balance sheet should be prepared in the form and with the particulars given in Schedule VI, Part I and the profit and loss account should make the disclosures required by Part II of that Schedule of the Companies Act, 1956. A producer company like any other company is requiring to company with applicable accounting standards.

Internal Audit - Every producer company shall get the internal audit of its accounts done, at such interval and in such manner, as may be specified in its Articles. The internal audit shall be carried out by a chartered accountant as defined in section 2(1)(6) of the Chartered Accountants Act, 1949. Under the Chartered Accountants Act, 1949, he should also possess the certificate of practice without which he is debarred from public practice.

Duties of Auditor (Section 581ZG specifies duties of the auditor of a producer company and the same should not be mixed up with duties of internal auditors) - The auditor here, undoubtedly refers to the statutory auditor appointed under section 224 or 224A or 619 or 619B of the Act. Section 227 of the Act lays down the reporting duties of the statutory auditor as are generally applicable. The section presently under discussion specifies certain additional duties of reporting by the statutory auditor of a producer company, whose appointments and other related matters shall be as per sections 224 to 233 of the Act.

Additional duties of reporting- Without prejudice to the provisions of section 227 of the Act, the auditor shall also report on the following—

- (i) The amounts of debts due along with particulars of bad debts, if any;
- (ii) The verification of cash balance and securities;
- (iii) The details of assets and liabilities;
- (iv) All transactions which appear to be contrary to the provisions of Part IXA of the Act relating to producer company;



- (v) Loans given by the producer company to the directors;
- (vi) Donations or subscriptions given by the producer company; and
- (vii) Any other matter considered necessary by the auditor.

Donation or subscription by Producer Company - A producer company may make donation or subscription to any individual or institution, subject to approval by a special resolution of the company. The purposes for which donation/ subscription can be made are - (z) promoting the social and economic welfare of producer members or producers amongst general public or (ii) promoting the mutual assistance principles. The aggregate amount of all the donation and subscription in any financial year shall not exceed three per cent of the net profits of the producer company in the financial year immediately preceding the financial year in which the donation and subscription is made. By an explicit proviso to section 581ZH, producer companies have been debarred from making any political contribution directly or indirectly. Donation/subscription to political parties or for political purposes to any person is not permissible whether in cash or in kind or by making available services of its officers/ employees.

The powers to make donation or subscription or political contribution by a producer company are different from those contained in sections 293(1)(e) and 293A of the Act which apply to other companies.

General and Other Reserves - Every producer company is required to maintain a general reserve in every financial year, in addition to any reserve maintained by it in terms of the Articles of the company. The wording used in section 581ZI appears to be somewhat confusing inasmuch as a general reserve created in the past and carried to following financial year/years, unless fully used up, will remain maintained. The appropriate expression should have been 'credited' with further mention of the amount or the manner of determining the amount.

A producer company may also have other reserves, as per the requirement of its articles. Where a producer company does not have sufficient funds in a financial year for credit (transfer) to reserves to be maintained in terms of the articles, the members of the company will have to contribute sums for transfer to the reserves in proportion to their patronage in the business of the company in that year.

The Department of Company Affairs has by Notification No. GSR 641(E), dated August 7, 2003 has prescribed, pursuant to section 581ZL(1), the securities or assets in which a Producer Company registered under section 581C of the Act can make investment of its general reserve. They are (i) approved securities, fixed deposits, units and bonds issued by the Central or State Governments or cooperative societies, scheduled banks, (ii) in cooperative bank, state cooperative bank, cooperative land development bank or central cooperative bank, (iii) with any other scheduled bank, (iv) securities specified in section 20 of the Indian Trusts Act, 1882, (v) shares/ securities of multi-state cooperative societies or any other cooperative society, and (vi) the shares/securities or assets of a public financial institution (vide section 4A of the Act). Section 581ZL(1) apply to any producer company but the rules under reference apply to a producer company registered under section 581C. It seems section 581J Producer Company has been left out.

Loans to Members and investments (Sections 581ZK and 581ZZ)-Loans and Advances - The Board of a producer company may, subject to the provisions in its Articles, provide financial assistance to its members by way of : (a) credit facility in connection with the business of the producer company, for a period not exceeding six months and/or (b) loans and advances against security specified in the Articles, repayable within a period exceeding three months but not exceeding seven years from the date of disbursement of such loan or advances. No loan or advance can be granted to any director of the company concerned or to his relative unless approved by members in general meeting. This restriction on loan or advance to director or his relative will prevail even when he is a member of the company. An inference can be drawn by a reading of the above in conjunction with section 581B that a producer company does not possess an inherent power to extend loan or advance or any

other facility of the kind except to its members or directors. However, whether a producer company can grant any loan or advance to its employees will depend upon any specific enabling provision in the Articles. If directors can avail of loan/advance from the company, there is no reason to exclude employees from the facility.

Investments (Section 581ZL)- A producer company can make investments in certain instruments or in other producer company or in any other body corporate. The specific legal requirements follow:

Financial Instruments - Approved securities; fixed deposits; units, and bonds issued by the Government or cooperative bank or scheduled bank or in such other mode as may be prescribed. The investments shall be made in a manner to derive highest returns.

The sourcing for these investments shall be from the general reserves of the producer company. In other words, the aggregate investments made in various instruments as above should correspond but not exceed the aggregate of the general reserves held by the company. It is possible to have investments of a lesser amount than the aggregate of the general reserves depending upon circumstances. It seems that the detailed scope of investment in instruments will be prescribed by the DCA in due course.

Investment in shares [Section 581ZL(2) and (3)] - A producer company may for promoting its objects—

- (i) invest in shares of another producer company (to achieve scale of operation, market share, synergy, etc. - modes of promoting objectives);
- (ii) subscribe to the share capital of any other body corporate.

Under (ii) above, the investment is open to be made in any other company (not necessarily a producer company) and in any other body corporate. The immediate purpose of this investment may be formation of its subsidiary company or a joint, venture or some other arrangement or agreement that entails subscription to the shares of another company or companies or of a body corporate. However, this investment in shares of a non-producer company or a body corporate needs approval by way of a special resolution of the investing producer company.

Apart from the two situations mentioned above of investing in shares of companies and body corporates, a producer company, either by itself or together with its subsidiary(ies) may invest by way of subscription, purchase or otherwise in shares in any other company for an amount not exceeding thirty per cent of the aggregate of its paid up capital and free reserves. If an investment of the category is to go beyond the thirty per cent limit, it requires prior approval of the Central Government besides the special resolution [vide section 581K(4)]. In this context, it is necessary to understand the implication of the reference to 'free reserves' for calculating the investment ceiling for the category. 'Free reserves' certainly include general reserves. Under section 581ZL(1) the entire amount of the general reserves is available for making investment in financial instruments discussed above. When the entire amount of the general reserves has been invested in the financial instruments, can the amount in the general reserves form the basis of making investments in other mode? It seems, this provision has been drafted in tune with section 372A(1) of the Act, without regard to the earmarked use of the general reserves in financial instruments. Therefore, reference to free reserves here appear to be redundant as it is really not free for making other investments. If it is not free, then it cannot and should not constitute the basis for making other investments. However, since Part IXA has been legislated to form part of the Companies Act, 1956 only recently, clarifications and interpretation that would inevitably follow will help to correctly operate the provisions currently under discussion Le., investment by a producer company in other companies and body corporates excluding those covered by sub-sections (2) and (3) of section 581ZK.

All the investments of a producer company as discussed above must conform to the objects of the producer company, e.g., if a producer company makes an investment in an 'entertainment company', it would amount to an impermissible investment as the objects of a producer company do not have anything as such to do with an entertainment company.



Investments made in shares of a non-producer company or in a body corporate covered by sub-sections (3) and (4) of section 581K can be disposed of by the Board of the company with prior approval of the members expressed, in a special resolution.

Register of investments [Section 581ZL(7) & (8)]- A producer company which has made investments, shall keep at its registered office, a Register containing specified particulars of investments in shares of companies. This register is open to inspection by the members of the producer company concerned and they are entitled to take extracts from the Register of Investments. This provision again is an instance of loose drafting of a law. Sub-section (7) primarily requires the Register to be maintained for all the investments. 'All the investments' obviously should include investments in financial instruments also. Unfortunately the particulars required to be entered therein refer only to shares in companies. Even shares in other body corporates also have been left out. The particulars of investments in shares of companies including producer companies are as under :

- (1) Name of the company(ies) in which share have been acquired;
- (2) Number and value of shares; (value should mean acquisition price/consideration on the basis of normal accounting);
- (3) The date of acquisition; and
- (4) The manner and price at which any of the shares have been subsequently disposed of.

It seems the word 'acquired' should include 'subscribed', and accordingly points (2) and (3) above should be read.

Amalgamation, Merger or Division of Producer Company (Section 581ZN)- Various forms of coming together of producer companies have been provided in this section. These are adaptation of the provisions of section 395 read with section 391 of the Act. Under section 581ZN the coming together may take the form of transfer of the assets and liabilities of a producer company to another producer company, either in whole or in part, after approval by way of a resolution in the general meeting of the transferring producer company provided the transferee producer company had agreed to such transfer and had passed a resolution to that effect in its general meeting. The transferee producer company can only agree to the transfer if the same is in conformity with any of the objects for a producer company enumerated in section 581B of the Act. Apart from this mode, any two or more producer companies may, by resolution passed in their respective general meeting or special meeting, decide to (i) amalgamate and form a new producer company, or (ii) merge one producer company (merging company) with another such company (merged company). Therefore, coming together of producer companies can be by:

- (1) transfer of assets and liabilities either in whole or in part,
- (2) amalgamation of two or more producer companies, and
- (3) merger of two producer companies (merger may even be partial e.g., an undertaking out of several).

The mechanism of transfer does not entail life of any of the producer companies in agreement, unless all the assets and liabilities of the transferring company are transferred. In case of amalgamation, lives of both/all the amalgamating companies come to an end and in their places a new producer company is formed. In complete merger, the life of the merging company comes to an end and the merged company continues. Whatever may be mode or mechanism, all the producer companies involved in these arrangements have to get prior approval of their members in their respective meetings (general meeting in case of transfer and general or special meeting for the other two modes). The resolutions are to be approved by at least two-third majority of total number of members having the voting right, present and voting. It seems that sub-section (3) of this section has inadvertently omitted to mention special meeting of members mentioned in sub-section (2) for amalgamation or merger (special meeting has been mentioned as an alternative to general meeting). The resolution concerned shall contain all

particulars of the transfer of assets and liabilities or of amalgamation or merger as the case may be.

Prior notice in writing has to be given to the members and creditors of respective companies by the company concerned. The notice has to accompany a copy of the proposed resolution. The objective for giving the notice is to seek consent of the members and creditors to the proposal [sub-section (4)]. It may be observed that no period of notice has been specified for the purpose and as such provision of section 581ZA(8) requiring fourteen days' notice will apply for general meeting and the same period will apply for special meeting, if any, unless the Articles have provided for a notice of a longer duration. The members, in any case, has the right to attend the meeting and vote thereat reflecting their consent or otherwise. It seems that the creditors have the only recourse to give their consent or disapproval in writing to the company. So far members are concerned, it seems that they are not debarred from giving consent or disapproval in writing. If such a thing has happened and all or some of such members also attend the meeting and exercise their voting rights, then the written communication sent by the members will get nullified, if identity of members voting for or against the resolution is established. Clarification by appropriate Authority is need to strengthen this situation regarding members. It may be that written communication of members not present in the meeting may be accepted while the same from members present will get nullified.

A member or creditor not consenting to the resolution has the right to the following options, to be exercised within one month of the date of service of the notice on him:

- (i) non-consenting members can transfer their shares in the producer company to any active member of the company, with the approval of the Board. These may even be purchased by the producer company itself [vide sub-section 8(6)]
- (ii) non-consenting creditors would be entitled to withdraw their deposit/loan/ advance, as the case may be, from the company. This right of exercising option by members and creditors is unfettered by anything to the contrary contained in the Articles or in any contract with the company [sub-section (5)]. Any member or creditor who does not exercise this right within the period of one month mentioned above, shall be deemed to have consented to the resolution [sub-section (6)]. A resolution being discussed in the context of coming together of producer companies, shall not take effect until the expiry of one month (from the date of its passing) or the assent thereto of all the members and creditors has been obtained, whichever is earlier. As a practical understanding, it seems expiry of one month will be earlier in most cases as obtaining consent from all the creditors and members, if possible, would be a time-consuming process.

Division of a producer company [Section 581XN(1)(b)] - A producer company by passing resolution in its general meeting may divide itself into two or more new producer companies. All the procedures discussed above regarding giving of written notice, seeking consent to the proposal (resolution), option to members and creditors, consequence of non-exercising of the option and the period of non-implementation of the resolution shall apply to division of the producer company. Upon division of a producer company resulting into two or more producer companies, the erstwhile producer company shall cease to exist as its registration will be cancelled forthwith [vide sub-section (13)] and the resulting producer companies shall be registered.

Contents of the resolution [sub-section (8)]- The resolution referred to above for transfer, division, amalgamation or merger shall provide for:

- (a) the regulation of conduct of the producer company's affairs in future;
- (b) the purchase of shares or interest of any members of the producer company by other members or by the producer company itself;
- (c) in the case of purchase of shares of one producer company by another producer company, the consequent reduction of its share capital;
- (d) terminating, setting aside or modification of any agreement, howsoever, arrived between the company on the one hand and the directors, secretary and manager on the other hand, apart



from such terms and conditions as may, in the opinion of majority of shareholders, be just and equitable in the circumstances of the case;

- (e) terminating, setting aside or modification of any agreement between the company and any other person, not being the director, secretary or manager referred above, by giving due notice to the person concerned (modification can be made only after getting consent of the party concerned);
- (f) setting aside of any transfer, delivery of goods, payment, execution or other act relating to property, made or done by or against the producer company within three months before the date of passing of the resolution, which would if made or done against any individual, be deemed in his insolvency, to be a fraudulent preference (these involve third parties and can these be done without recourse to court ?);
- (g) transfer to the merged company of the whole or any part of the undertaking, property and liability of the producer company;
- (h) allotment or appropriation by the merged company of any shares, debentures, policies and other similar interests in the merged company;
- (i) continuation by or against the merged company of any legal proceedings pending by or against any producer company;
- (j) the dissolution without winding up of a producer company;
- (k) provision for any member/creditor who dissents;
- (l) taxes, if any, to be paid by the producer company; and
- (m) such incidental, consequential and supplemental matters as are necessary to secure that the division, amalgamation or merger shall be fully and effectively carried out.

On passing of the resolution and its taking effect, the resolution shall be sufficient conveyance to vest the assets and liabilities in the transferee [sub-section (9)].

The producer company shall [see (k) above] make arrangements for meeting in full or otherwise satisfying non-consenting member/creditor [sub-section (10)].

As indicated earlier, where whole of the assets and liabilities of a producer company are transferred to another producer company, pursuant to the resolution passed (vide sub-section (9) also), or where there is merger, the registration of the first mentioned company or the merging company, as the case may be, shall stand cancelled and the company shall be deemed to have been dissolved forthwith and shall cease to exist as a body corporate [sub-section (11)]. This provision applies only when there is a case of transfer of assets and liabilities, in entirety. A partial transfer on a partial merger will not result into dissolution of the transferring or merging producer company. As stated earlier, in case of an amalgamation, each of the amalgamating companies cease to exist after getting dissolved forthwith with cancellation of their registration. The amalgamated company that is formed shall be registered by the ROC as a producer company [sub-section (12)].

Pre-existing rights, obligations and legal proceedings [sub-section (14)] - the amalgamation, merger or division of companies (transfer of entire assets and liabilities should be presumed to be included) shall not in any manner affect any rights/ obligations/legal proceedings that related to the erstwhile producer company and the same may be continued or commenced by, or against, the resulting company(ies).

It is the responsibility of the ROC to strike off the names of every producer company deemed to have been dissolved under sub-sections (11) to (13). [The sub-section wrongly mentions (14) in place of (13).]

Appeal to the High Court - Under sub-section (16), any member or creditor or employee aggrieved

by the transfer of assets, division, amalgamation or merger may, within thirty days of passing of the resolution, prefer an appeal to the High Court. The High Court, after giving a reasonable opportunity to the person concerned, pass such orders as it may deem fit. While the appeal has been filed, the transfer of assets, division, amalgamation or merger of the producer company shall be subject to the decision of the High Court.

Penalties (Section 581ZM) - If any person, other than a producer company registered under Part IXA of the Act, carries on business under any name which contains the word, "Producer Company Limited", he or it shall be punishable with fine which may extend to rupees ten thousand for every day during which such name has been used.

A director of a producer company who willfully fails to furnish any information relating to the affairs of the producer company sought/required by a member or a person duly authorized for this purpose, shall be liable to imprisonment for a term that may extend to six months and with fine equivalent to five per cent of the turnover of that company during preceding financial year. Director or officer of a producer company making a default in handing over the custody of the books and other documents or property in his custody to the producer company concerned or failing to convene AGM or any other general meeting, shall be punishable with fine which may extend to rupees one lakh. In case of continuing default for the offence, an additional fine not exceeding rupees ten thousand per day of the default is leviable.

The offence for directors for not furnishing information to members etc. as above, is not compoundable under section 621A of the Act. However, other offences discussed above are compoundable.

Dispute Resolution (Section 581ZO) - Presumably taking into account the fact that in a producer company general members have more intimate interest in the affairs of the company than perhaps in other companies, possibility of internal disputes amongst and among the members and directors etc. is far greater. Here members are by and large producers and they supply their products to the company of which they are the members. Accordingly this section provides that where any dispute on formation, management or business of a producer company arises—

- (a) amongst members, former members or persons claiming to be members or nominees of deceased members; or
- (b) between a member, former member or a person claiming to be a member or nominee of a deceased member and the producer company, its Board, office bearers (the provision of this part has not indicated what would constitute "office bearers"), or liquidator, past or present; or
- (c) between the producer company or its Board, and any director, office bearer or any former director, or the nominee, heir or legal representative of any [deceased director of the producer company,

such dispute shall be settled by conciliation or by arbitration as provided under the Arbitration and Conciliation Act, 1996. The aforesaid parties to dispute shall be deemed to have consented in writing for determination of such disputes by conciliation or arbitration under the aforesaid Act. A dispute referred to above shall include:

- (i) a claim or any debt or other amount due;
- (ii) a claim by surety against the principal debtor, where the producer company has recovered from the surety amount in respect of any debtor or other amount due to it from the principal debtor as a result of the default of the principal debtor whether such debt or amount due be admitted or not;
- (iii) a claim by a producer company against its member for failure to supply or produce as required of him;
- (iv) a claim by a member against the producer company for not taking goods supplied by him.



On the primary issue (contention), if any of determining whether a dispute pertains to formation, management or business of the producer company, such matter shall be referred to the Arbitrator, whose decision shall be final.

It may be noted that any dispute involving the producer company with others i.e., third parties will, however, has to be referred to appropriate judicial forum.

Allied Provision - Section 581ZP deals with certain matters that may impact the producer company as a class of companies. They are (i) striking off name of producer company (ii) impact of the provisions of Part IXA of the Act on other laws, and (iii) application of the provisions of the Act regarding private companies on producer companies.

Striking off the name of producer company-'When the ROC is satisfied after serving show-cause notice on the producer company and its directors and after giving them reasonable opportunity to represent their cases that the producer company (i) has failed to commence business within one year of its registration, or (ii) has ceased to transact business with its members (the very foundation of the producer company concept) or (iii) is no longer carrying on any of its objects with which it was incorporated or operating pursuant to section 581B of the Act, the name of the producer company can be struck off the Register maintained by the ROC. In regard to (iii) above the ROC at the primary stage must have made due enquiry about non-functioning status of the producer company before issuing the show-cause notice and giving opportunity to the company and its directors to make representation against the allegation in the show-cause notice.

Where, however, the ROC has reasonable cause to believe that a producer company is not adhering to any of the mutual assistance principles specified in this part (another basic foundation of a producer company), he shall strike its name off the register in accordance with provisions of section 560 of the Act, relating to defunct companies. As such in regard to (i), (ii) and (iii) above the procedure laid down is simple before the ROC can exercise the power to strike off the name of the producer company from the register maintained by him as they all relate to matters of fact. But in case of the issue of striking off names for non-adherence with mutual assistance principles, the procedure is somewhat elaborate as laid down in section 560 of the Act. In such a case, it seems sub-section (6) of section 560 will remain open for restoring the name of the company in the register.

Any member of a producer company where the producer company's name has been struck off by the ROC on (i) or (ii) or (iii) above, who is aggrieved by the order of the ROC to strike off the name of the company, may appeal to the CLB within sixty days of the order. In that event the ROC's order will remain in abeyance until the appeal is disposed of. It implies that the ROC will not give effect to his order of striking off till the period for making appeal to his order is over and if appeal has been filed in due time, he will not act on his order until the appeal is disposed of. If as a result of the appeal, the order of the ROC is nullified then, there will not arise the case of striking off the name of the company from the register of the ROC.

Reconversion of a Producer Company to inter-State Co-operative Society (Sections 581ZS and 581ZT)

- An inter-State cooperative society which transformed itself to a producer company under section 581J in Part IXA of the Act can make an application to the High Court for returning to its earlier status on the basis of (i) a resolution passed by its members in a general meeting, where at least two-third of its members present voted for re-conversion or (ii) on request of its creditors representing at least three fourth in value of its total creditors. Upon receipt of the application, or shall be issued only in such modified form as have been agreed by both the Houses. It is, however, not clear how to deal with the situation of varying views of the Houses.

1.1.3. Associations not for profit

It is clear from the nomenclature itself that an "Association not for profit" is an association which is formed not for making profits but for promoting commerce, art, science, religion, charity or any other useful social purpose. Such an association may or may not be registered as a company under the

Companies Act. When such an association is registered as a company with limited liability, it may be given a licence by the Central Government.

According to sec. 13(1)(a), it is necessary that the name of a limited company must end with the word 'limited' in the case of a public company and with the words 'private limited' in the case of private company. However, sec. 25 permits the registration under a licence granted by the Central Government of, all 'associations not for profit with limited liability' without being required to use the word 'limited' or the words 'private limited' at the end of their names.

The Central Government may grant such a licence if the following two conditions are fulfilled:

- (i) It is intended to form a company for promoting commerce, art, science, religion, charity, or any other useful object;

Whether or not the persons dealing with each other, is a 'mutual club' or carrying on a trade, is largely a question of fact – *CIT v. Bankipur Club Ltd* [1997] 5Comp. LJ 113(SC).

- (ii) The company prohibits payment of any dividend to its members but intends to apply its profits or other income in the promotion of its objects.

When the above conditions are fulfilled, the Central Government may, by licence, direct that the association may be registered as a company with limited liability without the addition to its name of the word "limited" or the words "private limited" [Sec. 25(1)].

Trust companies do come within the purview of section 25 as it deals with companies formed to promote charity and provision has no application to case of trust companies what is to act as a trustee - *B. Ramachandra Adityan v. Educational Trustee Co. (P.) Ltd* [2003] 41 SCL 385 (Mad.).

Such a company is registered without paying any stamp duty on its memorandum and articles. On registration, the association enjoys all the privileges of a limited company, and is subject to all its obligations except those in respect of which exemption by a special or general order is granted by the Central Government [Sec. 25(2)].

The licence may be granted by the Central Government on such conditions and subject to such regulations, as it thinks fit, and such conditions and regulations shall be binding on the association to which licence is granted. The Central Government may also require that such conditions shall be inserted in the memorandum or in the articles or partly in the one and partly in the other [Sec. 25(5)].

The Central Government may, by general or special order, exempt the association from such provisions of the Act as may be specified in that order.

It is permissible for the Central Government to grant exemption either generally or specifically to a particular company from one or more of the provisions of the Act under sub-section (6) of section 25. Such exemption should normally be express and the Courts would be inclined to cull out the implied exemption - *C.P. Singhania v. Garware Club House* [2003] 46 SCL 650 (Bom.).

Alteration of memorandum of an 'Association not for profits'- The company which has been granted licence by the Central Government cannot alter the provisions of its memorandum with respect to its objects except with the previous approval of the Central Government signified in writing [Sec. 25(8)(a)]. If any alteration is made without the written approval of the Central Government, the Government may revoke the licence of such a body. [Sec. 25(8)(b)].

The licence granted by the Government under section 25 may also be revoked by the Central Government at any time. However, before revoking the licence, the Central Government shall give a written notice to the association indicating its intention to do so and shall give an opportunity of being heard in the matter [Sec. 25(7)]. On revocation of the licence, the association loses the exemption granted by such licence and the Registrar shall enter the word 'limited' or words 'private limited', as the case may be, at the end of the name in the register maintained by it. Examples of companies which are not for profits include Mohan Bagan Club, Gymkhana Club, Delhi District Cricket Association (D.D.C.A.) etc.



Partnership firm may become member - It may be noted that a partnership firm may become a member of such a company. However, on dissolution of the firm, its membership will come to an end [Sec. 25(4)].

Exemptions granted to section 25 companies - In exercise of the powers conferred by sub-section (6) of section 25 of the Companies Act, 1956 the Central Government has directed that a body to which a licence is granted under section 25 shall be exempted, inter alia, from the following:

- (1) The Secretary of such a company need not be possessing the qualifications prescribed under section 2(45).
- (2) Section 25 companies are exempted from the provisions of section 147 which relates to publication of name by the company.
- (3) Such companies are not required to comply with the provisions of section 160(1)(aa). Accordingly, the annual returns of such companies to be filed with the Registrar of Companies need not include particulars regarding the names of members and the respective dates on which they became members and the names of persons who ceased to be members since the date of the annual general meeting of the immediately preceding year, and the dates on which they so ceased.
- (4) Section 25 company is exempted from the provisions of section 166(2). It means that such a company may hold its annual general meeting on a day which is a public holiday. However, the time, date and place of each annual general meeting must be decided upon beforehand by the Board of Directors having regard to the directions, if any, given in this regard by the company in general meeting.
- (5) A general meeting of such a company may be called by giving a notice in writing of not less than 14 days as against a notice of 21 days as per section 171(1).
- (6) Minutes may be recorded within 30 days of the conclusion of every meeting where the articles of association provide for confirmation of minutes by circulation [Sec. 193].
- (7) Books of account relating to a period of not less than four years (as against eight years) as per section 209(4A) shall be preserved.
- (8) A document mentioned in sub-section (1) of section 219 may be sent not less than 14 days (as against 21 days) before the date of the general meeting.
- (9) The provisions of section 257 shall not apply to the companies whose articles provide for election of directors by ballot.
- (10) Any increase in the number of directors under section 259 shall not require the approval of the Central Government.
- (11) The provisions of section 264(1) relating to the filing of consent to act as a director with the company and with the Registrar of Companies is not applicable to such companies.
- (12) The provisions of section 285 shall apply only to the extent that the Board of Directors/Executive Committee/Governing Committee of such companies shall hold at least one meeting within every six calendar months (as against every three calendar months).
- (13) The provisions of section 287 shall apply only to the extent that the quorum for the Board meeting shall be either eight members or 1/4th of its total strength; whichever is less provided the quorum shall not be less than two members in any case.
- (14) The provisions of section 292 matters referred to in clauses (c), (d) and (e) of sub-section (1) may be decided by the Board by circulation instead of at a meeting.
- (15) The provisions of section 299 shall apply only to cases to which sub-sections (1) and (3) of section 297 apply.

- (16) The provisions of section 301** - a register shall be maintained only of contracts to which sub-sections (1) and (3) of section 297 apply.

Where Central Government had granted licence to company under section 25 after reading memorandum of association and articles of association including Article 41 which provided that election for office of directors would be held only once in five years, it was held that it amounted to grant of exemption from application of section 255, and, therefore, it was not necessary for company to follow provisions for retirement of one-third of its directors at each annual general meeting - C.P. Singhania v. Garware Club House [2003] 46 SCL 659 (Bom.).

Procedure for formation of a section 25 company- For establishing a company for charitable purpose and without the addition of the word "Limited" as part of its name, the promoters have to take the following steps to obtain permission of the Central Government.

- (1) An application has to be made to the Regional Director of the concerned region along with the following documents :
 - (a) Three copies of draft memorandum and articles of association of the proposed company.
 - (b) A declaration that all requirements pertaining to the formation of the company have been duly complied with.
 - (c) Three copies of list of names of the promoters as well as the proposed directors together with the names of companies in which they are interested along with the relevant particulars.
 - (d) A statement showing the assets and liabilities of the association as on the date of the application or within seven days of that date.
 - (e) An estimate of the future annual income and expenditure of the proposed company.
 - (f) A statement giving a brief description of the work proposed to be done after formation which must be non-commercial.
 - (g) A declaration that profits, if any, shall not be distributed by way of dividends but shall instead be used for furtherance of the cause for which the company has been established.
 - (h) A statement specifying briefly the grounds on which the application is made.
 - (i) A declaration by the applicants regarding their competence to make the application.
 - (j) Evidence of the payment of the prescribed fees.
 - (k) Letter of authority to make any corrections in the documents filed.
- (2) A copy of the application should also be filed with the concerned Registrar of companies along with the prescribed enclosures.
- (3) Within one week of submission of papers, publish a notice of the application made to the Regional Director in a newspaper and send a certified copy of that notice to the Regional Directors.
- (4) The Regional Director, after satisfying that all the formalities have been duly complied with shall issue the necessary licence.

1.1.4 Foreign company [Sec. 591]

A foreign company means a company incorporated outside India but having a place of business in India. Accordingly, a company which is incorporated outside India and employs agents in India but has no office or does not establish a place of business in India will not be a foreign company. A company shall be said to have a place of business in India will not be a foreign company. A company shall be said to have a place of business in India if it has a specified or identifiable place at which it carries on business such as an office, store house, godown or other premises having some concrete connection between locality and its business [Deverall v. Grand Advertisement Inc. [1954] 3 All ER 389].



As per section 602(c), having a share transfer office or share registration office will constitute a place of business [Employer's Liability Assurance Corporation v. Sedgwick, Collins & Co. [1927] AC 95]. In *Tovarishestvo Manufacture Ludvig Rabenek, Re* [1944] Ch. 404 it was held that where representatives of a company incorporated outside the country frequently visited and stayed in a hotel for looking after purchase of machinery and other articles, it was held that the company had a place of business in the hotel. However, in *Re, Oriel Ltd.* [1985] 3 All, ER 216, the Court of Appeal found that the mere fact that the directors of a company had a residence in England from which they acted on behalf of the company did not constitute the residence or an established place of business.

In *South India Shipping Corpn. Ltd v. Export-Import Bank of Korea* [1985] 2 All ER 219, the test applied for ascertaining whether a foreign company had established a place of business in England or not was that whether there was some specific location readily identifiable with the company by members of the public from which it could be deduced that some substantial business activity was being carried on. In this case, the company was held to be carrying on business in England by having leased premises from which it conducted promotional and research activities.

However, mere holding property cannot amount to having a place of business.

But, where the company delivered to the Registrar of Companies at Bombay documents under section 592 and such documents under that section are to be delivered within 30 days of the establishment of the place of business, it was held that by delivering the documents, the defendants had admitted that the company had established a place of business within India [*Framroze Rustomji Paymaster v. British Burmah Petroleum Co. Ltd* [1976] 46 Comp. Cas. 587 (Bom.)].

It may be noted that section 591 defines a foreign company in terms of its place of incorporation. If the company is established outside India and has a place of business in India, then only it will be a foreign company under the section. Accordingly, a company incorporated outside India having shareholders who are all Indian citizens and having its business outside India is not covered. Contrarily, a company incorporated in India but having all foreign shareholders shall be an Indian company and not a foreign company as contemplated under section 591.

A mere presence of a representative of a foreign company is not sufficient if his only authority is to solicit orders from customers but not to make contracts on behalf of the company [*P.J. Johnson v. Astrofiel Armadorn* [1989] 3 Comp. LJ 1].

The following activities are not held to constitute "carrying on of business" as per the law in the U.S.A. This provides a ready basis for determining the presence of a foreign company in India. However facts of each case have to be viewed in its own context:

- (1) maintaining and defending suit or action or other proceeding or effecting the settlement of any claim in dispute
- (2) holding meeting of shareholders or directors
- (3) maintaining bank accounts
- (4) maintaining offices or agents for the transfer, exchange and registration of shares or other securities
- (5) effecting sales through independent contractors
- (6) soliciting or procuring orders where such orders require acceptance of the company for becoming binding contracts
- (7) creating or financing of debts, charges, etc. on real or personal property
- (8) securing or collecting debts or enforcing claims to property of any kind
- (9) conducting any isolated transactions

The Court in *A/S Dampskib 'Hercules' v. Grand Trunk Pacific Rly. Co.* [1912] 1 K.B. 222, 223, considered

the extent of business which has to be carried on to make 'a place of business' for the purpose, in that case, to establish a sufficient presence within the jurisdiction for service of process.

A Canadian railway company's four directors were in London who formed a London Committee for the purpose of raising loans for the construction of the railway in Canada. They were using the office of another company without rent and transacted no other business than that of raising loans. The Court of Appeal held that the defendants were carrying on their business in the office used by the London Committee and could therefore be properly served with a writ.

Lord Buckley observed as follows :—

"We have only to see whether the Corporation is 'here'; if it is, it can be served. The best test is to ascertain whether the business is carried on here or at a definite place. In the present case, the Company has a paramount, and also a subsidiary object; its paramount object is to make and run a railway in Canada, to do which a great many things must first happen; it has a subsidiary object, namely, the raising of money to carry out its paramount object. The raising of this loan capital is part of the company's business and it is done here by a London Committee constituted of the directors resident in England."

Provisions relating to Foreign Companies

A foreign company has to furnish to the Registrar the following documents within 30 days of the establishment of the business in India: [Sec. 592]

- (a) A certified copy of the charter, statute or memorandum and articles of the company or other instrument constituting or defining the constitution of the company; and if the instrument is not in English language, a certified translation thereof.
- (b) The full particulars of the registered or principal office of the company.
- (c) A list of directors and secretary of the company, giving name in full, usual residential address, nationality of origin, his business, occupation and particulars of other directorships held by him.
- (d) The name(s) and address(es) of one or more persons resident in India, authorised to accept, on behalf of the company, service of process and any notices or other documents required to be served on the company. Any document, etc., served on such a person shall be deemed to have been served on the company. Where no such person is designated, the service may be left at the company's principal place of business [Sec. 596].
- (e) The full address of the office of the company in India which is to be deemed to be principal place of business in India.

When any change occurs in the above particulars, the Registrar must be intimated accordingly [Sec. 593].

The aforesaid documents shall be required to be filed at two places, first, with the Registrar of the State where the principal place of business is situated and, second, with the Registrar at New Delhi [Sec. 597].

If the company establishes any branch or branches of its business in India, no further information need be given except that with the annual accounts, the company should deliver three copies of a list of its places of business in India as at the date with reference to which the accounts are made out [Sec. 594(3)].

Other Obligations [Sec. 595]

A foreign company is further bound by the following obligations :

- (1) The company shall in every prospectus inviting subscription, in India, for its shares or debentures, state the country in which the company is incorporated;
- (2) It shall conspicuously exhibit on the outside of every office or place of business, its name and the country of incorporation in English and the original vernacular (local) language;



- (3) It shall cause the name of the company and of the country in which the company is incorporated, to be stated in legible English characters in all business letters, letter heads and letter papers and in all notices and other official publications of the company;
- (4) If the liability of the members of the company is limited, it shall cause notice of that fact:
 - (a) in every prospectus as aforesaid and in all business letters, letter heads, letter papers, notices, advertisements and other official publications of the company, in legible English characters;
 - (b) conspicuously exhibit on the outside of every office or place where it carries on business in India, in legible English characters and also in legible characters of the languages or one of the languages in general use in the locality in which the office or place is situated.

(5) **Obligation regarding accounts [Sec. 594]**

Every foreign company shall, in every calendar year,—

- (a) make out a balance sheet and profit and loss account in such form, containing such particulars and including or having annexed or attached thereto such documents (including in particular documents relating to every subsidiary of the foreign company) as under the provisions of this Act it would, if it had been a company within the meaning of this Act, have been required to make out and lay before the company in general meeting; and
- (b) deliver a copy* of those documents to the Registrar. [Sec. 594(1)]

However, the Central Government may, by notification in the Official Gazette, direct that, in the case of any foreign company or class of foreign companies, the requirements of clause (a) shall not apply or shall apply subject to such exceptions and modifications as may be specified in the notification. [Proviso to sub-section (1) of sec. 594]

If any document as is mentioned in sub-section (1) is not in the English language, there shall be annexed to it a certified translation thereof. [Sec. 594(2)]

Further, sub-section (3) of section 594 requires every foreign company to send to the Registrar a copy of a list in the prescribed form of all places of business established by the company in India as at the date with reference to which the balance sheet referred to in sub-section (1) is made out.

Position regarding World Accounts

Three copies of balance sheet and profit and loss account, including documents relating to every subsidiary of the foreign company, as submitted by it to the prescribed authority in the country of its incorporation under the provisions of the law in that country, shall be filed with the Registrar.

The world accounts shall be delivered to the Registrar within a period of nine months from the close of the financial year of the foreign company. The Registrar at New Delhi may, however, extend this period by three months [Rule ISA of Companies (Central Government's) General Rules and Forms, 1956].

Position regarding Indian business accounts

Three copies of balance sheet and profit and loss account of Indian business accounts of a foreign company duly audited by a practising Chartered Accountant in India, in the form prescribed in Schedule VI shall be filed with the Registrar within 9 months of the close of the financial year.

The aforesaid accounts have to be filed with the Principal Registrar (i.e., Registrar of Companies, New Delhi) and the concerned Registrar having jurisdiction over the principal place of business of the foreign company [Sec. 597].

The Registrar at New Delhi may extend this period by 3 months. It may be noted that the Indian accounts have to be drawn up in Indian rupees.

Inspection of Accounts of a Foreign Company

The profit and loss account of Indian business of a foreign company which, if incorporated under this Act would be deemed to be that of a private company shall not be open to inspection by any person other than a member of the company.

(6) Registration of charges, etc. [Sec. 600]

The provisions of sections 124 to 145 relating to registration of charges, appointment of receivers and keeping of registers, documents and books of account shall apply *mutatis mutandis* (with necessary changes) to foreign companies.

Further, section 209 shall also be applicable to foreign companies to the extent of requiring them to keep at the principal place of business in India, the books of account with respect to monies received and expended, sales and purchases made, and assets and liabilities in relation to their business in India. Section 600 [as amended by the Companies (Amendment) Act, 1974] has further made certain other sections of the Companies Act applicable to foreign companies. Accordingly, the provisions of section 159 relating to the filing of annual return with the Registrar subject to such modifications and adaptations, as may be made by rules made under the Act, apply to a foreign company. Similarly, provisions of sections 209, 209A, 233B and sections 234 to 246 have been made applicable to the Indian business of a foreign company as they apply to a company incorporated in India.

(7) Requirements as to prospectus [Sees. 603 to 608]

A foreign company may, even if it has no place of business in India, issue a prospectus offering shares or debentures for subscription. But, the prospectus shall have to comply with the provisions of sections 603 to 608 of the Act relating to prospectus. For example, it shall have to be in the form and contain matters and returns specified in Schedule II. It must also be registered with the Registrar before it is issued [Sec. 605].

In addition to the general requirements of the Act, the prospectus of a foreign company has to contain particulars with respect to the following matters:—

- (a) The instrument containing or defining the constitution of the company;
- (b) The provisions of law under which the company was incorporated;
- (c) An address in India where the above instrument and the enactments or provisions of law may be inspected. If they are not in the English language, the certified English copy should be made available;
- (d) The date and country of incorporation;
- (e) Whether the company has an established place of business in India and if so, the address of its principal office in India.

(8) Foreign companies in which not less than 50% of the paid-up share capital is in Indian hands

Section 591(2) provides that where not less than 50% of the paid-up share capital (whether equity or preference or partly equity, partly preference) of a company incorporated outside India and having an established place of business in India, is held by one or more citizens of India or by one or more bodies corporate incorporated in India whether singly or in the aggregate, such company shall be required to comply with all the provisions of the Companies Act with regard to the business carried on by it in India as if it were a company incorporated in India.

(9) Foreign Companies - Obligations under section 209

Under the provisions of the Companies Act, every foreign company has to maintain its books of account relating to Indian business in the manner provided in section 209 and in each calendar year it has to file its world account. It has also to file a list of places of business, establishments in India. The foreign company is also under obligation under section 594 of the Companies Act to deliver 3 copies of its



world accounts. Three copies of balance sheets of Indian business accounts of a foreign company duly audited have also to be filed with the ROC within 9 months of the close of the financial year. The Indian account has to be drawn up in Indian rupees according to the requirements of Schedule VI [Advance Ruling Petition No. 14 of 1997, In re, [1998] 31 CLA 105 (AAR - New Delhi)].

(10) Penalty

If any foreign company fails to comply with the provisions applicable to it, the company and every officer or agent of the company who is in default shall be punishable with fine upto ₹ 10,000 and in the case of a continuing offence, with an additional fine upto ₹ 1,000 for every day during which the default continues [Sec. 598]. Presumably, the further fine for continuing default is leviable from the day next to the day of default.

Further, a foreign company which has failed to comply with the requirements applicable to it under the Companies Act, 1956 will be liable to be sued in respect of any contract, dealing or transaction it may have entered into; but shall not be entitled to enforce any contract by way of suit, set off or counter-claim. It cannot also institute any legal proceeding in respect of any such contract until it has complied with all the provisions of the Act relating to foreign companies.

(11) Winding-up

Where a foreign company which has been carrying on business in India, ceases to carry on such business in India, it may be wound up as an unregistered company under Part X (Sections 582 to 590 of the Companies Act).

A foreign company may be a Government company and it may be wound up or a scheme under section 391 may be sanctioned by the Court in India -(Rivers Steam Navigation Co. Ltd., In re [1967] 2 Comp. LJ 106).

A foreign company's business in India can be wound up even in cases where the company has been dissolved or otherwise ceased to exist under the laws of the country under which it was incorporated [Sec. 584].

Jurisdiction of Courts - The Court has no jurisdiction over a company incorporated in foreign country except in respect of cause of action arising at place where its office in India is located - Partap Singh v. Bank of America [1976] 46 Comp. Cas. 532 (Bom.).

In respect of foreign companies, it is the place where its principal place of business is situated which is deemed in law to be its registered office which decides the jurisdiction of the Court. In other words, the Court where the foreign company's principal place of business is situated would have jurisdiction in respect of any matter relating to such foreign company -Ban k Muscat SAOG, In re[2004]51 SCL191 (Kar.).

1.2 PROCEDURE FOR ALTERATION OF MEMORANDUM AND ARTICLES OF ASSOCIATION

Memorandum of Association - Meaning and importance

One of the first steps, in the formation of a company is to prepare a document called the memorandum of association. The memorandum of association of a company contains the fundamental conditions upon which alone the company has been incorporated. According to section 2(28) of the Companies Act, 1956 "Memorandum" means "Memorandum of association of a company as originally framed or altered from time to time in pursuance of any previous companies law or of this Act". This definition, however, does not state the nature of this document nor is indicative of its importance. According to Palmer, the memorandum of association is a document of great importance in relation to the proposed company. It contains the objects for which the company is formed and therefore identifies the possible scope of its operations beyond which its actions cannot go. It defines as well as confines the powers of the company. If anything is done beyond these powers, that will be ultra vires (beyond powers of) the company and so void.

In the celebrated case of *Ashbury Railway Carriage & Iron Co. Ltd, v. Riche* [1875] L.R. 7 H.L. 653, Lord Cairns observed: "the memorandum of association of a company defines the limitation on the powers of the company... it contains in it both that which is affirmative and that which is negative. It states affirmatively the ambit and extent of vitality and power which by law are given to the corporation and it states, if it is necessary to state, negatively, that nothing shall be done beyond that ambit__" Thus, it serves two purposes. It enables shareholders, creditors and all those who deal with the company to know what its powers are and what is the range of its activities. An intending shareholder can find out the purposes for which his money is going to be; used by the company and what risk he is taking in making the investment. Likewise, anyone dealing with the company, say, the supplier of goods or money, will know whether the transaction he intends to make with the company is within the objects of the company and not ultra vires its objects.

Form and contents

Section 14 requires that the memorandum of a company shall be drawn up in such a form as is given in Tables B, C, D & E in Schedule I to the Companies Act, 1956 as may be applicable in the case of the company, or as near thereto as circumstances admit. Section 15, read with sections 12 & 13, requires the memorandum to be printed, 1 - divided into paragraphs, numbered consecutively, and signed by at least seven persons (two in the case of private company) in the presence of at least one witness, who will attest the signature. Each of the subscribers must take at least one share and write opposite his name the number of shares he takes. The signatories to the Memorandum shall add their address, description and occupation. Similar particulars of the witness(es) should also be entered.

Section 13 requires the memorandum of a limited company (either by shares or by guarantee) to contain the following:

- (a) the name of the company, with 'limited' or 'private limited' as the last word(s) of the name in the case of a public company or a private company as the case may be;
- (b) the name of the State, in which the registered office of the company is to be situated;
- (c) the objects of the company, stating separately :
 - (i) the main objects to be pursued on incorporation;
 - (ii) objects incidental or ancillary to the attainment of the main objects;
 - (iii) "other objects" of the company not included in (i) and (ii) above;
- (d) the declaration that the liability of the members is limited;
- (e) the amount of authorised share capital (in the case of a company having share capital), divided into shares of fixed amounts;
- (f) in the case of companies (other than trading corporations) with objects not confined to one State, the States to whose territories the objects extend.

The above clauses of the memorandum are called compulsory clauses. In addition to these, the memorandum may contain other information, for example, rights attached to various classes of shares.

It may be noted that the memorandum of association of a company cannot contain anything contrary to the provisions of the Companies Act. If it does, the same shall be devoid of any legal effect (section 9). However, in *K. Leela Kumar vs. Government of India* [2002] 37 SCL 322, the Madras High Court held that the need or necessity for the retention of a clause in the articles of association, in order to maintain internal discipline among members of a private club and protect the fair image and status of the club, is a matter pertaining to private law or personal matters and no public law aspect or any violation of statutory rights or fundamental rights is involved therein. The wisdom or otherwise of the policy behind the bye-laws of a private club is not a matter for consideration in a writ petition under Article 226.



Now, let us discuss in detail, the various clauses of Memorandum of Association.

The name clause [Sec. 13(1)(a)] - A company being a distinct legal entity must have a name of its own to establish its separate identity. The promoters are free to choose any suitable name for the company provided:

- (a) The last word(s) in the name of the company, if limited by shares or guarantee is limited' or 'private limited', as the case may be. However, an "association not for profit", and incorporated as a company and licensed by the Central Government, may not use the word limited' or 'private limited' as part of its name, even though the liability of its members is limited [Section 25].
- (b) In the opinion of the Central Government, the name chosen is not undesirable [Section 20(1)]. According to sub-section (2) of section 20, a name which is identical with, or which resembles too nearly, the name by which a company in existence has been previously registered, may be deemed to be undesirable by the central government.

The registered office clause [Sec.13(1)(b)]- This clause states the name of the State in which the registered office of the company will be situated. Every company must have a registered office which establishes its domicile and is also the address at which the company's statutory books must normally be kept and to which notices and other communications can be sent. The notice of the exact situation (address) of the registered office shall be given to the Registrar of Companies in Form No.18, within 30 days from the date of incorporation [Section 146].

The objects clause [Sec.13(1)(c)& (d)]- The objects clause defines the objects of the company and indicates the sphere of its activities. A company cannot do anything beyond or outside its objects and any act done beyond that will be Ultra Vires and void and cannot be ratified even by the assent of the whole body of shareholders. Section 13(1)(d) read along with Tables 'B', 'C', 'D' and 'E' requires a company to divide its objects clause into two parts:

- (a) Main objects of the company to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of the main objects; and
- (b) Other objects of the company not included in the above clause.

Liability clause [Sec. 13(2)]- This clause states the nature of liability of the members. In

the case of a company limited by shares, a member can be called upon at any time to pay to the company the amount unpaid on the shares. Thus, if his shares are fully paid-up, his liability is nil. Where a shareholder holding a 10-rupee share has paid ₹5 on it, he can be called upon to pay the balance of ₹5. But if he has paid the full value of ₹10, he cannot be required to pay anything more even if the company owes huge debts to its creditors.

In the case of companies limited by guarantee, this clause will state the amount which every member undertakes to contribute to the assets of the company in the event of its being wound up.

In the case of unlimited liability company this clause need not be given in the memorandum of association. In fact, the absence of this clause in the memorandum means that the liability of its members is unlimited.

The capital clause [Sec. 13(4)(a)]- This clause states the amount of share capital with which the company is registered and the mode of its division into shares of fixed value, i.e., the number of shares into which the capital is divided and the amount of each share. The usual way to state the capital in the memorandum is: "the capital of the company is ₹10 lakhs divided into one lakh equity shares of ₹10 each".

This clause lays down the limit beyond which the company cannot issue shares without altering the memorandum as provided by section 94 of the Companies Act, 1956.

The association or subscription clause [Sec. 13(4)(c)] - At the end of the Memorandum of every company there is an association or subscription clause or a declaration of association which reads

something like this :—

“We, the several persons whose names and addresses and occupations are subscribed, are desirous of being formed into a company in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names.”

Then follow the names, addresses, descriptions and occupations of the subscribers, and the number of shares each subscriber has agreed to take and his signature attested by a witness.

The statutory requirements and outcome regarding subscription of memorandum are :—

- (a) the memorandum must be signed by each subscriber in the presence of at least one witness who must attest the signature;
- (b) each subscriber must take at least one share ;
- (c) each subscriber must write opposite his name the number of shares he takes [Sec. 13(4)(c)] ‘

It may be noted that each subscriber to the memorandum must pay for the shares he agrees to subscribe for. He cannot, after the registration of the company, repudiate his liability to subscribe, even on the ground that he was induced to sign by misrepresentation. Every subscriber to the Memorandum, on the incorporation of the company, becomes its member and as such contributory, irrespective of whether he has made payment for the shares subscribed. To the extent the subscribed shares remain unpaid, the same is a debt owed to the company [Sec. 36(2)].

Alteration of memorandum

Section 16 provides that the company cannot alter the conditions contained in memorandum except in the cases and in the mode and to the extent express provisions have been made in the Act. These provisions are explained herein below.

Change of name : Section 21 provides that the name of a company may be changed at any time by passing a special resolution at a general meeting of the company and with the written approval of the Central Government. However, no approval of the Central Government is necessary if the change of name involves only the addition or deletion of the word “private” (i.e., when public company is converted into a private company or vice versa). Again, it is not open to Registrar of Companies to insist for additional compliance of section 21, when Company Court, in exercise of its jurisdiction under section 394, has sanctioned scheme for amalgamation, which included change of name - Shreno Investment of Finance Ltd v. Registrar of Companies [2007]75SCL275(Guj.) See also Mysore Cements Ltd., In re [2010]97SCL 290 (Kar.).

Procedure : The application for change of name is required to be made to the Registrar in Form No. 1A with the prescribed fee to ascertain availability of the name. The period of validity of the name so allowed is normally sixty days unless extended by another thirty days.

The change must be communicated to the Registrar by filing Form No. 23 prescribed under the Companies (Central Government's) General Rules and Forms, 1956 along with a printed or type written copy of the special resolution within 30 days of the passing thereof.

The change in name shall be sanctioned by the Registrar in the light of guidelines prescribed by the Central Government in this behalf.

Change by ordinary resolution: If through inadvertence or otherwise, a company has been registered with a name which is identical with or too closely resembles the name of an existing company, the company may change its name by passing an ordinary resolution and by obtaining the approval of the Central Government in writing [Sec. 22].

As to whether Regional Director has the authority to pass an order under section 22, the Calcutta High Court held ‘yes’-Kalpana Polytec India Ltd, v. Union of India [1998] 16SCL207(Cal).



The rectification of the name must also be carried out if the Central Government so directs within a period of 12 months from the date of registration of the company. The direction of the Central Government is required to be complied with within a period of three months from the date thereof. Any default in complying with the direction of the Central Government renders the company and its officer in default liable for punishment with fine which may extend to ₹1,000 for every day during which the default continues [Sec. 22(2)].

In *Sidhvi Constructions (India) (P.) Ltd. v. Registrar of Companies* [1997] 24 CLA 207, the Andhra Pradesh High Court held that where a company is registered by a name identical with the name of a company registered earlier, the petition for change of name should be made within 12 months. A petition made later shall be barred by limitation under section 22 of the Companies Act, 1956.

The Registrar will enter the new name on the Register in place of the old name and shall issue a fresh certificate of incorporation with necessary alterations [Sec. 23(1)].

The change of name becomes effective on the issue of fresh certificate of incorporation. The Registrar will also make the necessary alteration in the memorandum of association of the company [Sec. 23(2)].

Effect of change of name:

1. The change of name shall not affect any rights/obligations of the company or render the same defective in legal proceedings by or against it. Moreover, any legal proceedings which might have been continued or commenced by or against the company by its former name may be continued by or against the company by its new name [Sec. 23(3)]

Where a company changes its name and the new name has been registered by the Registrar, the commencement of legal proceedings in the former name is not competent – *Malhati Tea Syndicate Ltd. v. Revenue Officer* [1973] 43 Comp. Cas. 337.

2. However, if any legal proceedings is commenced, after change of name, against the company, in its old name, it is a case of mere misdescription and not a case of proceeding against a person not in existence. It is not an incurable defect and plaint can be amended to substitute the new name – *Pioneer Protective Glass Fiber (P.) Ltd. v. Fiber Glass Pilkington Ltd.* [1986] 60 Comp. Cas. 707 (Cal.).
3. By change of name constitution of company does not change: In *Economic Investment Corporation Ltd. v. CIT* [1970] 40 Comp. Cas. 1 (Cal.) it was held that by change of name, the constitution of the company is not changed. The only thing that changes is its name; all the rights and obligations under the law of the old company pass to the new company. It is not similar to the reconstitution of a partnership, which in law means creation of a new legal entity altogether.

Where a company 'M' changed its name to 'E' on 23-9-1947 and it was assessed to income-tax in the name of 'M' for the year 1946-47, and in the course of certificate proceedings for the recovery of tax, a notice was sent to Bank 'A' who was holding money in the account of the company in the name of 'E', for payment of tax, it was held that the bank was holding money for 'M' which was the assessee.

Change of registered office – This may include –

- (a) Change of registered office from one premise to another premise in the same city, town or village [Sec. 146]

A company can change its registered office from one place to another within the local limits of the city, town or village where it is situated, by passing a resolution of the Board of directors. However, notice of the change should within 30 days of the change, be filed with the Registrar who shall record the same. The notice shall be given in Form No. 18.

It should be noted that change within the same city, town or village does not involve alternation of memorandum because in the registered office clause of the memorandum, it is only the name of the State which is mentioned and not the address of the registered office.

- (b) Change of registered office from one town or city or village to another town or city or village in the same State [Sec. 17A and Sec. 146].

In this case, the following procedure is to be followed:

- (i) **Special Resolution:** A special resolution is required to be passed at a general meeting of the shareholders.
- (ii) **Confirmation of Regional Director:** Confirmation of the Regional Director is to be obtained where the change is from jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies.

The Regional Director shall convey his confirmation within four weeks from the date of receipt of application for such change.

- (iii) **Copy of Special Resolution and Confirmation by Regional Directors to be filed with ROC:** A copy of the special resolution, as aforesaid, is to be filed with the Registrar within 30 days in Form 23. Copy of the confirmation by Regional Director shall be filed with the Registrar of Companies within two months of the date of confirmation together with a printed copy of the altered memorandum of association. The Registrar is required to register the same and certify the registration within one month from the date of filing of the said document. The Certificate shall be conclusive evidence that all the requirements of the Act with respect to the alteration and confirmation have been complied with and henceforth the memorandum, as altered, shall be the memorandum of the company.
- (iv) **Notice of New Location:** Within 30 days of the removal of the registered office, the notice of the new location has to be given to the Registrar who shall record the same.

Punishment in case of default- A company must have a registered office and must give a notice of the situation of the registered office and of every change therein to the Registrar of Companies within 30 days after the date of the incorporation of the company or after the date of the change in the situation of its office and in the event of default in complying the aforesaid requirements, every officer of the company who is in default shall be liable for punishment under section 146(4) and, thus, the liability for prosecution and punishment is that of the officer of the company who is in default - *Vijay Kumar Gupta v. Registrar of Companies* [2003] CL 777 (H.P.).

(c) **Change of registered office from one State to another State:** Section 17 provides for the shift of the registered office from one State to another and such shift involves alteration of memorandum. Registered office of a company can be shifted from one State to another by passing special resolution and confirmation thereof by the Company Law Board (now Central Government¹). The Company Law Board (now Central Government¹) 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. Also, the Company Law Board (now Central Government¹) will give an opportunity to members and creditors of the company, the Registrar and other persons interested in the company to be heard.

In *Upper Ganges Sugar & Industries Ltd., In re* [2000] 27 SCL 369 (CLB - Cal.), it was held that the CLB (now Central Government¹) has to ensure that all the formalities of the statute have been complied with, safeguarding the interests of the concerned parties. Section 17 confers discretionary jurisdiction including a power to impose conditions while granting the confirmation to the proposed alteration of memorandum. In exercising such jurisdiction, the CLB (now Central Government¹) is not expected to supplement or superimpose its wisdom over that of the shareholders who have already passed the resolution. In the circumstances, the CLB (now Central Government¹) will not go against the collective wisdom of the shareholders of the company expressed in the special resolution. This issue has to be left to the domestic decision of the shareholders as has been held in quite a number of cases. In this case, an objection having been raised by one of the creditors, CLB (now Central Government¹) confirmed



the alteration subject to the following conditions:

- (a) the interest of none of the employees of the company at its registered office shall be prejudiced by way of retrenchment or otherwise; and
- (b) the claim of any of the creditors including the objector shall neither be prejudiced nor adversely affected.

A certified copy of the CLB's (now Central Government's) order should be filed within three months thereof with the Registrar of Companies of each State—State where it was registered and the new State i.e., the State where the registered office has been shifted based. If it is not filed within the prescribed time, then the alteration shall, at the expiry of such period, become void and inoperative.

A notice of the new location of the registered office must be given to the Registrar of the State to which the office has been shifted, within thirty days after the change of the office [Section 146].

A company is in a position to shift its registered office from one State to another for certain purposes only. These are discussed in the following paragraphs (under 'Alteration of objects'— the grounds being common).

Note : Vide Companies (Second Amendment) Act, 2002

Alteration of objects clause - Section 17 empowers a company to change the place of its registered office from one State to another or to alter its objects by passing a special resolution. If alteration is sought on any of the following grounds for change of objects or change in its registered office, the position may be as under:

1. To carry on its business more economically and more efficiently [Section 17(1)(a)]

In *Dalmia Cement (Bharat) Ltd., In re* [1964] 34 Comp. Cas. 729 (Mad.) the Court observed that whether a company can carry on its business more economically or more efficiently is a matter for the judgment of the directors. If the directors consider that under the existing circumstances, it will be convenient and advantageous to combine the new objects with the existing objects, and if it appears that such a conclusion may be fairly arrived at, the Court will not go behind it and hold an enquiry as to whether the opinion of the directors is well founded or is justified.

The true legal position, observed the Delhi High Court, is that the business must remain substantially the same and the additions, alterations and changes should only be steps-in-aid to improve the efficiency of the company— *Delhi Bharat Grain Merchants Assn. Ltd., In re* [1974] 44 Comp. Cas. 214 (Delhi).

In *Re, Scientific Poultry Breeders Association* [1933] 3 Comp. Cas. 89 (CA), a company's memorandum prohibited payment of remuneration to the members of its governing body. It wanted, for efficient management, amendment in the memorandum to enable it to pay remuneration to its governing body members, which was allowed.

2. To attain its main purpose by new or improved means [Sec. 17(1)(b)]: For the companies registered after 10th October, 1965, there is no difficulty in ascertaining the main purpose because the memorandum would state it. But for the companies registered earlier, one has to look not only to the memorandum but also to what was actually being done.
3. To enlarge or change the local area of its operation [Sec. 17(1)(c)]: In *Indian Mechanical Gold Extracting Company, In re* [1891] 3 Ch. 538, the company's business was confined to the 'Empire of India'. It wanted to enlarge its operations by dropping these words. It was allowed to do so on the condition that the word 'Indian' was also dropped from its name.
4. To carry on some business which under existing circumstances may conveniently or advantageously be combined with the business of the company [Sec. 17(1)(d)]: In fact, most of the amendments sought in objects clause are based on this ground. This clause enables a company to diversify.

The working of the clause makes its scope very wide inasmuch as any activity which may either conveniently or advantageously be combined with the existing business may be allowed.

Thus, a company formed for generating power was allowed to carry on 'cold storage and other allied business'— *In re, Ambala Electric Supply Co. Ltd.* [1963] 33 Comp. Cas. 585 (Punj.).

In *Parent Tyre Co. Ltd.*, *In re* [1922] 2 Ch. 222, a tyre company was allowed to take power to undertake financial operations. Similarly, a company formed for business in jute was allowed to add business in rubber (*Juggilal Kamlatpat Jute Mills v. Registrar of Companies* [1966] 1 Comp. L.J. 292).

However, *Punjab Distilling Industries Ltd.*, which was engaged in carrying on distillery business and other allied objects was not allowed alteration of its objects so as to include a cinema business. The Punjab High Court held that it was not a business which could conveniently or advantageously be combined with the existing business—*Punjab Distilling Industries Ltd. v. Registrar of Companies* [1963] 33 Comp. Cas. 811 (Punj.).

Likewise, *Cyclists Touring Club Ltd* was not allowed to change its objects so as to admit motorists since one of the objects was to protect cyclists from motorists— *In re, Cyclists Touring Club Ltd.* [1907] 1 Ch. 269.

Is it permissible to alter main object(s)?

The answer is yes. Section 17(1)(b) allows alteration of the object clause on the ground of attaining the main purpose. Nothing in section 17 puts bar on alteration of the main object(s). 'Main purpose' used in section 17(1)(b) is a wider term than main object. Main object may be generation of powers by thermal process. But the underlying main purpose is generation of power. Now, if a company feels, with easier access to nuclear power that it would generate power also by setting up nuclear power plant, it should be permissible as it aids in furthering the main purpose and not depart from it. Therefore, here alteration of main object to include nuclear power generation would be possible. So long the harmony between the name of the company and its main object is not upset, alteration/modification of main object should be allowable.

Confirmation of alteration of objects is not to be refused only because new business is wholly different from existing business— *New Asiatic Insurance Co. Ltd.*, *In re* [1967] 37 Comp. Cas. 331 (Punj.); *New Asarwa Mfg. Co. Ltd.*, *In re* [1975] 45 Comp. Cas. 151 (Guj.), *Motilal Padampat Sugar Mills Co. (P.) Ltd.*, *In re* [1964] 34 Comp. Cas. 86 (All).

The detailed guidelines in this regard were laid down in *Straw Products Ltd. v. Registrar of Companies* [1969] 39 Comp. Cas. 974 (Ori.). These are:

- (i) The additional business need not be even akin to the existing business but it must not be destructive of or inconsistent with and detrimental to the existing business. It must leave the existing business substantially what it was before.
 - (ii) The question whether any additional business is one which may be conveniently or advantageously combined with the business of the company carried on at the time when the special resolution is passed, is essentially a business proposition and must be determined by the persons engaged in the business of the company.
 - (iii) The Court/CLB can confirm the alteration either wholly or in part subject to such terms and conditions as it may deem fit on being satisfied that the alterations sought to be confirmed are not beyond the scope of section 17(1) and do not adversely affect the rights and interests of the members of the company and/or of its creditors. No hard and fast rule can be laid down as to the quantum of evidence necessary for the satisfaction of the Court/CLB. The fact that the company is in sound financial position and that the shareholders unanimously or by majority decision seek alteration of the memorandum is a factum in favour of confirmation.
5. To restrict or abandon any of the objects specified in the memorandum [Section 17(1)(e)]: Even for deleting any portion of the object clause, the procedure laid down in section 17 has to be



followed. CLB has jurisdiction to confirm alteration which involves the abandonment of objects which are in their character fundamental. In *Hampstead Garden Suburb Trust Ltd, In re* [1963] 33 Comp. Cas. 166, it was held that where the nature of beneficiaries itself is sought to be changed, alteration does not fall within restriction or abandonment of an object and cannot be confirmed.

Can shift of objects from 'Other objects' to 'Main objects' be permitted under section 17.

The Company Law Board which was faced with the aforesaid issue in the case of *Mafatlal Consultancy Services (India) Ltd., In re* [1995] 17 C.L.A. 385 answered it in the negative. The facts of the case were as follows :

The petitioner-company was carrying on business of Registrars and Share Transfer Agents in accordance with the provisions of clause 70A of its memorandum of association. The company had sought to transfer clause 70A from the "other objects" to the main objects clause of the company. It accordingly passed the requisite resolutions under sections 149(2A) and 189 of the Act and prayed for confirmation by the Company Law Board. The reason given for seeking alteration was that the business of Registrars and Share Transfer Agents which it had been carrying on hitherto had now come within the purview of the Securities & Exchange Board of India and that for the purposes of registration with that Board, it had desired that the company should amend the objects clause by shifting the existing clause 70A from Part C to the main objects in Part A.

Rejecting the petition the CLB held that—

Section 17 of the Companies Act provides that a company may alter its memorandum of association with respect to its 'objects clause' only for purposes specified in sub-section (1) and for no other.

In the instant case the proposal of the company did not fall under any of these clauses. The request of the company could not be acceded to.

All the clauses of the 'object clause', whether stated under Part A or Part C are the objects of the company and a company is empowered to take up activities covered under any one of them and in fact it was already carrying on the business as per clause 70A. The company now sought to shift clause 70A in Part C to Part A. Such a transposition could not be deemed to be alteration as permissible under section 17.

6. To sell or dispose of the whole or any part of the undertaking or any of the undertakings [Sec. 17(1)(f)]: Where a company wishes to adopt a cut-back or retrenchment strategy, i.e., where it feels that it has either grown so big or diversified in various directions that management of the company has become difficult or uneconomical, it may alter its objects to sell or dispose of any of its undertakings. The decision of *Hindustan Lever* to divest itself of oil unit and its consequent sale to *Lipton India* (now *BBL*) is an illustration on this point.

7. To amalgamate with any other company or body of persons [Sec. 17(1)(g)]: In *Harikrishna Lohia v. Hoolungree T. Ltd* (Cal.) 1996, 4 CLJ 352 the Court held that the power to amalgamate may flow from the memorandum of association or it being acquired by resorting to the provisions in the statute. The provisions contained in sections 391 to 396 and section 494 illustrate some instances of statutory powers of amalgamating without any specific power in the memorandum. In the instant case, the company is seeking a mere bare power to alter the memorandum so as to provide for necessary amalgamation afterwards. The Court felt no necessity to pass an injunction order, restraining the company from altering its memorandum.

Procedure

Sections 17 and 18 of the Companies Act, 1956 provide that, the objects clause can be altered at the company level itself, viz., by passing a special resolution at a meeting of the shareholders. However, alteration can be made only on the grounds stated under sub-section (1) of section 17. To keep a check to this effect, section 18 provides that a special resolution passed by the company in relation to

clauses (a) to (g), of subsection (1) of section 17 must be filed by the company with the Registrar within one month of the date of such resolution.

The Registrar will register the documents and issue, within one month, a certificate which will be conclusive evidence that everything required has been done (section 18). If the required documents are not filed within the prescribed time, the alteration shall, at the expiry of such period, become void and inoperative [Section 19].

In case of the alteration of objects clause of the memorandum of association, a copy of the special resolution is required to be filed within a period of 30 days from the date of its passing. CLB (now Central Government) may, however, extend this period. But, in *Ganga Textiles Ltd, v. ROC* [1998] 16 SCL 677 it was held that the question of extension of time does not arise once the proceedings have already become void. On expiry of 30 days from the date of passing of the special resolution, the proceedings become void. Therefore, in the said case, filing of application for extension after a delay of 60 days could not be entertained. The company was, therefore, held liable for penal consequences.

Alteration of liability clause [Sec. 38] - The liability of a member of a company cannot be increased unless the member agrees in writing. The consent of the member may, however, be given either before or after the alteration. Increase in liability may be by way of subscribing for more shares than the number held by him at the date on which the alteration is made or in any other manner.

In case the company is a club or any other similar association and the alteration in the memorandum requires the member to pay recurring or periodical subscription or charges at a higher rate, although he does not agree in writing to be bound by the alteration, it shall be binding on him.

In case of unlimited liability company, the liability may be made limited or reduced by re-registration of the company. The alteration will, however, not affect any debts, liabilities, obligations or contracts entered into by or with the company before the registration of the unlimited company as a limited company [Sec. 32(3)].

Alteration of Capital Clause - Section 94 provides that, if the articles authorise, a company limited by share capital may, by an ordinary resolution passed in general meeting, alter the conditions of its memorandum in regard to capital so as—

1. to increase its authorised share capital by such amount as it thinks expedient by issuing fresh shares;
2. to consolidate and divide all or any of its share capital into shares of larger amount than its existing shares;
3. to convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination;
4. to sub-divide its shares, or any of them, into shares of smaller amount than fixed by the memorandum, but the proportion of paid and unpaid on each share must remain the same;
5. to cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person and thus diminish the amount of its share capital by the amount of the shares so cancelled.

These five clauses are now explained.

1. **Increase of authorised share capital:** A company, limited by shares, if the articles authorise, can increase its authorised share capital by passing an ordinary resolution. Similarly, a company not being limited by shares can increase the number of its members.

Within 30 days of the passing of the resolution, a notice of increase in the share capital must be filed with the Registrar of Companies in Form No. 5. On receipt of the notice, the Registrar shall record the increase and also make any alterations which may be necessary in the company's memorandum or articles or both.



If default is made in filing the notice, the company and every officer of the company who is in default shall be punishable with fine upto ₹500 per day during which the default continues (Sec. 97).

2. Consolidation and sub-division of shares : Consolidation is the process of combining shares of smaller denomination. For instance, 10 shares of ₹10 each may be consolidated into one share of ₹100.

Sub-division of shares is just the opposite of consolidation e.g., one share of ₹100 may be divided into 10 shares of ₹10 each.

Once a resolution has been passed, a copy of the resolution is required to be sent within thirty days to the Registrar of Companies.

3. Conversion of shares into stock and vice versa: Stock is simply a set of fully-paid up shares put together and is transferable in any denomination or fraction. On the other hand, a share is transferable as a whole; it cannot be split into parts. For example, a share of ₹10 can be transferred as a whole; it cannot be transferred in parts. But if 10 shares of ₹10 each fully paid are converted into stock, of ₹100, then the stockholder can transfer stock, say, worth ₹17 also.

Section 94 empowers a company to convert its fully paid-up shares into stock by passing a resolution in general meeting, if its articles authorise such conversion. A notice is to be filed with the Registrar within thirty days of the passing of the resolution specifying the shares so converted.

It is to be noted that stock cannot be issued in the first instance. It is necessary to first issue shares and have them fully paid-up and then convert them into stock. Also, stock can be reconverted into fully paid-up shares by passing a resolution in general meeting.

When shares are converted into stock, the shareholders are issued stock certificates. In the Register of Members, the amount of stock is written against the name of a particular member in place of number of shares. The stockholder is as much a member of the company as a shareholder.

4. Diminution of share capital: Sometimes, it so happens that shares are issued, but are not taken up by the members of the public and, therefore, not allotted. Section 94 provides that a company may, if its articles authorise, by resolution in general meeting, cancel shares which at the date of the passing of the resolution in that behalf have not been taken or agreed to be taken by any person and diminish the amount of the share capital by the amount of the shares so cancelled. This constitutes diminution of capital and should be distinguished from reduction of capital.

Articles of Association

Introduction

The articles of association of a company are its bye-laws or rules and regulations that govern the management of its internal affairs and the conduct of its business.

According to section 2(2) of the Companies Act, 1956 'articles' means the articles of association of a company as originally framed or as altered from time to time in pursuance of any previous companies laws or of the present Act, i.e., the Act of 1956.

The articles regulate the internal management of the company. They define the powers of its officers. They also establish a contract between the company and the members and between the members inter se. This contract governs the ordinary rights and obligations incidental to membership in the company. [Maresh Chandra Sanyalv. Calcutta Stock Exchange Association Ltd. AIR 1971 SC 422].

Articles are like the partnership deed in a partnership. They set out provisions for the manner in which the company is to be administered. In particular, they provide for matters like the making of calls; forfeiture of shares; directors' qualifications, appointment, powers and duties of auditors*; procedure for transfer and transmission of shares and debentures.

Contents

Articles usually contain provisions relating to the following matters:—

1. Share capital including sub-division thereof, rights of various shareholders, the relationship of these rights, payment of commission, share certificates;
2. Lien on shares;
3. Calls on shares;
4. Transfer of shares;
5. Transmission of shares;
6. Forfeiture of shares;
7. Surrender of shares;
8. Conversion of shares into stock;
9. Share warrants;
10. Alteration of capital;
11. General meetings and proceedings thereat;
12. Voting rights of members, voting by poll, proxies;
13. Directors, including first directors or directors for life, their appointment, remuneration, qualifications, powers and proceedings of Board of directors' meetings;
14. Dividends and reserves;
15. Accounts and audit;
16. Borrowing powers
17. Winding-up.

Alteration of articles

Section 31 provides that subject to the provisions of the Act and to the conditions contained in its memorandum¹; a company may, by special resolution alter or add to its articles. A printed or type-written copy of every special resolution altering the articles must be filed with the Registrar within 30 days of the passing of the special resolution as required by section 192. The right to alter just by passing special resolution is so important that a company cannot, in any manner, deprive itself of this power [Walker v. London Tramway Company [1879] 12 Ch. D. 705]. Also, the power to reduce or increase the number of members in the case of a company limited by guarantee without share capital, from time to time, as given in the articles cannot be exercised by the general committee (Board of Directors); it can be done only by a special resolution of the general body of members [Dharampal Bhasin v. B.N. Khanna (supra)]. However, in spite of the power to alter its articles, a company can exercise this power subject only, to certain limitations.

Effect of altered articles - Alteration binds members in the same way as original articles. The provision (of section 36) providing that the articles shall bind the company and the members to the same extent as if they had been signed by the company and by each member, means, the articles as originally framed, or as they may from time to time stand after they have been altered are valid under the provisions of the Act. There is clear power to alter the articles, and as altered, they bind members just in the same way as did the original articles.

Right of a shareholder to transfer his shares is always subject to provisions in articles of association as well as section 31. A transferee, therefore, cannot have a better right than the transferor. The rights of a transferee until the transfer becomes effective, as against the company will again be subject



to the provisions of the articles of association and the relevant provisions of the Act. The alteration affecting the articles of association in exercise of the said power cannot, therefore, be challenged by the transferee on the ground of mala fide - Mathrubhumi Printing & Co. Ltd. v. Vardhaman Publishers Ltd. (supra).

Procedure for alteration of articles of association- For effecting alteration to the articles of association, the following procedure is required to be followed :—

1. The proposal has to be approved by the Board of directors. The Board will fix the date and time of the general meeting. It will also approve the draft notice of the meeting, the special resolution and explanatory statement. The secretary, if any, will be authorised to convene the general body meeting.
2. Where the alteration requires taking or subscribing for more shares than the number held by the members on the date of alteration or the alteration proposes to increase the liability of members, the consent of the members should be obtained in writing either before or after any such alteration is made [section 381.

However, where the company is a club or any other association and the alteration requires the member to pay recurring or periodical subscriptions or charges at a higher rate, a member shall be liable even though he does not agree in writing to be bound by the alteration [sec. 38, proviso (b)].

3. The secretary shall convene the meeting on the appointed day. In the meeting the necessary special resolution amending the articles of association shall be passed.
4. Within 30 days of the passing of the resolution, a certified copy thereof shall be filed with the Registrar of Companies along with Form No. 23 [vide section 192(1) of the Companies Act].
5. Where the alteration of the articles has the effect of converting a public company into a private company, the company shall, within three months from the date of the passing of the special resolution, make an application in Form No. 1B to the Regional Director concerned for his approval of the alteration (vide section 31 of the Companies Act).
6. After getting the approval of the Central Government (Registrar of Companies), printed copy of the articles, as altered, should be filed by the company with the Registrar of Companies within one month of the date of receipt of order of approval.
7. Six copies of the amendments (one of which shall be certified) should be sent to the stock exchange(s) on which the shares of the company are listed, as soon as they have been adopted by the company in the general meeting (as per the Standard Listing Agreement).
8. Alteration should be noted in every copy of the articles of association, and the articles issued after the date of alteration should be in accordance with the altered articles (section 40). A default in this regard shall invite penalty against the company as well as every officer in default. The penalty provided under the section is fine upto ₹100 for each copy so issued.

1.3 PROCEDURE FOR ISSUE OF SHARES AND SECURITIES

1.3.1 Procedure – The various procedures related to shares are detailed hereunder:-

Share [Sec. 2(46)]

- (a) A 'Share' is smallest unit into which the capital of the company is divided.
- (b) Section 2(46) of the Companies Act, 1956 defines a share as "a share in the share capital of a company, and includes stock except where a distinction between stock and share is expressed or implied".

For example, where a company has a share capital of Rs 1,00,000 divided into 10,000 units of ₹ 10 each, then each unit of Rs 10 is called a share of Rs 10 each and a person who has taken 10 shares of that company is said to have share in the share capital of the company to the extent of Rs 100.

- (c) A share represents such proportion of the interest of the shareholders as the amount paid up thereon bears to the total capital payable to the company.
- (d) A share may be partly paid up or fully paid up.
- (e) A share is a measure of the interest in the company's assets to which a person holding a share is entitled.

Public Issue of Shares

Every Company needs funds for its business. Funds requirement can be for short term or for long term. To meet short term requirements, the may approach banks, lenders & may even accept fixed deposits from public/shareholders. To meet its long term requirements, funds can be raised either through loans from lenders, Banks, Institutions etc. (which carry financial burden) or through issue of capital. Capital can be raised through private placement of shares, public issue, right issue etc. Public issue means raising funds from public. Promoters of the Company may have plans for the Company, which may require infusion of money. The main purpose of the public issue, amongst others, is to raise money through public and get its shares listed at any of the recognized stock exchanges in India.

SEBI(Issue of Capital and Disclosure Requirements) Regulations,2009 with respect to public issue of equity shares or any other security convertible into equity shares

General conditions: These conditions are common for Public Issues (IPOs as well as FPOs) and Rights Issues:

- (1) Any issuer offering specified securities through a public issue or rights issue shall satisfy the conditions as laid down in these regulations at the time of filing draft offer document with the Board (unless stated otherwise) and at the time of registering or filing the final offer document with the Registrar of Companies or Designated Stock Exchange, as the case may be.
- (2) No issuer shall make a public issue or rights issue of specified securities:
 - (a) if the issuer, any of its promoters, promoter group or directors or persons in control of the issuer are debarred from accessing the capital market by the Board;
 - (b) if any of the promoters, directors or persons in control of the Issuer was or also is a promoter, director or person in control of any other company which is debarred from accessing the capital market under any order or directions made by the Board;
 - (c) if the issuer of convertible debt instruments is in the list of wilful defaulters published by the Reserve Bank of India or it is in default of payment of interest or repayment of principal amount in respect of debt instruments issued by it to the public, if any, for a period of more than six months;
 - (d) unless it has made an application to one or more recognised stock exchanges for listing of specified securities on such stock exchanges and has chosen one of them as the designated stock exchange:
Provided that in case of an initial public offer, the issuer shall make an application for listing of the specified securities in at least one recognised stock exchange having nationwide trading terminals;
 - (e) unless it has entered into an agreement with a depository for dematerialisation of specified securities already issued or proposed to be issued;



- (f) unless all existing partly paid-up equity shares of the issuer have either been fully paid up or forfeited;
 - (g) unless firm arrangements of finance through verifiable means towards seventy five per cent of the stated means of finance, excluding the amount to be raised through the proposed public issue or rights issue or through existing identifiable internal accruals, have been made.
- (3) Warrants may be issued alongwith public issue or rights issue of specified securities subject to the following:
- (a) the tenure of such warrants shall not exceed twelve months from their date of allotment in the public/rights issue;
 - (b) not more than one warrant shall be attached to one specified security.
- (4) The amount for general corporate purposes, as mentioned in objects of the issue in the draft offer document filed with the Board, shall not exceed twenty five per cent of the amount raised by the issuer by issuance of specified securities.

Appointment of Merchant Banker and other intermediaries

- (1) The issuer shall appoint one or more merchant bankers, at least one of whom shall be a lead merchant banker and shall also appoint other intermediaries, in consultation with the lead merchant banker, to carry out the obligations relating to the issue.
- (2) The issuer shall, in consultation with the lead merchant banker, appoint only those intermediaries which are registered with the Board.
- (3) Where the issue is managed by more than one merchant banker, the rights, obligations and responsibilities, relating *inter alia* to disclosures, allotment, refund and underwriting obligations, if any, of each merchant banker shall be predetermined and disclosed in the offer document as specified in **Schedule I**:

Provided that where any of the merchant bankers is an associate of the issuer, it shall declare itself as a marketing lead manager and its role shall be limited to marketing of the issue.

- (4) The lead merchant banker shall, only after independently assessing the capability of other intermediaries to carry out their obligations, advise the issuer on their appointment.
- (5) The issuer shall enter into an agreement with the lead merchant banker in the format specified in **Schedule II** and with other intermediaries as required under the respective regulations applicable to the intermediary concerned:

Provided that such agreements may include such other clauses as the issuer and the intermediary may deem fit without diminishing or limiting in any way the liabilities and obligations of the merchant bankers, other intermediaries and the issuer under the Act, the Companies Act, 1956, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and the rules and regulations made thereunder or any statutory modification or statutory enactment thereof:

Provided further that in case of ASBA process, the issuer shall take cognizance of the deemed agreement of the issuer with Self Certified Syndicate Banks.

- (6) An issuer shall, in case of an issue made through the book building process, appoint syndicate members and in the case of any other issue, appoint bankers to issue, at all mandatory collection centres as specified in **Schedule III** and such other collection centres as it may deem fit.
- (7) The issuer shall appoint a registrar which has connectivity with all the depositories:

Provided that if issuer itself is a registrar to an issue registered with the Board, then another registrar to an issue shall be appointed as registrar to the issue:

Provided further that the lead merchant banker shall not act as a registrar to the issue in which it is also handling the post issue responsibilities.

Explanation: For the purpose of this regulation, in case of a book built issue, the lead merchant banker appointed by the issuer shall act as the lead book runner.

Filing of offer document

- (1) No issuer shall make,
 - (a) a public issue; or
 - (b) a rights issue, where the aggregate value of the specified securities offered is fifty lakh rupees or more, unless a draft offer document, along with fees as specified in **Schedule IV**, has been filed with the Board through the lead merchant banker, at least thirty days prior to registering the prospectus, red herring prospectus or shelf prospectus with the Registrar of Companies or filing the letter of offer with the designated stock exchange, as the case may be.
- (2) The Board may specify changes or issue observations, if any, on the draft offer document within thirty days from the later of the following dates:
 - (a) the date of receipt of the draft offer document ; or
 - (b) the date of receipt of satisfactory reply from the lead merchant bankers, where the Board has sought any clarification or additional information from them; or
 - (c) the date of receipt of clarification or information from any regulator or agency, where the Board has sought any clarification or information from such regulator or agency; or
 - (d) the date of receipt of a copy of in-principle approval letter issued by the recognised stock exchanges.
- (3) If the Board specifies changes or issues observations on the draft offer document, the issuer and lead merchant banker shall carry out such changes in the draft offer document and comply with the observations issued by the Board before registering the prospectus, red-herring prospectus or shelf prospectus, as the case may be, with the Registrar of Companies or filing the letter of offer with the designated stock exchange.
- (4) The issuer shall, simultaneously while registering the prospectus, red herring prospectus or shelf prospectus with the Registrar of Companies or filing the letter of offer with the designated stock exchange or before the opening of the issue, file a copy thereof with the Board through the lead merchant banker.
- (5) The lead merchant banker shall, while filing the offer document with the Board in terms of subregulation (1) and sub-regulation (4), file a copy of such document with the recognised stock Exchange(s) where the specified securities are proposed to be listed.
- (6) The offer document filed with the Board under this regulation shall also be furnished to the Board in a soft copy in the manner specified in **Schedule V**.

In-principle approval from Recognised Stock Exchanges

The issuer shall obtain in-principle approval from recognised stock exchanges as follows:

- (a) in case of an initial public offer, from all the recognised stock exchanges in which the issuer proposes to get its specified securities listed; and
- (b) in case of a further public offer and rights issue:
 - (i) where the specified securities are listed only on recognised stock exchanges having nationwide trading terminals, from all such stock exchanges;
 - (ii) where the specified securities are not listed on any recognised stock exchange having



nationwide trading terminals, from all the stock exchanges in which the specified securities of the issuer are proposed to be listed;

- (iii) where the specified securities are listed on recognised stock exchanges having nationwide trading terminals as well as on the recognised stock exchanges not having nationwide trading terminals, from all recognised stock exchanges having nationwide trading terminals.

Documents to be submitted before opening of the issue

- (1) The lead merchant bankers shall submit the following to the Board along with the draft offer document:
 - (a) a copy of the agreement entered into between the issuer and the lead merchant bankers as per format specified **in Schedule II**;
 - (b) a due diligence certificate as per **Form A of Schedule VI**;
 - (c) in case of an issue of convertible debt instruments, a due diligence certificate from the debenture trustee as per **Form B of Schedule VI**;
 - (d) a certificate in the format specified in **Part C of Schedule VIII**, confirming compliance of the conditions mentioned therein.
- (2) The lead merchant bankers shall submit the following documents to the Board after issuance of observations by the Board or after expiry of the period stipulated in sub-regulation (2) of regulation 6 if the Board has not issued observations:
 - (a) a statement certifying that all changes, suggestions and observations made by the Board have been incorporated in the offer document;
 - (b) a due diligence certificate as per **Form C of Schedule VI**, at the time of registering the prospectus with the Registrar of Companies;
 - (c) a copy of the resolution passed by the board of directors of the issuer for allotting specified securities to promoters towards amount received against promoters' contribution, before opening of the issue;
 - (d) a certificate from a Chartered Accountant, before opening of the issue, certifying that promoters' contribution has been received in accordance with these regulations, accompanying therewith the names and addresses of the promoters who have contributed to the promoters' contribution and the amount paid by each of them towards such contribution;
 - (e) a due diligence certificate as per **Form D of Schedule VI**, immediately before the opening of the issue, certifying that necessary corrective action, if any, has been taken;
 - (f) a due diligence certificate as per **Form E of Schedule VI**, after the issue has opened but before it closes for subscription.
- (3) The issuer shall, at the time of filing draft offer document with the recognised stock exchange where the specified securities are proposed to be listed, submit the Permanent Account Number, bank account number and passport number of its promoters to such stock exchange.

Draft offer document to be made public

- (1) The draft offer document filed with the Board shall be made public, for comments, if any, for a period of at least twenty one days from the date of such filing, by hosting it on the websites of the Board, recognised stock exchanges where specified securities are proposed to be listed and merchant bankers associated with the issue.
- (2) The lead merchant bankers shall, after expiry of the period stipulated in sub-regulation (1), file with the Board a statement giving information of the comments received by them or the issuer on the

draft offer document during that period and the consequential changes, if any, to be made in the draft offer document.

- (3) The issuer either on the date of filing the draft offer document with the Board or on the next day shall make a public announcement in one English National daily newspaper with wide circulation, one Hindi National daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated, disclosing to the public the fact of filing of draft offer document with the Board and inviting the public to give their comments to the Board in respect of disclosures made in the draft offer document.

Fast Track Issue

- (1) Nothing contained in sub-regulations (1), (2) and (3) of regulation 6 and regulations 7 and 8 shall apply to a public issue or rights issue if the issuer satisfies the following conditions:
 - (a) the equity shares of the issuer have been listed on any recognised stock exchange having nationwide trading terminals for a period of at least three years immediately preceding the reference date;
 - (b) the average market capitalisation of public shareholding of the issuer is at least three thousand crore rupees;
 - (c) the annualised trading turnover of the equity shares of the issuer during six calendar months immediately preceding the month of the reference date has been at least two per cent of the weighted average number of equity shares listed during such six months' period:

Provided that for issuers, whose public shareholding is less than fifteen per cent of its issued equity capital, the annualised trading turnover of its equity shares has been at least two per cent of the weighted average number of equity shares available as free float during such six months' period;

- (d) the issuer has redressed at least ninety five per cent of the complaints received from the investors till the end of the quarter immediately preceding the month of the reference date;
 - (e) the issuer has been in compliance with the equity listing agreement for a period of at least three years immediately preceding the reference date:

Provided that if the issuer has not complied with the provision of the equity listing agreement relating to composition of board of directors, for any quarter during the last three years immediately preceding the reference date, but is compliant with such provisions at the time of filing of offer document with the Registrar of Companies or designated stock exchange, as the case may be, and adequate disclosures are made in the offer document about such non-compliances during the three years immediately preceding the reference date, it shall be deemed as compliance with the condition;

- (f) the impact of auditors' qualifications, if any, on the audited accounts of the issuer in respect of those financial years for which such accounts are disclosed in the offer document does not exceed five per cent of the net profit or loss after tax of the issuer for the respective years;
 - (g) no show-cause notices have been issued or prosecution proceedings initiated or pending against the issuer or its promoters or whole time directors as on the reference date;
 - (h) the entire shareholding of the promoter group of the issuer is held in dematerialized form on the reference date.
- (2) The issuer shall file the offer document with the Board and the recognised stock exchanges in accordance with sub-regulations (4), (5) and (6) of regulation 6 and shall pay fees to the Board as specified in **Schedule IV**.
- (3) The lead merchant bankers shall submit to the Board, the following documents along with the offer document:



- (a) a due diligence certificate as per **Form A of Schedule VI** including additional confirmations as specified in **Form F of Schedule VI**;
- (b) in case of a fast track issue of convertible debt instruments, a due diligence certificate from the debenture trustee as per **Form B of Schedule VI**.

Explanation: For the purposes of this regulation:

- (I) "Reference Date" means:
 - (a) in case of a public issue by a listed issuer, the date of registering the red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with the Registrar of Companies; and
 - (b) in case of a rights issue by a listed issuer, the date of filing the letter of offer with the designated stock exchange.
- (II) "Average Market Capitalisation of public Shareholding" means the sum of daily market capitalisation of public shareholding for a period of one year up to the end of the quarter preceding the month in which the proposed issue was approved by the shareholders or the board of the issuer, as the case may be, divided by the number of trading days.

Opening of an issue

- (1) Subject to the compliance with sub-section (4) of section 60 of the Companies Act, 1956, a public issue or rights issue may be opened:
 - (a) within twelve months from the date of issuance of the observations by the Board; or
 - (b) within three months of expiry of the stipulated period of 30 days, if the Board has not issued observations:
- (2) In case of shelf prospectus, the first issue may be opened within three months of issuance of observations by the Board.
- (3) The issuer shall, before registering the red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with the Registrar of Companies or filing the letter of offer with the designated stock exchange, as the case may be, file with the Board through the lead merchant bankers, an updated offer document highlighting all changes made in the offer document.
- (4) Notwithstanding anything contained in this regulation, if there are changes in the offer document in relation to the matters specified in **Schedule VII**, the updated offer document or new draft offer document, as the case may be, shall be filed with the Board along with fees specified in **Schedule IV**.
- (5) An issue shall be opened after atleast three working days from the date of registering the red herring prospectus with the Registrar of Companies.

Dispatch of issue material

The lead merchant bankers shall dispatch the offer document and other issue material including forms for ASBA to the designated stock exchange, syndicate members, underwriters, bankers to the issue, investors' associations and Self Certified Syndicate Banks in advance.

Underwriting

- (1) Where the issuer making a public issue (other than through the book building process) or rights issue, desires to have the issue underwritten, it shall appoint the underwriters in accordance with Securities and Exchange Board of India (Underwriters) Regulations, 1993.

- (2) Where the issuer makes a public issue through the book building process, such issue shall be underwritten by book runners or syndicate members:
Provided that seventy five per cent [sixty per cent, if public issue is made with at least ten per cent public offer under clause (b) of sub-rule (2) of rule 19 of the Securities Contracts (Regulation) Rules, 1957] of the net offer to public proposed to be compulsorily allotted to qualified institutional buyers for the purpose of compliance of the eligibility conditions specified in sub-regulation (2) of regulation 26 and [regulation 27] cannot be underwritten.
- (3) The issuer shall enter into underwriting agreement with the book runner, who in turn shall enter into underwriting agreement with syndicate members, indicating therein the number of specified securities which they shall subscribe to at the predetermined price in the event of under-subscription in the issue.
- (4) If syndicate members fail to fulfil their underwriting obligations, the lead book runner shall fulfil the underwriting obligations.
- (5) The book runners and syndicate members shall not subscribe to the issue in any manner except for fulfilling their underwriting obligations.
- (6) In case of every underwritten issue, the lead merchant banker or the lead book runner shall undertake minimum underwriting obligations as specified in the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992.
- (7) Where hundred per cent. of the offer through offer document is underwritten, the underwriting obligations shall be for the entire hundred per cent of the offer through offer document and shall not be restricted upto the minimum subscription level.

Minimum subscription

The minimum subscription to be received in an issue shall not be less than ninety per cent of the offer through offer document.

- (2) In the event of non-receipt of minimum subscription referred to in sub-regulation (1), all application moneys received shall be refunded to the applicants forthwith, but not later than:
 - (a) fifteen days of the closure of the issue, in case of a non-underwritten issue; and
 - (b) seventy days of the closure of the issue, in the case of an underwritten issue where minimum subscription including devolvement obligations paid by the underwriters is not received within sixty days of the closure of the issue.
- (3) The offer document shall contain adequate disclosures regarding minimum subscription as specified in **Part A of Schedule VIII**.
- (4) Nothing contained in this regulation shall apply to:
 - (a) offer for sale of specified securities;
 - (b) public issue by infrastructure companies if the disclosures regarding the alternate source of funding of the objects of the issue have been made in the offer document.

Explanation: For the purpose of clause (b) of sub-regulation (4), the term "infrastructure company" means, an enterprise wholly engaged in the business of (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining any infrastructure facility.



Oversubscription

No allotment shall be made by the issuer in excess of the specified securities offered through the offer document:

Provided that in case of oversubscription, an allotment of not more than ten per cent of the net offer to public may be made for the purpose of making allotment in minimum lots.

Monitoring agency

- (1) If the issue size exceeds five hundred crore rupees, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by a public financial institution or by one of the scheduled commercial banks named in the offer document as bankers of the issuer:

Provided that nothing contained in this clause shall apply to an offer for sale or an issue of specified securities made by a bank or public financial institution or an insurance company.

- (2) The monitoring agency shall submit its report to the issuer in the format specified in **Schedule IX** on a half yearly basis, till the proceeds of the issue have been fully utilised.

Manner of calls

If the issuer proposes to receive subscription monies in calls, it shall ensure that the outstanding subscription money is called within twelve months from the date of allotment in the issue and if any applicant fails to pay the call money within the said twelve months, the equity shares on which there are calls in arrear along with the subscription money already paid on such shares shall be forfeited:

Provided that it shall not be necessary to call the outstanding subscription money within twelve months, if the issuer has appointed a monitoring agency as specified in these regulations.

Allotment, refund and payment of interest

- (1) The issuer and merchant bankers shall ensure that specified securities are allotted and/or application moneys are refunded within fifteen days from the date of closure of the issue.
- (2) Where specified securities are not allotted and/or application moneys are not refunded within the period stipulated in sub-regulation (1), the issuer shall undertake to pay interest at such rate and within such time as disclosed in the offer document.

Restriction on further capital issues

No issuer shall make any further issue of specified securities in any manner whether by way of public issue, rights issue, preferential issue, qualified institutions placement, issue of bonus shares or otherwise:

- (a) in case of a fast track issue, during the period between the date of registering the red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with the Registrar of Companies or filing the letter of offer with the designated stock exchange and the listing of the specified securities offered through the offer document or refund of application moneys; or
- (b) in case of other issues, during the period between the date of filing the draft offer document with the Board and the listing of the specified securities offered through the offer document or refund of application moneys; unless full disclosures regarding the total number of specified securities and amount proposed to be raised from such further issue are made in such draft offer document or offer document, as the case may be.

PROVISIONS AS TO PUBLIC ISSUE
PART I-ELIGIBILITY REQUIREMENTS

Reference date

An issuer making a public issue shall satisfy the following conditions of this regulations as on the date of filing draft offer document with the Board and also as on the date of registering the offer document with the Registrar of Companies.

Conditions for initial public offer(IPO)

(1) An issuer may make an initial public offer, if:

- (a) it has net tangible assets of at least three crore rupees in each of the preceding three full years (of twelve months each), of which not more than fifty per cent. are held in monetary assets:

Provided that if more than fifty per cent. of the net tangible assets are held in monetary assets, the issuer has made firm commitments to utilise such excess monetary assets in its business or project;

- (b) it has a minimum average pre-tax operating profit of rupees fifteen crore,calculated on a restated and consolidated basis,during the three most profitable years out of the immediately preceding five years.

Provided that extraordinary items shall not be considered for calculating distributable profits;

- (c) it has a net worth of at least one crore rupees in each of the preceding three full years (of twelve months each);
 - (d) the aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed five times its pre-issue net worth as per the audited balance sheet of the preceding financial year;
 - (e) if it has changed its name within the last one year, at least fifty per cent of the revenue for the preceding one full year has been earned by it from the activity indicated by the new name.
- (2) An issuer not satisfying the condition stipulated in sub-regulation(1) may make an initial public offer if the issue is made through the book-building process and the issuer undertakes to allot,at least seventy five per cent of the net offer to public, to qualified institutional buyers and to refund full subscription money if it fails to make the said minimum allotment to qualified institutional buyers.
- (3) An issuer may make an initial public offer of convertible debt instruments without making a prior public issue of its equity shares and listing thereof.
- (4) An issuer shall not make an allotment pursuant to a public issue if the number of prospective allottees is less than one thousand.
- (5) No issuer shall make an initial public offer if there are any outstanding convertible securities or any other right which would entitle any person with any option to receive equity shares after the initial public offer:

Provided that the provisions of this sub-regulation shall not apply to:

- (a) a public issue made during the currency of convertible debt instruments which were issued through an earlier initial public offer, if the conversion price of such convertible debt instruments was determined and disclosed in the prospectus of the earlier issue of convertible debt instruments;
- (b) outstanding options granted to employees pursuant to an employee stock option scheme framed in accordance with the relevant Guidance Note or Accounting Standards, if any, issued by the Institute of Chartered Accountants of India in this regard.



- (6) Subject to provisions of the Companies Act, 1956 and these regulations, equity shares may be offered for sale to public if such equity shares have been held by the sellers for a period of at least one year prior to the filing of draft offer document with the Board in accordance with sub-regulation (1) of regulation 6:

Provided that in case equity shares received on conversion or exchange of fully paid-up

compulsorily convertible securities including depository receipts are being offered for sale, the holding period of such convertible securities as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period referred in this sub-regulation:

Provided further that the requirement of holding equity shares for a period of one year shall not apply:

- (a) in case of an offer for sale of specified securities of a government company or statutory authority or corporation or any special purpose vehicle set up and controlled by any one or more of them, which is engaged in infrastructure sector;
 - (b) if the specified securities offered for sale were acquired pursuant to any scheme approved by a High Court under sections 391-394 of the Companies Act, 1956, in lieu of business and invested capital which had been in existence for a period of more than one year prior to such approval.
- (7) No issuer shall make an initial public offer, unless as on the date of registering prospectus or red herring prospectus with the Registrar of Companies, the issuer has obtained grading for the initial public offer from at least one credit rating agency registered with the Board.

Explanation: For the purposes of this regulation:

- (I) "Net Tangible Assets" mean the sum of all net assets of the issuer, excluding intangible assets as defined in Accounting Standard 26 (AS 26) issued by the Institute of Chartered Accountants of India;
- (II) "Project" means the object for which monies are proposed to be raised to cover the objects of the issue;
- (III) In case of an issuer which had been a partnership firm, the track record of distributable profits of the partnership firm shall be considered only if the financial statements of the partnership business for the period during which the issuer was a partnership firm, conform to and are revised in the format prescribed for companies under the Companies Act, 1956 and also comply with the following:
 - (a) adequate disclosures are made in the financial statements as required to be made by the issuer as per Schedule VI of the Companies Act, 1956;
 - (b) the financial statements are duly certified by a Chartered Accountant stating that:
 - (i) the accounts and the disclosures made are in accordance with the provisions of Schedule VI of the Companies Act, 1956;
 - (ii) the accounting standards of the Institute of Chartered Accountants of India have been followed;
 - (iii) the financial statements present a true and fair view of the firm's accounts;
- (IV) In case of an issuer formed out of a division of an existing company, the track record of distributable profits of the division spun-off shall be considered only if the requirements regarding financial statements as provided for partnership firms in Explanation III are complied with;
- (V) "Bid-ask spread" means the difference between quotations for sale and purchase;
- (VI) The term "infrastructure sector" includes the facilities or services as specified in **Schedule X**.

Conditions for further public offer [FPO]

An issuer may make a further public offer if it satisfies the conditions laid down in SEBI Regulations with respect to IPOs.

PART II - PRICING IN PUBLIC ISSUE

Pricing

An issuer may determine the price of specified securities in consultation with the lead merchant banker or through the book building process.

- (2) An issuer may determine the coupon rate and conversion price of convertible debt instruments in consultation with the lead merchant banker or through the book building process.
- (3) The issuer shall undertake the book building process in a manner specified in **Schedule XI**.

Differential pricing

An issuer may offer specified securities at different prices, subject to the following:

- (a) retail individual investors or retail individual shareholders [or employees of the issuer entitled for reservation made under regulation 42 making an application for specified securities of value not more than one lakh rupees,] may be offered specified securities at a price lower than the price at which net offer is made to other categories of applicants:

Provided that such difference shall not be more than ten per cent of the price at which specified securities are offered to other categories of applicants;

- (b) in case of a book built issue, the price of the specified securities offered to an anchor investor shall not be lower than the price offered to other applicants;
- (c) in case of a composite issue, the price of the specified securities offered in the public issue may be different from the price offered in rights issue and justification for such price difference shall be given in the offer document.
- (d) in case the issuer opts for the alternate method of book building in terms of Part D of Schedule XI, the issuer may offer specified securities to its employees at a price lower than the floor price:

Provided that the difference between the floor price and the price at which specified securities are offered shall not be more than ten percent of the floor price.

Price and price band

- (1) The issuer may mention a price or price band in the draft prospectus (in case of a fixed price issue) and floor price or price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before registering the prospectus with the Registrar of Companies:

Provided that the prospectus registered with the Registrar of Companies shall contain only one price or the specific coupon rate, as the case may be.

- (2) If the issuer shall announce the floor price or price band at least five working days before the opening of the bid (in case of an initial public offer) and at least one working day before the opening of the bid (in case of a further public offer), in all the newspapers in which the pre issue advertisement was released.
- (3) The announcement referred to in sub-regulation (2) shall contain relevant financial ratios computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" in the prospectus.
- (3A) The announcement referred to in sub-regulation(2) and the relevant financial ratios referred to in sub-regulation(3) shall be disclosed on the websites of those stock exchanges where the securities



are proposed to be listed and shall also be pre-filled in the application forms available on the websites of the stock exchanges.

- (4) The cap on the price band shall be less than or equal to one hundred and twenty per cent of the floor price.
- (5) The floor price or the final price shall not be less than the face value of the specified securities.

Explanation: For the purposes of sub-regulation (4), the "cap on the price band" includes cap on the coupon rate in case of convertible debt instruments.

Face value of equity shares.

- (1) Subject to the provisions of the Companies Act, 1956, the Act and these regulations, an issuer making an initial public offer may determine the face value of the equity shares in the following manner:

- (a) if the issue price per equity share is five hundred rupees or more, the issuer shall have the option to determine the face value at less than ten rupees per equity share:

Provided that the face value shall not be less than one rupee per equity share;

- (b) if the issue price per equity share is less than five hundred rupees, the face value of the equity shares shall be ten rupees per equity share:

Provided that nothing contained in this sub-regulation shall apply to initial public offer made by any government company, statutory authority or corporation or any special purpose vehicle set up by any of them, which is engaged in infrastructure sector.

- (2) The disclosure about the face value of equity shares (including the statement about the issue price being "X" times of the face value) shall be made in the advertisements, offer documents and application forms in identical font size as that of issue price or price band.

Explanation: For the purposes of this regulation, the term "infrastructure sector" includes the facilities or services as specified in **Schedule X**.

PART III - PROMOTERS' CONTRIBUTION

Minimum promoters' contribution

- (1) The promoters of the issuer shall contribute in the public issue as follows:
 - (a) in case of an initial public offer, not less than twenty per cent of the post issue capital:

Provided that in case the post issue shareholding of the promoters is less than twenty per cent., alternative investment funds may contribute for the purpose of meeting the shortfall in minimum contribution as specified for promoters, subject to a maximum of ten per cent of the post issue capital.
 - (b) in case of a further public offer, either to the extent of twenty per cent of the proposed issue size or to the extent of twenty per cent of the post-issue capital;
 - (c) in case of a composite issue, either to the extent of twenty per cent of the proposed issue size or to the extent of twenty per cent of the post-issue capital excluding the rights issue component.
- (2) In case of a public issue or composite issue of convertible securities, minimum promoters' contribution shall be as follows:
 - (a) the promoters shall contribute twenty per cent as stipulated in clauses (a), (b) or (c) of sub-regulation (1), as the case may be, either by way of equity shares or by way of subscription to the convertible securities:

Provided that if the price of the equity shares allotted pursuant to conversion is not predetermined and not disclosed in the offer document, the promoters shall contribute only by way of subscription to the convertible securities being issued in the public issue and shall undertake in writing to subscribe to the equity shares pursuant to conversion of such securities.

- (b) in case of any issue of convertible securities which are convertible or exchangeable on different dates and if the promoters' contribution is by way of equity shares (conversion price being pre-determined), such contribution shall not be at a price lower than the weighted average price of the equity share capital arising out of conversion of such securities.
- (c) subject to the provisions of clause (a) and (b) above, in case of an initial public offer of convertible debt instruments without a prior public issue of equity shares, the promoters shall bring in a contribution of at least twenty per cent. of the project cost in the form of equity shares, subject to contributing at least twenty per cent. of the issue size from their own funds in the form of equity shares:

Provided that if the project is to be implemented in stages, the promoters' contribution shall be with respect to total equity participation till the respective stage vis-à-vis the debt raised or proposed to be raised through the public issue.

- (3) In case of a further public offer or composite issue where the promoters contribute more than the stipulated minimum promoters' contribution, the allotment with respect to excess contribution shall be made at a price determined in terms of the provisions of regulation 76 or the issue price, whichever is higher.
- (4) The promoters shall satisfy the requirements of this regulation at least one day prior to the date of opening of the issue and the amount of promoters' contribution shall be kept in an escrow account with a scheduled commercial bank and shall be released to the issuer along with the release of the issue proceeds:

Provided that where the promoters' contribution has already been brought in and utilised, the issuer shall give the cash flow statement disclosing the use of such funds in the offer document;

Provided further that where the minimum promoters' contribution is more than one hundred crore rupees, the promoters shall bring in at least one hundred crore rupees before the date of opening of the issue and the remaining amount may be brought on pro-rata basis before the calls are made to public.

Explanation: For the purpose of this regulation:

- (I) Promoters' contribution shall be computed on the basis of the post-issue expanded capital:
 - (a) assuming full proposed conversion of convertible securities into equity shares;
 - (b) assuming exercise of all vested options, where any employee stock options are outstanding at the time of initial public offer in terms of proviso (b) to sub-regulation (5) of regulation 26.
- (II) For computation of "weighted average price":
 - (a) "weights" means the number of equity shares arising out of conversion of such specified securities into equity shares at various stages;
 - (b) "price" means the price of equity shares on conversion arrived at after taking into account predetermined conversion price at various stages.

Securities ineligible for minimum promoters' contribution

- (1) For the computation of minimum promoters' contribution, the following specified securities shall not be eligible:



- (a) specified securities acquired during the preceding three years, if they are:
 - (i) acquired for consideration other than cash and revaluation of assets or capitalisation of intangible assets is involved in such transaction; or
 - (ii) resulting from a bonus issue by utilisation of revaluation reserves or unrealized profits of the issuer or from bonus issue against equity shares which are ineligible for minimum promoters' contribution;
- (b) specified securities acquired by promoters and alternative investment funds during the preceding one year at a price lower than the price at which specified securities are being offered to public in the initial public offer:

Provided that nothing contained in this clause shall apply:

- (i) if promoters /alternative investment funds,as applicable, pay to the issuer, the difference between the price at which specified securities are offered in the initial public offer and the price at which the specified securities had been acquired;
- (ii) if such specified securities are acquired in terms of the scheme under sections 391-394 of the Companies Act, 1956, as approved by a High Court, by promoters in lieu of business and invested capital that had been in existence for a period of more than one year prior to such approval;
- (iii) to an initial public offer by a government company, statutory authority or corporation or any special purpose vehicle set up by any of them, which is engaged in infrastructure sector;
- (c) specified securities allotted to promoters and alternative investment funds during the preceding one year at a price less than the issue price, against funds brought in by them during that period, in case of an issuer formed by conversion of one or more partnership firms, where the partners of the erstwhile partnership firms are the promoters of the issuer and there is no change in the management:

Provided that specified securities, allotted to promoters against capital existing in such firms for a period of more than one year on a continuous basis, shall be eligible;

- (d) specified securities pledged with any creditor.
 - (2) Specified securities referred to in clauses (a) and (c) of sub-regulation (1) shall be eligible for the computation of promoters' contribution, if such securities are acquired pursuant to a scheme which has been approved under sections 391-394 of the Companies Act, 1956.

Explanation: For the purposes of clause (b) of sub-regulation (1), the term "infrastructure sector" includes the facilities or services as specified in **Schedule X**.

Requirement of minimum promoters' contribution not applicable in certain cases

The requirements of minimum promoters' contribution shall not apply in case of:

- (a) an issuer which does not have any identifiable promoter;
- (b) a further public offer, where the equity shares of the issuer are not infrequently traded in a recognised stock exchange for a period of at least three years and the issuer has a track record of dividend payment for at least immediately preceding three years:

Provided that where promoters propose to subscribe to the specified securities offered to the extent greater than higher of the two options available in clause (b) of sub-regulation (1) of regulation 32, the subscription in excess of such percentage shall be made at a price determined in terms of the provisions of regulation 76 or the issue price, whichever is higher.

(c) rights issues.

Explanation: For the purpose of clause (b), the words “infrequently traded” have the same meaning as assigned to them in Explanation to sub-regulation (5) of regulation 20 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 and the reference date for the purpose of computing the annualised trading turnover referred to in the said Explanation shall be the date of filing the draft offer document with the Board and in case of a fast track issue, the date of filing the offer document with the Registrar of Companies before opening of the issue.

PART IV - RESTRICTION ON TRANSFERABILITY (LOCK-IN) OF PROMOTERS' CONTRIBUTION, ETC.

Date of commencement of lock in and inscription of non-transferability

- (1) Save as otherwise provided in this Chapter, specified securities held by promoters and persons other than promoters shall not be transferable (hereinafter referred to as “lock-in”) from the date of allotment of the specified securities in the proposed public issue for the period stipulated in these regulations.
- (2) The certificate of specified securities which are subject to lock-in shall contain the inscription “non transferable” and the lock-in period and in case such specified securities are dematerialised, the issuer shall ensure that lock-in is recorded by the depository.
- (3) Where the specified securities which are subject to lock-in are partly paid-up and the amount called-up on such specified securities is less than the amount called-up on the specified securities issued to the public, the “lock-in” shall end only on the expiry of three years after such specified securities have become pari-passu with the specified securities issued to the public.

Lock-in of specified securities held by promoters.

In a public issue, the specified securities held by promoters shall be locked-in for the period stipulated hereunder:

- (a) minimum promoters' contribution including contribution made by alternative investment funds, referred to in proviso to clause (a) of sub-regulation (1) of regulation 32, shall be locked-in for a period of three years from the date of commencement of commercial production or date of allotment in the public issue, whichever is later;
- (b) promoters' holding in excess of minimum promoters' contribution shall be locked-in for a period of one year:

Provided that excess promoters' contribution as provided in proviso to clause (b) of regulation 34 shall not be subject to lock-in.

Explanation: For the purposes of this clause, the expression “date of commencement of commercial production” means the last date of the month in which commercial production in a manufacturing company is expected to commence as stated in the offer document.

Lock-in of specified securities held by persons other than promoters.

In case of an initial public offer, the entire pre-issue capital held by persons other than promoters shall be locked-in for a period of one year:

Provided that nothing contained in this regulation shall apply to:

- (a) equity shares allotted to employees under an employee stock option or employee stock purchase scheme of the issuer prior to the initial public offer, if the issuer has made full disclosures with respect to such options or scheme in accordance with **Part A of Schedule VIII**;
- (b) equity shares held by a venture capital fund or a foreign venture capital investor for a period of at least one year prior to the date of filing the draft prospectus with the Board:



Explanation: For the purpose of clause (b), in case such equity shares have resulted pursuant to conversion of fully paid-up compulsorily convertible securities, the holding period of such convertible securities as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period and convertible securities shall be deemed to be fully paid-up, if the entire consideration payable thereon has been paid and no further consideration is payable at the time of their conversion.

Lock-in of specified securities lent to stabilising agent under green shoe option.

The lock-in provisions of these regulations shall not apply with respect to the specified securities lent to stabilising agent for the purpose of green shoe option, during the period starting from the date of lending of such specified securities and ending on the date on which they are returned to the lender in terms of sub-regulation (5) or (6) of regulation 45:

Provided that the specified securities shall be locked-in for the remaining period from the date on which they are returned to the lender.

Pledge of locked-in specified securities.

Specified securities held by promoters and locked-in may be pledged with any scheduled commercial bank or public financial institution as collateral security for loan granted by such bank or institution, subject to the following:

- (a) if the specified securities are locked-in in terms of clause (a) of regulation 36, the loan has been granted by such bank or institution for the purpose of financing one or more of the objects of the issue and pledge of specified securities is one of the terms of sanction of the loan;
- (b) if the specified securities are locked-in in terms of clause (b) of regulation 36 and the pledge of specified securities is one of the terms of sanction of the loan.

Transferability of locked-in specified securities.

Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 1997, the specified securities held by promoters and locked in as per regulation 36 may be transferred to another promoter or any person of the promoter group or a new promoter or a person in control of the issuer and the specified securities held by persons other than promoters and locked-in as per regulation 37 may be transferred to any other person holding the specified securities which are locked-in along with the securities proposed to be transferred:

Provided that lock-in on such specified securities shall continue for the remaining period with the transferee and such transferee shall not be eligible to transfer them till the lock-in period stipulated in these regulations has expired.

PART V - MINIMUM OFFER TO PUBLIC, RESERVATIONS, ETC.

Minimum offer to public.

- (1) Subject to the provisions of sub-clause (b) of clause (2) of rule 19 of Securities Contracts (Regulations) Rules, 1957, the net offer to public:
 - (a) in case of an initial public offer, shall be at least ten per cent or twenty five per cent of the post-issue capital, as the case may be; and
 - (b) in case of a further public offer, shall be at least ten per cent or twenty five per cent of the issue size, as the case may be.
- (2) Nothing contained in sub-regulation (1) shall apply if the issuer is:
 - (a) a government company or statutory authority or corporation or any special purpose vehicle set up and controlled by any one or more of them, which is engaged in infrastructure sector;

- (b) an infrastructure company fulfilling the following conditions:
 - (i) its project has been appraised by one or more public financial institutions;
 - (ii) not less than fifty per cent. of the project cost is financed by one or more such institutions, jointly or severally, by way of loan or subscription to equity shares or a combination of both, irrespective of whether they appraise the project or not.

Explanation: For the purpose of this regulation:

- (I) The term “infrastructure company” means, an enterprise wholly engaged in the business of (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining any infrastructure facility;
- (II) The term “infrastructure sector” includes the facilities or services as specified in **Schedule X**.

Reservation on competitive basis.

- (1) In case of an issue made through the book building process, the issuer may make reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of the following categories of persons:
 - (a) employees of the issuer including employees of the promoting companies in case of a new issuer;
 - (b) shareholders (other than promoters) of:
 - (i) listed promoting companies, in case of a new issuer; and
 - (ii) listed group companies, in case of an existing issuer:

Provided that if the promoting companies are designated financial institutions or state and central financial institutions, the shareholders of such promoting companies shall not be eligible for the reservation on competitive basis;

- (c) persons who, as on the date of filing the draft offer document with the Board, are associated with the issuer as depositors, bondholders or subscribers to services of the issuer making an initial public offer:

Provided that the issuer shall not make the reservation to the issue management team, syndicate members, their promoters, directors and employees and for the group or associate companies of the issue management team and syndicate members and their promoters, directors and employees;

- (2) In case of an issue made other than through the book building process, the issuer may make reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of the following categories of persons:
 - (a) employees; and in case of a new issuer, persons who are in the permanent and full time employment of the promoting companies excluding the promoters and an immediate relative of the promoter of such companies;
 - (b) shareholders (other than promoters) of:
 - (i) listed promoting companies, in the case of a new issuer; and
 - (ii) listed group companies, in the case of an existing issuer:

Provided that if the promoting companies are designated financial institutions or state and central financial institutions, the shareholders of such promoting companies shall not be eligible for the reservation on competitive basis.



- (3) In case of a further public offer (not being a composite issue), the issuer may make reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of retail individual shareholders of the issuer.
- (4) The reservation on competitive basis shall be subject to following conditions:
 - (a) the aggregate of reservations for employees shall not exceed five per cent of the post issue capital of the issuer;
 - (b) reservation for shareholders shall not exceed ten per cent of the issue size;
 - (c) reservation for persons who as on the date of filing the draft offer document with the Board, have business association as depositors, bondholders and subscribers to services with the issuer making an initial public offer shall not exceed five per cent of the issue size;
 - (d) no further application for subscription in the net offer to public category shall be entertained from any person (except an employee and retail individual shareholder) in favour of whom reservation on competitive basis is made;
 - (e) any unsubscribed portion in any reserved category may be added to any other reserved category and the unsubscribed portion, if any, after such inter-se adjustments among the reserved categories shall be added to the net offer to the public category;
 - (f) in case of under-subscription in the net offer to the public category, spill-over to the extent of under-subscription shall be permitted from the reserved category to the net public offer category;
 - (g) value of allotment to any employee in pursuance of reservation made under sub-regulations (1) or (2), as the case may be, shall not exceed two lakh rupees.
- (5) In the case of reserved categories, a single applicant in the reserved category may make an application for a number of specified securities which exceeds the reservation.

Explanation: For the purposes of this regulation:

- (I) The term "reservation on competitive basis" means reservation wherein specified securities are allotted in proportion of the number of specified securities applied for in respect of a particular reserved category to the number of specified securities reserved for that category;
- (II) The term "new issuer" means an issuer which has not completed twelve months of commercial operation and its audited operative results are not available.

Allocation in net offer to public.

- (1) No person shall make an application in the net offer to public category for that number of specified securities which exceeds the number of specified securities offered to public.
- (2) In an issue made through the book building process under sub-regulation (1) of regulation 26, the allocation in the net offer to public category shall be made as follows:
 - (a) not less than thirty five per cent to retail individual investors;
 - (b) not less than fifteen per cent to non-institutional investors;
 - (c) not more than fifty per cent to qualified institutional buyers, five per cent of which shall be allocated to mutual funds;

Provided that in addition to five per cent allocation available in terms of clause(c), mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers;

(2A) In an issue made through the book building process under sub-regulation(2) of regulation 26, the allocation in the net offer to public category shall be as follows:

- (a) not more than ten per cent to retail individual investors;
- (b) not more than fifteen per cent to non-institutional investors;
- (c) not less than seventy five per cent to qualified institutional buyers, five per cent of which shall be allocated to mutual funds:

Provided that in addition to five per cent allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.

- (3) In an issue made through the book building process, the issuer may allocate upto thirty per cent of the portion available for allocation to qualified institutional buyers to an anchor investor in accordance with the conditions specified in this regard in Schedule XI.
- (4) In an issue made other than through the book building process, allocation in the net offer to public category shall be made as follows:
 - (a) minimum fifty per cent to retail individual investors; and
 - (b) remaining to:
 - (i) individual applicants other than retail individual investors; and
 - (ii) other investors including corporate bodies or institutions, irrespective of the number of specified securities applied for;
 - (c) the unsubscribed portion in either of the categories specified in clauses (a) or (b) may be allocated to applicants in the other category.

Explanation: For the purpose of sub-regulation (4), if the retail individual investor category is entitled to more than fifty per cent. on proportionate basis, the retail individual investors shall be allocated that higher percentage.

Safety-net arrangement

An issuer may provide for a safety-net arrangement for the specified securities offered in any public issue in consultation with the merchant banker after ascertaining the financial capacity of the person offering the safety-net arrangement, subject to disclosures specified in this regard in **Part A of Schedule VIII**:

Provided that any such arrangement shall provide for an offer to purchase up to a maximum of one thousand specified securities per original resident retail individual allottee at the issue price within a period of six months from the last date of despatch of security certificates or credit of demat account.

Explanation: For the purpose of this regulation, the term "safety net arrangement" means an arrangement provided by the issuer under which a person offers to purchase specified securities from the original resident retail individual allottees at the issue price.

Period of Subscription

- (1) Except as otherwise provided in these regulations, a public issue shall be kept open for at least three working days but not more than ten working days including the days for which the issue is kept open in case of revision in price band.
- (2) In case the price band in a public issue made through the book building process is revised, the bidding (issue) period disclosed in the red herring prospectus shall be extended for a minimum period of three working days:

Provided that the total bidding period shall not exceed ten working days.



Price stabilisation through green shoe option.

- (1) An issuer making a public issue of specified securities may provide green shoe option for stabilising the post listing price of its specified securities, subject to the following:
 - (a) the issuer has been authorized, by a resolution passed in the general meeting of shareholders approving the public issue, to allot specified securities to the stabilizing agent, if required, on the expiry of the stabilisation period;
 - (b) the issuer has appointed a merchant banker or book runner, as the case may be, from amongst the merchant bankers appointed by the issuer as a stabilising agent, who shall be responsible for the price stabilisation process;
 - (c) prior to filing the draft offer document with the Board, the issuer and the stabilising agent have entered into an agreement, stating all the terms and conditions relating to the green shoe option including fees charged and expenses to be incurred by the stabilising agent for discharging his responsibilities;
 - (d) prior to filing the offer document with the Board, the stabilising agent has entered into an agreement with the promoters or pre-issue shareholders or both for borrowing specified securities from them in accordance with clause (g) of this sub-regulation, specifying therein the maximum number of specified securities that may be borrowed for the purpose of allotment or allocation of specified securities in excess of the issue size (hereinafter referred to as the "over- allotment"), which shall not be in excess of fifteen per cent of the issue size;
 - (e) subject to clause (d), the lead merchant banker or lead book runner, in consultation with the stabilising agent, shall determine the amount of specified securities to be over-allotted in the public issue;
 - (f) the draft and final offer documents shall contain all material disclosures about the green shoe option specified in this regard in **Part A of Schedule VIII**;
 - (g) in case of an initial public offer pre-issue shareholders and promoters and in case of a further public offer pre-issue shareholders holding more than five per cent specified securities and promoters, may lend specified securities to the extent of the proposed over-allotment;
 - (h) the specified securities borrowed shall be in dematerialised form and allocation of these securities shall be made pro-rata to all successful applicants.
- (2) For the purpose of stabilisation of post-listing price of the specified securities, the stabilising agent shall determine the relevant aspects including the timing of buying such securities, quantity to be bought and the price at which such securities are to be bought from the market.
- (3) The stabilisation process shall be available for a period not exceeding thirty days from the date on which trading permission is given by the recognised stock exchanges in respect of the specified securities allotted in the public issue.
- (4) The stabilising agent shall open a special account, distinct from the issue account, with a bank for crediting the monies received from the applicants against the over-allotment and a special account with a depository participant for crediting specified securities to be bought from the market during the stabilisation period out of the monies credited in the special bank account.
- (5) The specified securities bought from the market and credited in the special account with the depository participant shall be returned to the promoters or pre-issue shareholders immediately, in any case not later than two working days after the end of the stabilization period.
- (6) On expiry of the stabilisation period, if the stabilising agent has not been able to buy specified securities from the market to the extent of such securities over-allotted, the issuer shall allot specified securities at issue price in dematerialised form to the extent of the shortfall to the special account with the depository participant, within five days of the closure of the stabilisation period and such

specified securities shall be returned to the promoters or pre-issue shareholders by the stabilising agent in lieu of the specified securities borrowed from them and the account with the depository participant shall be closed thereafter.

- (7) The issuer shall make a listing application in respect of the further specified securities allotted under sub-regulation (6), to all the recognised stock exchanges where the specified securities allotted in the public issue are listed and the provisions of Chapter VII shall not be applicable to such allotment.
- (8) The stabilising agent shall remit the monies with respect to the specified securities allotted under sub-regulation (6) to the issuer from the special bank account.
- (9) Any monies left in the special bank account after remittance of monies to the issuer under subregulation (8) and deduction of expenses incurred by the stabilising agent for the stabilisation process shall be transferred to the Investor Protection and Education Fund established by the Board and the special bank account shall be closed soon thereafter.
- (10) The stabilising agent shall submit a report to the stock exchange on a daily basis during the stabilisation period and a final report to the Board in the format specified in **Schedule XII**.
- (11) The stabilising agent shall maintain a register for a period of at least three years from the date of the end of the stabilisation period and such register shall contain the following particulars:
 - (a) The names of the promoters or pre-issue shareholders from whom the specified securities were borrowed and the number of specified securities borrowed from each of them;
 - (b) The price, date and time in respect of each transaction effected in the course of the stabilisation process; and
 - (c) The details of allotment made by the issuer on expiry of the stabilisation process.

Pre-issue advertisement for public issue

- (1) Subject to the provisions of section 66 of the Companies Act, 1956, the issuer shall, after registering the red herring prospectus (in case of a book built issue) or prospectus (in case of fixed price issue) with the Registrar of Companies, make a pre-issue advertisement in one English national daily newspaper with wide circulation, Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated.
- (2) The pre-issue advertisement shall be in the format and shall contain the disclosures specified in **Part A of Schedule XIII**.

Minimum application value

- (1) The issuer shall stipulate in the offer document, the minimum application size in terms of number of specified securities which shall fall within the range of minimum application value of ten thousand rupees to fifteen thousand rupees.
- (2) The issuer shall invite applications in multiples of the minimum application value, an illustration whereof is given in **Schedule XIV**.
- (3) The minimum sum payable on application shall not be less than twenty five per cent of the issue price:

Provided that in case of an offer for sale, the issue price payable for each specified security shall be brought in at the time of application.

Explanation: For the purpose of this regulation, “minimum application value” shall be with reference to the issue price of the specified securities and not with reference to the amount payable on application.



Allotment procedure and basis of allotment

- (1) The allotment of specified securities to applicants other than retail individual investors and anchor investors shall be on proportionate basis within the specified investor categories and the number of securities allotted shall be rounded off to the nearest integer, subject to minimum allotment being equal to the minimum application size as determined and disclosed by the issuer:

Provided that value of specified securities allotted to any person in pursuance of reservation made under clause (a) of sub-regulation (1) or clause (a) of sub-regulation (2) of regulation 42, shall not exceed two lakh rupees.

- (1A) the allotment of specified securities to each retail individual investor shall not be less than the minimum bid lot, subject to availability of shares in retail individual investor category, and the remaining available shares, if any, shall be allotted on a proportionate basis.
- (2) The executive director or managing director of the designated stock exchange along with the post issue lead merchant bankers and registrars to the issue shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the allotment procedure as specified in **Schedule XV**.

Utilisation of subscription money

The post-issue lead merchant banker shall ensure that moneys received in respect of the issue are released to the issuer in compliance with the provisions of section 73 of the Companies Act, 1956.

Annual Updation Of Offer Document

The disclosures made in the red herring prospectus while making an initial public offer, shall be updated on an annual basis by the issuer and shall be made publicly accessible in the manner specified by the Board.

RIGHTS ISSUE

SEBI regulations regarding rights issues

Applicability

These guidelines apply to the rights issues made by existing listed companies (i.e., companies whose equity capital is listed). Therefore, a company whose debentures/bonds are listed but not the equity (i.e., shares) will not be governed by these guidelines.

These guidelines are not applicable where the size of the issue is upto Rs.50 lakhs (including premium, if any).

Record Date.

- (1) A listed issuer making a rights issue shall announce a record date for the purpose of determining the shareholders eligible to apply for specified securities in the proposed rights issue.
- (2) The issuer shall not withdraw rights issue after announcement of the record date.
- (3) If the issuer withdraws the rights issue after announcing the record date, it shall not make an application for listing of any of its specified securities on any recognised stock exchange for a period of twelve months from the record date announced under sub-regulation (1):

Provided that the issuer may seek listing of its equity shares allotted pursuant to conversion or exchange of convertible securities issued prior to the announcement of the record date, on the recognised stock exchange where its securities are listed.

Restriction on rights issue.

- (1) No issuer shall make a rights issue of equity shares if it has outstanding fully or partly convertible debt instruments at the time of making rights issue, unless it has made reservation of equity shares

of the same class in favour of the holders of such outstanding convertible debt instruments in proportion to the convertible part thereof.

- (2) The equity shares reserved for the holders of fully or partially convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms on which the equity shares offered in the rights issue were issued.

Letter of offer, abridged letter of offer, pricing and period of subscription.

- (1) The abridged letter of offer, along with application form, shall be dispatched through registered post or speed post to all the existing shareholders at least three days before the date of opening of the issue:

Provided that the letter of offer shall be given by the issuer or lead merchant banker to any existing shareholder who has made a request in this regard.

- (2) The shareholders who have not received the application form may apply in writing on a plain paper, along with the requisite application money.
- (3) The shareholders making application otherwise than on the application form shall not renounce their rights and shall not utilise the application form for any purpose including renunciation even if it is received subsequently.
- (4) Where any shareholder makes an application on application form as well as on plain paper, the application is liable to be rejected.
- (5) The issue price shall be decided before determining the record date which shall be determined in consultation with the designated stock exchange.
- (6) A rights issue shall be open for subscription for a minimum period of fifteen days and for a maximum period of thirty days.
- (7) The issuer shall give only one payment option out of the following to all the investors-
 - (a) part payment on application with balance money to be paid in calls; or
 - (b) full payment on application:

Provided that where the issuer has given the part payment option to investors, such issuer shall obtain the necessary approvals to facilitate the same.

Pre-Issue Advertisement for rights issue.

- (1) The issuer shall issue an advertisement for rights issue disclosing the following:
 - (a) the date of completion of despatch of abridged letter of offer and the application form;
 - (b) the centres other than registered office of the issuer where the shareholders or the persons entitled to receive the rights entitlements may obtain duplicate copies of the application forms in case they do not receive the application form within a reasonable time after opening of the rights issue;
 - (c) a statement that if the shareholders entitled to receive the rights entitlements have neither received the original application forms nor they are in a position to obtain the duplicate forms, they may make application in writing on a plain paper to subscribe to the rights issue;
 - (d) a format to enable the shareholders entitled to apply against their rights entitlements, to make the application on a plain paper specifying therein necessary particulars such as name, address, ratio of rights issue, issue price, number of equity shares held, ledger folio numbers, depository participant ID, client ID, number of equity shares entitled and applied for, additional shares if any, amount to be paid along with application, and particulars of cheque, etc. to be drawn in favour of the issuer's account;



- (e) a statement that the applications can be directly sent by the shareholders entitled to apply against rights entitlements through registered post together with the application moneys to the issuer's designated official at the address given in the advertisement;
 - (f) a statement to the effect that if the shareholder makes an application on plain paper and also on application form both his applications shall be liable to be rejected at the option of the issuer.
- (2) The advertisement shall be made in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where registered office of the issuer is situated, at least three days before the date of opening of the issue.

Reservation for employees alongwith rights issue.

Subject to other applicable provision of these regulations the issuer may make reservation for employees alongwith rights issue subject to the condition that value of allotment to any employee shall not exceed two lakh rupees.

Utilisation of funds raised in rights issue.

The issuer shall utilise funds collected in rights issues after the finalisation of the basis of allotment.

Procedure for issue of right shares

For issue of right shares, a company is required to follow the procedure as laid down in section 81 of the Companies Act and also the regulations issued by SEBI in this regard.

The various steps involved for issue of rights shares may be noted as follows:

1. See that the rights issue is within the authorized share capital of the company. If not, steps should be taken to increase the same.
2. If the right shares are to be issued out of 'unclassified shares', take steps to amend the capital clause to classify 'unclassified shares' as equity/preference shares proposed to be issued.
3. Notify the stock exchange concerned the date of the Board meeting at which the rights issue is proposed to be considered.
4. Where the issue size exceeds ₹50 lakhs, take steps for the appointment of eligible merchant banker since, as per SEBI regulations, the appointment of a eligible merchant banker in case of rights issue of listed companies exceeding ₹50 lakhs is mandatory.
5. In case the issue is proposed to be made at a premium, fix the premium in consultation with the lead manager to the issue.
6. Appoint registrars and the underwriters. Appointment of underwriters, as per SEBI regulations, is, however, optional.
7. Note that there can be no preferential allotment in respect of the rights issue except in favour of employees provided the value of allotment does not exceed ₹2 lakh.
8. In consultation with the stock exchange(s), fix the record date for the proposed issue.
9. If it is proposed to offer shares to persons other than the existing members, a general meeting be convened and a special resolution or an ordinary resolution in lieu of special resolution or an ordinary resolution in lieu of special resolution passed for the purpose in terms of section 81(1A). It may be noted that the Central Government's approval is necessary in case of ordinary resolution.
10. If issue is to be offered to NRIs, file the requisite form and declarations with RBI. No prior approval of the RBI is required for offer of shares to NRIs on non-repatriation basis.
11. Forward six sets of letter of offer to the concerned stock exchange.

12. Note that in case the rights issue is withdrawn after the announcement of the record date, the regional stock exchange will not permit the making of application for listing of shares for a minimum period of 12 months from the record date.
13. Make arrangements with bankers for acceptance of share application forms.
14. Make arrangements for dispatch of letters of offer to shareholders containing details as per section 81 of the Companies Act, 1956 as well as SEBI regulations.
15. Ensure that the issue is kept open for a minimum period of 15 days but not beyond 30 days.
16. Open a specific bank account for keeping subscription received against rights issue. Note that the money deposited in this account cannot be utilized until and unless the company has received from the concerned regional stock exchange(s) approval for utilization of this money.
17. In case the company does not receive 90% of the issue amount including accepted devolvement from underwriters within 60 days from the date of the closure of the issue, the amount of subscription received shall be required to be refunded.
18. Prepare a scheme of allotment in consultation with stock exchange(s).
19. Convene Board meeting and make allotment of shares.
20. File return of allotment in Form No.2 with Registrar of Companies within 30 days of allotment.
21. Complete other formalities such as refund of excess application money, issue of allotment letters, making of entries in various registers, etc.
22. Forward a report in the prescribed form to the SEBI within 15 days of the date of finalization of allotment or within 15 days of refund or money in case of failure of issue.
23. Note that if the instrument of transfer of shares has been delivered to the company but the same has not been registered till the date of closure of register of members, keep in abeyance the offer of rights shares relating to the shares involved in the transfer [sec.206A] of the Companies Act, 1956.

BONUS SHARES

Meaning of Bonus Shares

Bonus shares are the shares which are issued without any consideration by converting eligible profits or reserves into paid up share capital.

Conditions for the Issue of Bonus Shares

1. **Authorised by Articles**—The Articles must authorise to issue Bonus shares,
2. **Board's Resolution**—The Board of Directors must pass a resolution recommending its decision to issue bonus shares.
3. **Ordinary Resolution**—The members must pass an ordinary resolution at general meeting to approve Board's resolution recommending the issue of bonus shares.
4. **SEBI Guidelines**—The Bonus Issue must be as per SEBI Guidelines.
5. **Sources for issue of Bonus shares**—Bonus shares can be issued out of the following sources:
 - (a) Undistributed Profits/Reserves which are available for Dividend
 - (b) Securities Premium as per Sec. 78
 - (c) Capital Redemption Reserve as per Sec. 80
6. **Fully Paid Shares**—Bonus shares must be fully paid up.
7. **To existing shareholders only**— Bonus shares must be issued only to the existing share holders.



Similarity Between Bonus Shares and Right Shares

Both are issued to existing shareholders. However, in certain circumstances, rights shares need not be offered to the existing shareholders.

Distinction between Bonus Shares and Right Shares

Bonus shares differ from Right shares in the following respects:

Basis of Distinction	Bonus Shares	Right Shares
1. Provisions Applicable	Sec. 78, Sec. 80, Sec. 205	Sec. 81
2. Manner of Issue	These are issued by Capitalizing the accumulated profits/reserves.	These are issued by issuing new share capital.
3. Consideration	These are issued without any consideration.	These are issued for cash.
4. Transfer of Right to Receive	Right to receive bonus shares can- not be transferred to another person.	Right to subscribe for right shares can be transferred to another person.
5. Apply	Shareholders are not required to apply for bonus shares.	Shareholders are required to apply to subscribe for right shares.
6. Option	Shareholders have no option to receive bonus shares less than/ more than those offered.	Shareholders have an option to apply for right shares less than/more than those offered.
7. Cash inflow	There is no cash inflow.	There is cash inflow.
8. Fully paid up	These are always fully paid up.	These may be fully/partly paid up.
9. Issue to Existing Shareholders	These are always issued to existing shareholders.	These may or may not be issued to existing shareholders

Restriction on bonus issue

Section 93. (1) No issuer shall make a bonus issue of equity shares if it has outstanding fully or partly convertible debt instruments at the time of making the bonus issue, unless it has made reservation of equity shares of the same class in favour of the holders of such outstanding convertible debt instruments in proportion to the convertible part thereof.

(2) The equity shares reserved for the holders of fully or partly convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms or same proportion on which the bonus shares were issued.

Completion of bonus issue

Section 95. (1) An issuer, announcing a bonus issue after the approval of its board of directors and not requiring shareholders' approval for capitalisation of profits or reserves for making the bonus issue, shall implement the bonus issue within fifteen days from the date of approval of the issue by its board of directors:

Provided that where the issuer is required to seek shareholders' approval for capitalisation of profits or reserves for making the bonus issue, the bonus issue shall be implemented within two months from the date of the meeting of its board of directors wherein the decision to announce the bonus issue was taken subject to shareholders' approval.

(2) Once the decision to make a bonus issue is announced, the issue cannot be withdrawn.

ISSUE OF SHARES AT A PREMIUM [SECTION 78]

Meaning of Issue of Shares at a Premium

Shares are said to be issued at a premium when they are issued at a price higher than the face value. The excess of issue price over the face value is called as the amount of 'Securities Premium' e.g. if a share of ₹ 10 is issued at ₹ 15, it is said that the share has been issued at a premium of ₹ 5.

Implied Power to Issue Shares at a Premium

A company may issue shares at a premium even though there is no express authority in its Articles since the company has an implied power to issue shares at a premium.

Transfer of Premium to Securities Premium Account

Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on those shares must be transferred to an account, to be called the Securities Premium Account. The word 'amount' refers to cash premium and the word 'Value' refers to a premium other than cash. Securities issued for consideration other than cash will be treated as having been issued at a premium if the value of the assets in consideration of which they are issued is more than the nominal value of the securities.

Purposes for which Securities Premium can be utilized

- (a) Though there are no restrictions in the Companies Act, 1956 on the issue of shares at a premium but there are restrictions on the application of Securities Premium. According to Section 78 of the Companies Act, 1956, the Securities Premium may be applied only for the following purposes:
 - (i) To issue fully paid bonus shares to the members;
 - (ii) To write off preliminary expenses of the company;
 - (iii) To write off the expenses of or the commission paid or discount allowed on any issue of shares or debentures of the company;
 - (iv) To provide for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company;
- (b) According to Sec 77A, a company may buy back its own shares or other specified securities out of Securities Premium Account.
- (c) The use of Securities Premium Account for purposes other than those mentioned above requires the compliance of the provisions of the Act relating to reduction of share capital.

Notes:

- (i) The amount of securities premium may be demanded alongwith the application money/allotment money/call money.
- (ii) The amount of securities premium may be demanded either in lumpsum or in installments e.g. partly with application money and balance with allotment money,
- (iii) Even when the shares are issued at a premium for consideration other than cash, a sum equal to the amount of premium must be transferred to the 'Securities Premium Account'. [Head Henry & Co. Ltd. v. Ropher, (1951) 2 All. E.R. 994]
- (iv) There is no prohibition in the Act against issue of securities at different premiums. [C/T. v. Standard Vacuum OH Company, AIR (1966) SC 1963]

Issue of Shares at a Discount [Section 79]

Meaning of issue of Shares at a Discount

Shares are said to be issued at a discount when they are issued at a price lower than the face value.



The excess of the face value over the issue price is called as the amount of discount e.g. if a share of ₹ 10 is issued at ₹ 9, it is said that the share has been issued at a discount of Re 1.

Six Conditions for Issue of Shares at Discount [Section 79(2)]

According to Section 79 of the Companies Act 1956, a company may issue the shares at a discount only if the following conditions are fulfilled:

- (i) **Class** : The shares must belong to a class of shares already issued;
- (ii) **Ordinary Resolution** : The issue must be authorised by an ordinary resolution of the company;
- (iii) **Sanction** : The sanction of the “Central Government must be obtained;
- (iv) **Maximum Rate of Discount** : The resolution must specify the maximum rate of discount at which the shares are to be issued. No resolution shall be sanctioned by the ‘Central Government if the maximum rate of discount specified in the resolution exceeds 10% unless it is of opinion that a higher percentage of discount may be allowed in the special circumstances of the case;
- (v) **Completion of 1 year** : At least 1 year must have elapsed since the date on which the company was entitled to commence business;
- (vi) **Time Limit of Issue**: The issue must be made within 2 months from the date of receiving the sanction of the ‘Central Government or within such extended time as the ‘Central Government may allow.

Disclosure Requirements [Section 79(4)]

Every prospectus relating to the issue of the shares shall contain particulars of the discount allowed on the issue of the shares or of so much of that discount as has not been written off at the date of the issue of the prospectus.

Consequences of improper Issues of Shares at a Discount

1. **Penalty for Default [Section 79(4)]**: In case of default, the company, and its every officer in default, shall be punishable with fine upto ₹ 500.
2. **Directors Liabilities**: The directors render themselves liable to compensate the company to the extent of the amount of discount. [Hirsche v. Sims, [1894] A.C. 654].
3. **Members Liability**: Even the acceptor of shares, in such a case has to pay back to the company the amount of discount if he holds the shares [Re. Pitkin (James) & Co., [1916] 95 L.J. Ch. 318], This he would have to do if the conditions of Section 79 are not satisfied, despite the fact that he did not know the legal effect of his contract to take shares at a discount or that the memorandum or articles give the directors the power to issue shares at a discount [Welden v. Saffery, [1897] A.C. 229; Re Pitkin Supra]. But the allottee may avoid liability to take the shares if he applies on discovery of illegality of the discount allowed without delay, before commencement of the winding up of the company, to have his name removed as a shareholder provided he has not otherwise agreed to keep the shares [Re Midland Electric Co., [1889] 60 L.T. [1892] Bom. 7].

SEBI REGULATIONS FOR PREFERENTIAL ISSUE

Regulations for Preferential Issue not to apply in certain cases

- (1) The provisions of this regulations shall not apply where the preferential issue of equity shares is made:
 - (a) pursuant to conversion of loan or option attached to convertible debt instruments in terms of sub-sections (3) and (4) of sections 81 of the Companies Act, 1956;
 - (b) pursuant to a scheme approved by a High Court under section 391 to 394 of the Companies Act, 1956;

- (c) in terms of the rehabilitation scheme approved by the Board of Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985:

Provided that the lock-in provisions of this Chapter shall apply to such preferential issue of equity Shares.

- (2) The provisions of this regulations relating to pricing and lock-in shall not apply to equity shares allotted to any financial institution within the meaning of sub-clauses (ia) and (ii) of clause (h) of section 2 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993 (51 of 1993).
- (3) The provisions of regulation 73 and regulation 76 shall not apply to a preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, where the Board has granted relaxation to the issuer in terms of regulation 29A of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, if adequate disclosures about the plan and process proposed to be followed for identifying the allottees are given in the explanatory statement to notice for the general meeting of shareholders.
- (4) The provisions of sub-regulation (2) of regulation 72 and sub-regulation (6) of regulation 78 shall not apply to a preferential issue of specified securities where the proposed allottee is a Mutual Fund registered registered with the Board or Insurance Company registered with Insurance Regulatory and Development Authority.

Relevant date.

For the purpose of this regulations, "relevant date" means:

- (a) in case of preferential issue of equity shares, the date thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue:

Provided that in case of preferential issue of equity shares pursuant to a scheme approved under the Corporate Debt Restructuring framework of Reserve Bank of India, the date of approval of the Corporate Debt Restructuring Package shall be the relevant date.

- (b) in case of preferential issue of convertible securities, either the relevant date referred to in clause (a) of this regulation or a date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.

Explanation: Where the relevant date falls on a weekend/holiday, the day preceding the weekend/holiday will be reckoned to be the relevant date.

Conditions for preferential issue.

- (1) A listed issuer may make a preferential issue of specified securities, if:
 - (a) a special resolution has been passed by its shareholders;
 - (b) all the equity shares, if any, held by the proposed allottees in the issuer are in dematerialised form;
 - (c) the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement with the recognised stock exchange where the equity shares of the issuer are listed;
 - (d) the issuer has obtained the Permanent Account Number of the proposed allottees.
- (2) The issuer shall not make preferential issue of specified securities to any person who has sold any equity shares of the issuer during the six months preceding the relevant date:

Provided that in respect of the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, the Board may grant relaxation from the requirements of this sub-regulation, if the Board has granted relaxation in terms of regulation 29A of the Securities and Exchange



Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 to such preferential allotment.

Disclosures.

- (1) The issuer shall, in addition to the disclosures required under section 173 of the Companies Act, 1956 or any other applicable law, disclose the following in the explanatory statement to the notice for the general meeting proposed for passing special resolution:
 - (a) the objects of the preferential issue;
 - (b) the proposal of the promoters, directors or key management personnel of the issuer to subscribe to the offer;
 - (c) the shareholding pattern of the issuer before and after the preferential issue;
 - (d) the time within which the preferential issue shall be completed;
 - (e) the identity of the proposed allottees, the percentage of post preferential issue capital that may be held by them and change in control, if any, in the issuer consequent to the preferential issue;
 - (f) an undertaking that the issuer shall re-compute the price of the specified securities in terms of the provision of these regulations where it is required to do so;
 - (g) an undertaking that if the amount payable on account of the re-computation of price is not paid within the time stipulated in these regulations, the specified securities shall continue to be locked-in till the time such amount is paid by the allottees.
- (2) The issuer shall place a copy of the certificate of its statutory auditor before the general meeting of the shareholders, considering the proposed preferential issue, certifying that the issue is being made in accordance with the requirements of these regulations.
- (3) Where specified securities are issued on a preferential basis to promoters, their relatives, associates and related entities for consideration other than cash, the valuation of the assets in consideration for which the equity shares are issued shall be done by an independent qualified valuer, which shall be submitted to the recognised stock exchanges where the equity shares of the issuer are listed:

Provided that if the recognised stock exchange is not satisfied with the appropriateness of the valuation, it may get the valuation done by any other valuer and for this purpose it may obtain any information, as deemed necessary, from the issuer.
- (4) The special resolution shall specify the relevant date on the basis of which price of the equity shares to be allotted on conversion or exchange of convertible securities shall be calculated.

Explanation: For the purpose of sub-regulation (3), the term 'valuer' has the same meaning as is assigned to it under clause (r) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Issue of Sweat Equity) Regulations, 2002.

Allotment pursuant to special resolution.

- (1) Allotment pursuant to the special resolution shall be completed within a period of fifteen days from the date of passing of such resolution:

Provided that where any application for exemption from the applicability of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 or any approval or permission by any regulatory authority or the Central Government for allotment is pending, the period of fifteen days shall be counted from the date of order on such application or the date of approval or permission, as the case may be:

Provided further that where the Board has granted relaxation to the issuer in terms of regulation 29A of

SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, shall be made by it within such time as may be specified by the Board in its order granting the relaxation:

Provided further that requirement of allotment within fifteen days shall not apply to allotment of specified securities on preferential basis pursuant to a scheme of corporate debt restructuring as per the corporate debt restructuring framework specified by the Reserve Bank of India.

- (2) If the allotment of specified securities is not completed within fifteen days from the date of special resolution, a fresh special resolution shall be passed and the relevant date for determining the price of specified securities under this Chapter will be taken with reference to the date of latter special resolution.

Tenure of convertible securities.

The tenure of the convertible securities of the issuer shall not exceed eighteen months from the date of their allotment.

Pricing of equity shares.

- (1) If the equity shares of the issuer have been listed on a recognised stock exchange for a period of six months or more as on the relevant date, the equity shares shall be allotted at a price not less than higher of the following:
 - (a) The average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the twenty six weeks preceding the relevant date; or
 - (b) The average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.
- (2) If the equity shares of the issuer have been listed on a recognised stock exchange for a period of less than twenty six weeks as on the relevant date, the equity shares shall be allotted at a price not less than the higher of the following:
 - (a) the price at which equity shares were issued by the issuer in its initial public offer or the value per share arrived at in a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, pursuant to which the equity shares of the issuer were listed, as the case may be; or
 - (b) the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the period shares have been listed preceding the relevant date; or
 - (c) the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.
- (3) Where the price of the equity shares is determined in terms of sub-regulation (2), such price shall be recomputed by the issuer on completion of twenty six weeks from the date of listing on a recognised stock exchange with reference to the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during these twenty six weeks and if such recomputed price is higher than the price paid on allotment, the difference shall be paid by the allottees to the issuer.
- (4) Any preferential issue of specified securities, to qualified institutional buyers not exceeding five in number, shall be made at a price not less than the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.



Explanation: For the purpose of this regulation, 'stock exchange' means any of the recognised stock exchanges in which the equity shares are listed and in which the highest trading volume in respect of the equity shares of the issuer has been recorded during the preceding six months prior to the relevant date.

Payment of consideration.

- (1) Full consideration of specified securities other than warrants issued under this Chapter shall be paid by the allottees at the time of allotment of such specified securities:

Provided that in case of a preferential issue of specified securities pursuant to a scheme of corporate debt restructuring as per the corporate debt restructuring framework specified by the Reserve Bank of India, the allottee may pay the consideration in terms of such scheme.

- (2) An amount equivalent to at least twenty five per cent of the consideration determined in terms of regulation 76 shall be paid against each warrant on the date of allotment of warrants.
- (3) The balance seventy five per cent. of the consideration shall be paid at the time of allotment of equity shares pursuant to exercise of option against each such warrant by the warrant holder.
- (4) In case the warrant holder does not exercise the option to take equity shares against any of the warrants held by him, the consideration paid in respect of such warrant in terms of sub-regulation (2) shall be forfeited by the issuer.

Lock-in of specified securities.

- (1) The specified securities allotted on preferential basis to promoter or promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to promoter or promoter group, shall be locked-in for a period of three years from the date of allotment of the specified securities or equity shares allotted pursuant to exercise of the option attached to warrant, as the case may be:

Provided that not more than twenty per cent of the total capital of the issuer shall be locked-in for three years from the date of allotment:

Provided further that equity shares allotted in excess of the twenty per cent shall be locked-in for one year from the date of their allotment pursuant to exercise of options or otherwise, as the case may be.

- (2) The specified securities allotted on preferential basis to persons other than promoter and promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to such persons shall be locked in for a period of one year from the date of their allotment.
- (3) The lock-in of equity shares allotted pursuant to conversion of convertible securities other than warrants, issued on preferential basis shall be reduced to the extent the convertible securities have already been locked-in.
- (4) The equity shares issued on preferential basis pursuant to a scheme of corporate debt restructuring as per the Corporate Debt Restructuring framework specified by the Reserve Bank of India shall be locked-in for a period of one year from the date of allotment:
Provided that partly paid up equity shares, if any, shall be locked-in from the date of allotment and the lock-in shall end on the expiry of one year from the date when such equity shares become fully paid up.
- (5) If the amount payable by the allottee, in case of re-calculation of price under sub-regulation (3) of regulation 76 is not paid till the expiry of lock-in period, the equity shares shall continue to be locked in till such amount is paid by the allottee.
- (6) The entire pre-preferential allotment shareholding of the allottees, if any, shall be locked-in from the relevant date upto a period of six months from the date of preferential allotment.

Explanation: For the purpose of this regulation:

- (I) The expression “total capital of the issuer” means:
 - (a) equity share capital issued by way of public issue or rights issue including equity shares issued pursuant to conversion of specified securities which are convertible; and
 - (b) specified securities issued on a preferential basis to promoter or promoter group.
- (II) (a) For the computation of twenty per cent. of the total capital of the issuer, the amount of minimum promoters’ contribution held and locked-in, in the past in terms of Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000 or these regulations shall be taken into account.
- (b) The minimum promoters’ contribution shall not again be put under fresh lock-in, even though it is considered for computing the requirement of twenty per cent of the total capital of the issuer, in case the said minimum promoters’ contribution is free of lock-in at the time of the preferential issue.

Transferability of locked-in specified securities and warrants issued on preferential basis.

Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 1997, specified securities held by promoters and locked-in in terms of sub-regulation (1) of regulation 78 may be transferred among promoters or promoter group or to a new promoter or persons in control of the issuer.

Provided that lock-in on such specified securities shall continue for the remaining period with the transferee.

PRIVATE PLACEMENTS

In recent years, the predictable phases of company development - and the accompanying stages of financing - have changed dramatically. During the “bull market years” of the late 1990s, many small private companies began to grow at accelerated rates and, with a strong IPO market as a driving force, entered the public arena rapidly to continue to further their growth. However, as the IPO market began to lose steam, companies looked for alternative sources of financing.

While an initial public offering is a suitable option for many private companies ready to make that significant jump, going public is not always the logical next step for others. Depending on the nature of a company’s business, along with its unique financial needs and goals, a private placement may make more sense.

A private placement is the sale of securities to a limited number of qualified private investors. While an IPO is the initial sale of shares to the general public, a typical private placement is offered only to institutional investors and accredited individuals and entities that meet certain eligibility requirements.

For companies, private placements can provide an infusion of cash more quickly and less expensively than a public offering. Private placements are also generally not subject to public disclosure obligations. They typically allow companies to have a great deal of control over the process - the company can decide how much to sell, at what price, and to whom. However, those decisions do require a tremendous amount of due diligence and careful deliberation.

For investors, securities purchased through a private placement typically fall into the realm of alternative assets - investments that often have a low correlation to public markets and offer essential diversification to portfolios dominated by traditional stocks and bonds. Private placements also may give investors more control of their private equity allocations. Unlike venture capital - which usually takes the form of funds raised by venture capital firms and invested in portfolios of private companies - investments through private placements are made on an individual basis.



Private Placement

The sale of securities to a relatively small number of select investors as a way of raising capital. Investors involved in private placements are usually large banks, mutual funds, insurance companies and pension funds. Private placement is the opposite of a public issue, in which securities are made available for sale on the open market.

Private placements are exempt from the registration requirements of the federal Securities Act of 1933 and public disclosure requirements as long as certain requirements are met. The sale of securities through private placements cannot involve any public offering, public solicitation, or advertising. In addition, private placements must comply with state laws and anti-fraud provisions of securities laws. Companies must disclose to potential investors all of the pertinent information needed to make a fully informed decision.

Securities sold through private placement securities can take different forms. Typically, they involve the sale of either debt or equity.

Private Placement - Benefits

One of the benefits of private placement securities is the relatively low cost of issuing the securities. Unlike a public offering, there is no need to involve brokers or underwriters in the sale of the options. Small businesses may also find this approach helpful in terms of maintaining confidentiality. Since the offering does not have to be registered with the same level of detail as a public offering, the business can offer investors the opportunity to remain anonymous to all but a few directly involved with the sale.

Private placements are good options for companies that need to generate capital but, for whatever reasons, aren't suitable for venture capital or a public offering. As noted previously, private placements can enable companies to raise capital more quickly and in a less costly manner than a public offering. A company may also wish to avoid the consuming task of meeting public disclosure obligations required when making a public offering.

While public offerings also impose minimum issue sizes, private placements generally involve smaller transactions than IPOs. The typical candidate for a private placement has established a proven track record of success and shown readiness to advance to the next stage of growth. The company should be a compelling investment opportunity.

Private companies considering private placements need to assess whether they possess certain crucial elements. The company should have several key positions filled with top-notch managers, particularly in sales. It should anticipate a strong future growth rate and potential exit strategy for investors.

Private Placements - Investors

Investments in private placements carry a high degree of risk for various reasons. Securities sold through private placements are not publicly traded and, therefore, are less liquid. Additionally, investors may receive restricted stock that may be subject to holding period requirements. Companies seeking private placement investments tend to be in earlier stages of development and have not yet been fully tested in the public marketplace.

Investing in private placements requires high risk tolerance, low liquidity concerns, and long-term commitments. Investors must be able to afford to lose their entire investment. For those reasons, these offerings may be made available only to certain institutional investors and high net worth individuals and entities. As with all alternative investments, investors must meet certain eligibility tests to qualify as purchasers. Currently, entities must have assets of at least \$5 million (or all individual owners meet accredited investor tests). Individuals must have a net worth of more than \$1 million or gross income for each of the last two years of at least \$200,000 (\$300,000 with spouse) with the expectation of the same income in the current year.

Investors should also be mindful that the company may require more capital in the future to continue

growing, with no guarantee that it will be successful in securing it. But investors may reap huge rewards for the risks - most importantly, the potential for high returns. Also, because of the long timeframe, investments made now won't be affected by current market volatility.

Private Placements - Working Mechanism

A company seeking a private placement issues a Private Placement Memorandum, or PPM. The PPM details the company's financial situation and business plan, as well as any other pertinent information about the company and the offering. However, a great deal of preparation is required before the PPM is issued. The first step is to consult attorneys who specialize in private placements. They should oversee all of the paperwork included in the PPM to help to ensure that the company is meeting SEC and state requirements during the process.

Although potential investors will typically conduct independent research, companies should be careful about how they promote themselves in the PPM. Investors may try to bring suit against the issuer if they feel that the company failed to live up to representations made in the PPM.

An investment bank typically acts as an intermediary between the company issuing the PPM and potential investors. Once investors decide to invest, they complete a subscription agreement.

In today's increasingly varied business landscape, different company circumstances require different financing solutions. Private placements are opportunities for companies to generate capital and grow their businesses without going public, while offering investors early access to promising companies.

Both company owners and potential investors must devote a great deal of time and effort to successfully complete a private placement, but both also stand to gain considerably from this type of investment vehicle.

1.1.2. Sweat Equity, ESOP, ESPS and Shares with Differential Voting Rights

Issue of Sweat Equity [Section 79A]

Meaning of Issue of Sweat Equity

Sweat equity shares means 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 property rights or value additions, by whatever name called. (Explanation II to Section 79A)

Conditions for Issue of Sweat Equity

According to Section 79A(1), a company may issue sweat equity shares if the following conditions are fulfilled, namely:

- (a) **Class** the shares must belong to a class of shares already issued;
- (b) **Special Resolution** the issue must be authorised by a special resolution passed by the company in the general meeting;
- (c) **Contents of Resolution** the resolution must specify the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;
- (d) **Completion of 1 year** At least 1 year must have elapsed since the date on which the company was entitled to commence business;
- (e) **As per SEBI Guidelines** the sweat equity shares of a company whose equity shares are listed on a recognised stock exchange must be issued in accordance with the regulations made by the Securities and Exchange Board of India in this behalf:

Provided that in the case of a company whose equity shares are not listed on any recognised stock exchange, the sweat equity shares are issued in accordance with the guidelines as may be prescribed.



Meaning of Company for the Purpose of Section 79A

The expression “a company means the company incorporated, formed and registered under this Act and includes its subsidiary company incorporated in a country outside India”.

Applicability of Other Provisions

All the limitations, reiterations and provisions relating to equity shares shall be applicable to such sweat equity shares.

Effect of Sec. 79A

Sec. 79A applies irrespective of anything contained in Sec. 79.

Employees Stock Option Scheme (ESOS)

‘Employee stock option’ means the option given to the whole time directors, officers or employees of a company which gives such directors, officers or employees the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a pre-determined price [Section 2(15A), added by the Companies (Amendment) Act, 2000]. The SEBI has issued guidelines for ESOS of listed companies. These guidelines are also applicable for Employee Stock Purchase Scheme (ESPS) which means a scheme under which the company offers shares to employee as part of public issue or otherwise.

SEBI Guidelines, in this regard, inter alia, provide as follows:

1. No ESOS shall be offered unless the disclosures, as specified in Schedule IV, are made by the company to the prospective option grantees and the company constitutes a Compensation Committee for administration and superintendence of the ESOS. Compensation committee shall be a committee of the Board of directors consisting of a majority of independent directors.
2. Issue of stock options at a discount to the market price would be regarded as another form of employee compensation and would be treated as such in the financial statements of the company regardless of the quantum of discount on the exercise price of the options.
3. Subject to the aforesaid financial treatment ESOS would not be covered by the pricing provisions of SEBI's preferential allotment regulations.
4. The issue of ESOS would be subject to approval by shareholders through a special resolution.
5. There would be no restriction on the maximum number of shares to be issued to a single employee. However, separate resolution in general meeting shall be obtained in case of; (a) employees being offered equal to or more than 1% shares during any one year; (b) grant of option to employees of subsidiary or holding company.
6. A minimum period of one year between grant of options and its vesting has been prescribed. After one year, the period during which the option can be exercised would be determined by the company. Company may specify a lock in period.

The employee shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to him, till shares are issued on exercise of option.

7. The operation of the ESOS scheme would have to be under the superintendence and directions of a Compensation Committee.
8. ESOS would be open to all permanent employees (whether working in India or abroad) and to the directors (whole-time or part-time) of the company but not to: (i) employee who is a promoter or belongs to the promoter group; (ii) a director who either by himself or through his relatives or through anybody corporate holds more than 10% of the outstanding equity shares of the company. With the specific approval

of the shareholders, the Scheme would be allowed to cover the employees of a subsidiary or a holding company.

9. Directors report shall contain the following disclosures:

- (i) the total number of shares covered by the ESOS as approved by the shareholders;
- (ii) the pricing formula;
- (iii) options granted, options vested, options exercised, options forfeited, extinguishment or modification of options, money realized by exercise of options, total number of options in force, employee-wise details of options granted to senior managerial personnel and to any other employee who receive a grant in any one year of options amounting to 5% or more of options granted during that year.
- (iv) fully diluted earnings per share (EPS) computed in accordance with international accounting standards.

10. Company may vary the terms of ESOS by passing a special resolution provided variation:

- (i) relates to options not yet exercised;
- (ii) is not prejudicial to the interests of option holders.

11. Option granted to an employee shall not be transferable to any person.

12. Options granted cannot be pledged, hypothecated, mortgaged or otherwise alienated in any other manner.

13. In the event of death, options granted to an employee shall vest in the legal successor/nominee.

14. In case of permanent incapacity, all options granted shall vest in him as on the date of incapacitation.

15. Auditor to certify that the scheme has been implemented as per guidelines. Certificate of the auditor to be placed at AGM.

16. By virtue of the powers under Section 11 read with Section 11A of the Securities and Exchange Board of India Act, 1992, SEBI has made amendments to ESOS/ESPS guidelines and Listing Agreement as per Circular CIC/CFD/DIL/3/2013.

As per clause 22B, no ESOS/ESPS of listed companies shall involve acquisition of securities from the secondary market.

Further to this circular, listed entities are required to do the following:

- 1. If their ESOS/ ESPS involves dealing of securities in secondary market, such companies will be required to inform the details of their schemes to the Stock Exchanges within 30 days from date of this circular, in the format provided in Annexure II (ie., 17.02.2013).
- 2. Also, they shall align their ESOS / ESPS with the new rule on or before 30.06.2013

EMPLOYEE STOCK PURCHASE SCHEME [ESPS]

A. Eligibility to participate in ESPS

- 1. An employee shall be eligible to participate in ESPS of the company.
- 2. An employee who is a promoter or belongs to the promoter group shall not be eligible to participate in the ESPS.
- 3. A director who either by himself or through his relatives or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company shall not be eligible to participate in the ESPS.



B. Shareholder Approval

1. No ESPS can be offered to employees of a company unless the shareholders of the company approve ESPS by passing a special resolution in the general meeting.
2. The explanatory statement to the notice shall specify:
 - (a) the price of the share and also the number of shares to be offered to each employee.
 - (b) the appraisal process for determining the eligibility of employee for ESPS.
3. The number of shares offered may be different for different categories of employees.
4. The special resolution shall state that the company shall conform to the specified accounting policies.

C. Pricing and Lock-in

1. The company shall have the freedom to determine price of shares to be issued under an ESPS.
2. Shares issued under an ESPS shall be locked-in for a minimum period of one year from the date of allotment.
3. If the ESPS is part of a public issue and the shares are issued to employees at the same price as in the public issue, the shares issued to employees pursuant to ESPS shall not be subject to any lock-in.

D. Disclosure and Accounting Policies

The Directors' Report or Annexure thereto shall contain, inter alia, the following disclosures:

- (a) the details of the number of shares issued in ESPS;
- (b) the price at which such shares are issued;
- (c) employee-wise details of the shares issued to;
 - (i) senior managerial personnel;
 - (ii) any other employee who is issued shares in any one year amounting to 5% or more shares issued during that year;
 - (iii) identified employees who were issued shares during any one year equal to or exceeding 1% of the issued capital of the company at the time of issuance;
- (d) diluted earnings per share (EPS) pursuant to issuance of shares under ESPS; and
- (e) consideration received against the issuance of shares.

E. Preferential Allotment

Nothing in these guidelines shall apply to shares issued to employees in compliance with the SEBI Guidelines on Preferential Allotment.

F. Listing

In case of listed companies, the shares arising pursuant to an ESOS and shares issued under an ESPS, shall be eligible for listing in any recognized stock exchange only if such scheme (i.e., ESOS or ESPS) is in accordance with these Guidelines.

Note- By virtue of the powers under Section 11 read with Section 11A of the Securities and Exchange Board of India Act, 1992, SEBI has made amendments to ESOS/ESPS guidelines and Listing Agreement as per Circular CIC/CFD/DIL/3/2013.

As per clause 22B, no ESOS/ESPS of listed companies shall involve acquisition of securities from the secondary market.

Further to this circular, listed entities are required to do the following:

1. If their ESOS/ ESPS involves dealing of securities in secondary market, such companies will be required to inform the details of their schemes to the Stock Exchanges within 30 days from date of this circular, in the format provided in Annexure II (ie., 17.02.2013).
2. Also, they shall align their ESOS / ESPS with the new rule on or before 30.06.2013

Eligibility Conditions for Issue of Equity Shares with Differential Voting Rights

- (a) Distributable profits:** The Company must have distributable profits for 3 financial years preceding the relevant financial year.
- (b) No default in filing requirements:** The company must not have defaulted in filing of annual accounts and annual returns for 3 financial years preceding the relevant financial year.
- (c) No failure in payment of debts etc.:** The company must not have defaulted in—
 - (i) repayment of deposits or interest thereon; or
 - (ii) redemption of debentures (i.e., non-payment of interest on debentures does not disqualify a company from issuing shares with differential voting rights); or
 - (iii) payment of dividend (i.e., non-declaration and consequent non-payment of dividend does not disqualify a company from issuing shares with differential voting rights).
- (d) No conviction:** The company is not convicted for any offence under—
 - (i) Securities and Exchange Board of Indian, 1992 (SEBI Act)
 - (ii) Securities (Contracts) Regulation Act, 1956 (SCRA)
 - (iii) Foreign Exchange Management Act, 1999 (FEMA)

Approval for Issue

- (a) Articles' Authorisation:** Specific power in articles is required.
- (b) Ordinary Resolution:** Ordinary Resolution must be passed by postal ballot if the company is listed company.
- (c) Requirements of Notice:** The notice shall be accompanied by an explanatory statement. Contents of the explanatory statement shall be as follows:
 - (i) The rate of voting right such shares shall carry.
 - (ii) The scale or proportion to which the voting rights of such shares will vary.

Conditions

- (a) Conversion not permissible:** Conversion of equity share capital with differential voting rights into equity share capital without differential voting rights or vice versa is not permissible.
- (b) Maximum limit:** The shares with differential voting rights shall not exceed 25% of the total share capital issued.
- (c) Rights of members:** The members holding shares with differential voting rights shall be entitled to bonus shares and right shares of the same class.
- (d) Other rights:** The members holding shares with differential voting rights shall enjoy all other rights to which any other member is entitled to.
- (e) Procedural requirements:** The register of member shall contain the particulars of differential rights to which the holder of such shares is entitled to.



1.3.3 Preference Shares – various provisions

PREFERENCE SHARE - Meaning

According to Section 85 of the Companies Act, 1956, a preference share is one which carries the following two rights:

1. **a right to receive dividend** at a stipulated rate or of a fixed amount before any dividend is paid on equity shares; and
2. **a right to receive repayment** of capital on winding up of the company, before the capital of equity shareholders is returned.

Issue and Redemption of Preference Shares

There must be specific provisions in the articles of association empowering the board to issue preference shares, as well as setting out the terms and conditions subject to which such preference shares can be issued. The legal framework for this is set out in Section 80 of the act. The maximum period for which preference shares can be issued shall not exceed 20 years (according to Section 80A). This means that preference shares must be redeemed within a period of 20 years from the date of issue and companies are prohibited from issuing irredeemable preference shares. It is also necessary to ensure that the authorized capital of the company provides for issue of preference shares. If not, Clause V of the memorandum of association (ie, the capital clause) must be amended before issuing preference shares

The articles may set down terms and conditions subject to which preference shares can be issued. Such conditions should include the following;

- Such preference shares shall be redeemed out of the profits of the company which are otherwise available for dividends or out of the proceeds of a fresh share issue made specifically for redemption.
- No such shares shall be redeemed unless they are fully paid.
- If payable on redemption, the premium shall be provided out of the company's profits or the company's security premium account before the shares are redeemed.
- Where shares are redeemed otherwise than from the proceeds of a fresh issue, the company is required to transfer, out of the profits of the company which would otherwise be available for dividends, to a capital redemption reserve account a sum equal to the nominal amount of shares redeemed. The reserve account is treated as if it were paid-up share capital. This is based on the fundamental principle that the capital of the company must be maintained intact. The subscription made to the capital of a company cannot be taken back, but can be converted into liquid cash by the sale of relative shares in the market. For the same reason, the redemption of preference shares must be done only out of the company's profits. Such redemption is an exception to the prohibition contained in Section 77 of the act as the company cannot buy its own shares.
- The articles may also provide for other terms and methods of redeeming preference shares. This may include:
 - whether the preference shares are convertible into equity shares of the company;
 - the timing of conversion or redemption, or whether this is at the option of the company;
 - whether the dividend payable is cumulative or non-cumulative; and
 - whether redemption will be made in installments by drawing lots or in full as the board may decide in accordance with the articles.

In the case of cumulative preference shares, the fixed dividend accumulates to the credit of the preference shareholder.

Redemption of Redeemable Preference Shares [Section 80]

Which Company can Issue Redeemable Preference Shares?

A Company limited by shares may, if authorised by its Articles, issue redeemable preference shares.

Can a Company Issue Irredeemable Preference Shares after the commencement of the Companies (Amendment) Act, 1988?

No Company limited by shares shall issue irredeemable preference shares. [Section 80(5A)]

What can be the Maximum Period of Redemption?

After the commencement of the Companies (Amendment) Act, 1988, no company limited by shares shall issue any preference share which is redeemable after the expiry of a period of 20 years from the date of issue. [Section 80(5A)]

What are the Restrictions on the Redemption of Redeemable Preference Shares ?

According to Section 80, the redemption of preference shares is subject to the following restrictions:

- (i) **Fully paid**—Such shares can be redeemed only if they are fully paid,
- (ii) **Two Sources of Redeeming such shares**

Such shares can be redeemed only out of the following two sources:

- (a) **Divisible Profits** i.e. Profit available for distribution as dividend. Some of the examples of Divisible Profits are as under:

1. General Reserve	2. Reserve Fund
3. Dividend Equalisation Fund	4. Insurance Fund
5. Workman's Compensation Fund	6. Workman's Accident Fund
7. Profit and Loss Account	

- (b) **Proceeds of fresh issue of shares** (whether Equity or Preference) made for the purpose of redemption.

What constitute the proceeds is explained as follows:

In case of fresh issue of shares	What constitute the proceeds.....
(a) At Par	Nominal value of shares issued
(b) At Premium	Nominal value of shares issued
(c) At Discount	Net amount received (i.e., Nominal Value less discount on issue of shares)

Note: These shares may be Equity shares or Preference shares.

- (iii) **Two Sources of providing Premium** if any, payable on redemption.

The premium, if any, payable on redemption must be provided for out of any of the following two sources:

- (a) Securities Premium Account
- (b) Profits (whether divisible or not) e.g. Capital Reserve

- (iv) **Transfer to CRR A/c**—Where any such shares are redeemed out of divisible profits, an amount equivalent to the nominal value of the shares so redeemed, must be transferred out of divisible profits to **Capital Redemption Reserve Account**.

- (v) **Utilization of CRR**—The Capital Redemption Reserve Account may be applied by the company in issuing fully paid bonus shares to the members of the company.



- (vi) The provision of this Act relating to the reduction of share capital of a company shall apply to Capital Redemption Reserve Account as if it is paid up share capital of the company. [Section 80(1)(d)]

Does the Redemption of Preference Shares Constitute Reduction of Authorised Share Capital?

The redemption of preference shares by a company shall not be taken as reducing the amount of its authorised share capital. [Section 80(3)]

Has Company Power to Issue New Shares?

Where in pursuance of this section, a company has redeemed or is about to redeem any preference shares, it shall have power to issue shares upto the nominal amount of the shares redeemed or to be redeemed as if these shares have never been issued. [Section 80(4)]

Does the Issue of New Shares Constitute an Increase of Authorised Share Capital?

For the purpose of calculating the fees payable u/s 611, the share capital shall not be deemed to be increased by the issue of new shares before the redemption of old shares, if the old shares are redeemed within 1 month after the issue of the new shares. [Section 80(4)]

Penalties for Contravention

If a company fails to comply with the provisions of Section 80, the Company and every officer of the company who is in default shall be punishable with fine which may extend to ₹ 10,000. [Section 80(6)]

1.3.4. Share Capital – alteration, reduction, consolidation, conversion, sub-division, increase, forfeiture, cancellation and surrender of shares

Alteration of Share Capital Clause [Sec. 94 to sec. 97]

The provisions relating to the alteration of Share Capital are given below:

- 1. Authority in Articles:** A limited company having a share capital may alter the Capital Clause of its memorandum only if it is authorised by its articles of association to do so. [Section 94(1)]
- 2. Manner of Alteration:** A company may alter the Capital Clause in the following manner:
 - (a) by increasing its nominal share capital by issue of new shares; [e.g. from 1 crore to 5 crore]
 - (b) by consolidating the existing shares into shares of larger amount than its existing shares; [e.g. Conversion of Shares of ₹ 10 each into shares of ₹ 100 each]
 - (c) by Converting fully paid shares into stock or vice versa;
 - (d) by sub-dividing the existing shares into shares of smaller amount than its existing shares; [e.g. Conversion of shares of ₹ 100 each into shares of ₹ 10 each]
 - (e) by cancelling its unissued shares.

Note: A cancellation of shares under Section 94 shall not be deemed to a reduction of share capital within the meaning of the Act.

- 3. Ordinary Resolution:** An ordinary resolution is required to be passed at its general meeting. [Section 9(2)]
- 4. Notice to Registrar within 30 days:** A notice specifying alteration made must be given to the Registrar within 30 days of alteration. [Sections 95(1) and 97(1)]
- 5. Duty of Registrar:** The Registrar shall make the necessary alteration in the memorandum or articles or both. [Section 95(2)]
- 6. Consequences of Default:** If default is made in filing the notice as aforesaid, the company and every officer in default must be punishable with the fine upto ₹ 500 for every day during which the default continues. [Sections 95(3) and 97(3)]

- 7. Inapplicability of Provisions to Stock:** Where a company has converted any of its shares into stock, such provisions of the Act as are applicable to shares shall cease to apply to such shares which have been converted into stock. [Section 96]
- 8. Notice of Increase:** Notice of increase in authorised capital or number of members beyond registered number in case of a company not limited by shares must be given to the Registrar. [Section 97]

Note: Notice of increase must be given to the registrar even when the new shares may not have been issued to any shareholder. [Mahalaxmi Mills Co. Ltd. v. State, (1969) Comp. Case 342]

Increase of Share Capital

Sec. 94A. Share capital to stand increased where an order is made under section 81(4):

- (1) Notwithstanding anything contained in the Companies Act, where the Central Government has, by an order made under sub-section (4) of section 81, directed that any debenture or loan or any part thereof shall be converted into shares in a company, the conditions contained in the memorandum of such company shall, where such order has the effect of increasing the nominal share capital of the company, stand altered and the nominal share capital of such company shall stand increased by an amount equal to the amount of the value of the shares into which such debentures or loans or part thereof has been converted.
- (2) Where, in pursuance of an option attached to debentures issued or loans raised by the company, any public financial institution proposes to convert such debentures or loans into shares in the company, the Central Government may, on the application of such public financial institution direct that the conditions contained in the memorandum of such company shall stand altered and the nominal share capital of such company shall stand increased by an amount equal to the amount of the value of the shares into which such debentures or loans or part thereof has been converted.
- (3) Where the memorandum of a company becomes altered, whether by reason of an order made by the Central Government under sub-section (1) of section 81 or sub-section (2) of this section, the Central Government shall send a copy of such order to the Registrar and also to the company and on receipt of such order, the company shall file in the prescribed form, within thirty days from the date of such receipt, a return to the Registrar with regard to the increase of share capital and the Registrar shall, on receipt of such order and return, carry out the necessary alterations in the memorandum of the company.

Sec.97. Notice of Increase of Share Capital or of Members:

- (1) Where a company having a share capital, whether its shares have or have not been converted into stock, has increased its share capital beyond the authorised capital, and where a company, not being a company limited by shares, has increased the number of its members beyond the registered number, it shall file with the Registrar, notice of the increase of capital or of members within thirty days after the passing of the resolution authorising the increase ; and the Registrar shall record the increase and also make any alterations which may be necessary in the company's memorandum or articles or both.
- (2) The notice to be given as aforesaid shall include particulars of the classes of shares affected and the conditions, if any, subject to which the new shares have been or are to be issued.
- (3) If default is made in complying with this section, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to five hundred rupees for every day during which the default continues.



Procedure for increasing Share Capital

The following procedure has to be followed by a limited company having a share capital, for increasing its authorised share capital:

1. The company has to make sure that its articles of association contain a provision authorising it to increase its authorised share capital. If there is no such provision then the company has to take steps for alteration of its articles of association in accordance with the provisions of section 31 of the Companies Act, 1956, so as to provide for increase in the share capital of the company before increasing its authorised share capital.
2. Issue notice in accordance with the provisions of Section 286 of the Act for convening a Board meeting.
3. Hold the meeting—
 - (i) to decide about the increase in the authorised share capital of the company;
 - (ii) to fix time, date and venue for holding general meeting of the company to pass an ordinary resolution for increasing the authorized share capital of the company [Refer Section 94(2)];
 - (iii) to approve notice, agenda and explanatory statement to be annexed to the notice of the general meeting as per Section 173(2) of the Act;
 - (iv) to authorise the company secretary to issue, on behalf of the Board, notice of the general meeting as approved by the Board.
4. Soon after the conclusion of the Board meeting, send to the stock exchanges, where the securities of the company are listed, particulars of the proposed increase in the authorised share capital of the company.
5. Issue notice of the general meeting to all members, directors and the auditors of the company.
6. In case of a listed company forward three copies of the notice of the general meeting to the concerned stock exchanges as per the Listing Agreement.
7. Hold the general meeting and pass ordinary/special resolution the resolution for increasing the authorised share capital of the company [Refer Section 94(2)];
8. Forward a copy of the proceedings of the general meeting to the concerned stock exchange as per the Listing Agreement.
9. File with the Registrar within thirty days of passing of the resolution, if it is a special resolution, e-form 23 with a certified true copy of the special resolution passed at the general meeting along with a copy of the explanatory statement annexed to the notice of the general meeting, copy of altered Memorandum of Association and Articles of Association, and the prescribed filing fee.
10. File with ROC, e-form 5 along with the registration fee on increased authorised capital as per rates prescribed under Schedule X to the Act within 30 days of the passing of the resolution.

The mandatory attachments along with e-form 5 are:

- (a) Altered memorandum of association
- (b) Altered articles of association
- (c) Proof of receipt of Central Government order, if any for increase of authorized share capital.

Note:

- Stamp duty on e-Form 1, Memorandum of Association (MOA) and Articles of Association (AOA) can be paid electronically through MCA portal and in such case submission of physical copies of the uploaded e-Form 1, MoA and AoA to the office of the ROC is not required.

- Payment of stamp duty electronically through MCA portal is mandatory in respect of the States which have authorized the Central Government to collect stamp duty on their behalf. In respect of the States from whom the authorization is yet to be received, the company will continue to pay stamp duty outside the MCA portal. List of states/union territories for which stamp duty cannot be paid electronically is available on the website of MCA.
 - In case stamp duty is not paid electronically through MCA portal, it is required to deliver simultaneously the original stamped physical copies of the uploaded e-Form 1, MoA and AoA along with a copy of challan/receipt in the concerned office of RoC failing which such e-Form shall be put into "Waiting for user clarification" in term of Regulation 17 of the Companies Regulations, 1956
 - Refund of stamp duty, if any, will be processed by the respective state or union territory government in accordance with the rules and procedures as per the state or union territory Stamp Act.
11. In the case of a listed company, forward six copies (one of them certified) of the amendment to the memorandum to all the stock exchanges, where the securities of the company are listed.
 12. Alter the capital clause in all the copies of the memorandum and articles of association of the company lying in the office of the company so that no unaltered copy thereof be issued to any person.

FORFEITURE OF SHARES

Meaning of Forfeiture of Shares

Forfeiture of shares is compulsory termination of membership of a member and confiscation of his shares as a penalty for non-payment of a call or other sum due on shares.

Power to Forfeit Shares in Articles of Association

Power to forfeit the shares can be exercised only if the Articles expressly so provide. Such power must be exercised bona fide (i.e., in good faith) and for the benefit of the company. It must not be collusive or fraudulent. Such power should not be exercised to expel a member or relieve a friend or relative from liability. Such power must be exercised, strictly according to the procedure stated in the Articles.

Grounds for Forfeiture of Shares in Articles of Association

The Articles may provide for forfeiture of shares not only for non-payment of call but also for other grounds say non-compliance of any other arrangement according to the prescribed condition. But such grounds must not be opposed to statute or public policy. [Calcutta Stock Exchange v. S.N. Nandy & Co., (1950) (Cal)]

In Naresh Chander Sanyal v. The Calcutta Stock Exchange, (1971) (SC), where the Articles provide for forfeiture if a member failed to carry out the arrangement according to the prescribed conditions. The forfeiture was held to be valid.

Procedure for a Valid Forfeiture

Regulations 29,30,31 and 34 of Table A of Schedule I of the Companies Act, 1956 provides for the procedure to be followed for forfeiture:

1. **As per Articles:** Power of forfeiture must be exercised only on the basis of various grounds specified in Articles.
2. **Notice:** Notice must be served upon the defaulting member. Such notice must—
 - (a) require the member to pay unpaid call together with an accrued interest (if any)
 - (b) mention a day at least 14 days ahead from the date of service of the notice on or before which the payment is required to be made.



- (c) state that if the payment is not made on or before the date mentioned in the notice, the shares in respect of which call was made would be liable to be forfeited.

Note: A notice is deemed to be served if sent by registered post with acknowledgement due (A.D.) at the registered address of the members. But where a notice, though sent, came back unserved, the company must make enquiry at the proper address of the member whose shares are to be forfeited.

- 3. Board's Resolution:** The Board of directors must pass a resolution before actual forfeiture is exercised.

Effects of Forfeiture

1. On forfeiture of shares, member ceases to be a member of the company.
2. Liability of Ex-member

If the Company goes into liquidation	Liability of Ex-Members
(a) Within 1 year of forfeiture	He may be put on 'B' list of contributories
(b) After 1 year but within 3 years of forfeiture	He may be held liable as an ordinary debtor but not as a contributor.

3. Reduction of Capital Forfeiture of shares results in reduction of capital unless the shares are reissued.
4. Forfeited shares become the property of the company.
5. The annual return must specify the total number of shares forfeited [Section 159]

Re-issue of Forfeited Shares

1. The forfeited shares may be reissued in accordance with the provision of Articles.
2. The reissue does not amount to allotment. It is merely a sale of forfeited shares. Hence, no return is to be filed in respect of reissue of forfeited shares.
3. Re-issue price cannot be less than the amount unpaid on those shares.
4. Profit on reissue of partly paid up forfeited shares belong to the company and not to the defaulter.
5. Profit on re-issue of fully paid up forfeited shares may be refunded to the defaulter. [Naresh Chandra Sanyal v. The Calcutta Stock Exchange]

STOCK

Meaning of Stock

"Stock" is an aggregate of fully paid shares which have been legally consolidated. The consolidated amount is divisible into fractions of any amount, regardless of the nominal value of the shares that have been consolidated. It thus represents a part of the fully paid capital of the company.

Conditions for Conversion of Share into Stock [Sec. 94(1)(c)]

- (a) A company must be limited by shares.
- (b) Articles must authorise the conversion of share into stock.
- (c) Ordinary resolution must be passed in a general meeting,
- (d) Shares must be fully paid up.
- (e) The notice of conversion must be given to the Registrar within 30 days of the conversion.

Note: All the provisions which are applicable to shares only, shall cease to apply as to so much of share capital as is converted into stock. [Sec. 96]

Reconversion of Stock into Shares

- (1) A limited company that has converted paid-up shares into stock (before the repeal by this Act of the power to do so) may reconvert that stock into paid-up shares of any nominal value.
- (2) A company may exercise the power conferred by this section only if its members have passed an ordinary resolution authorising it to do so.
- (3) A resolution under subsection (2) may authorise a company to exercise the power conferred by this section—
 - (a) on more than one occasion;
 - (b) at a specified time or in specified circumstances.

Notice to registrar of reconversion of stock into shares

- (1) If a company exercises a power conferred by section 620 (reconversion of stock into shares) it must within one month after doing so give notice to the registrar, specifying the stock affected.
- (2) The notice must be accompanied by a statement of capital.
- (3) The statement of capital must state with respect to the company's share capital immediately following the exercise of the power—
 - (a) the total number of shares of the company,
 - (b) the aggregate nominal value of those shares,
 - (c) for each class of shares—
 - (i) prescribed particulars of the rights attached to the shares,
 - (ii) the total number of shares of that class, and
 - (iii) the aggregate nominal value of shares of that class, and
 - (d) the amount paid up and the amount (if any) unpaid on each share (whether on account of the nominal value of the share or by way of premium).
- (4) If default is made in complying with this section, an offence is committed by—
 - (a) the company, and
 - (b) every officer of the company who is in default.
- (5) A person guilty of an offence under this section is liable on summary conviction to a fine not exceeding level 3 on the standard scale and, for continued contravention, a daily default fine not exceeding one-tenth of level 3 on the standard scale.

Sub-Division or Consolidation of Shares

- (1) A limited company having a share capital may—
 - (a) sub-divide its shares, or any of them, into shares of a smaller nominal amount than its existing shares, or
 - (b) consolidate and divide all or any of its share capital into shares of a larger nominal amount than its existing shares.
- (2) In any sub-division, consolidation or division of shares under this section, the proportion between the amount paid and the amount (if any) unpaid on each resulting share must be the same as it was in the case of the share from which that share is derived.



- (3) A company may exercise a power conferred by this section only if its members have passed a resolution authorising it to do so.
- (4) A resolution under subsection (3) may authorise a company—
 - (a) to exercise more than one of the powers conferred by this section;
 - (b) to exercise a power on more than one occasion;
 - (c) to exercise a power at a specified time or in specified circumstances.
- (5) The company's articles may exclude or restrict the exercise of any power conferred by this section.

Notice to registrar of sub-division or consolidation

- (1) If a company exercises the power conferred by section 618 (sub-division or consolidation of shares) it must within one month after doing so give notice to the registrar, specifying the shares affected.
- (2) The notice must be accompanied by a statement of capital.
- (3) The statement of capital must state with respect to the company's share capital immediately following the exercise of the power—
 - (a) the total number of shares of the company,
 - (b) the aggregate nominal value of those shares,
 - (c) for each class of shares—
 - (i) prescribed particulars of the rights attached to the shares,
 - (ii) the total number of shares of that class, and
 - (iii) the aggregate nominal value of shares of that class, and
 - (d) the amount paid up and the amount (if any) unpaid on each share (whether on account of the nominal value of the share or by way of premium).
- (4) If default is made in complying with this section, an offence is committed by—
 - (a) the company, and
 - (b) every officer of the company who is in default.
- (5) A person guilty of an offence under this section is liable on summary conviction to a fine not exceeding level 3 on the standard scale and, for continued contravention, a daily default fine not exceeding one-tenth of level 3 on the standard scale.

Cancellation of Shares

According to clause (e) of Sub-section (1) of Section 94 of the Companies Act, 1956, a limited company having a share capital may, if so authorised by its articles, cancel its shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

Sub-section (2) of Section 94 of the section lays down that the powers conferred by this section shall be exercised by the company in general meeting and shall not require confirmation by court.

A cancellation of shares in pursuance of this section shall not be deemed to be a reduction share capital within the meaning of the Companies Act. Infact, this is known as diminution of share capital. [Refer Section 94(3)].

Here the cancellation of shares means cancellation of shares of a particular unissued class of shares and not the paid up share capital.

Section 95(1) of the Act makes it obligatory on the part of a limited company having share capital, which has cancelled any share capital, to give notice thereof to the Registrar, within thirty days of the passing of the resolution, specifying the shares cancelled and the Registrar shall record the same in the memorandum of the company. Sub-section (2) of this section says that the Registrar shall thereupon record the notice, and make any alterations which may be necessary in the company's memorandum or articles or both.

Surrender of Shares

Surrender of shares is voluntary return of shares for the purpose of cancellation.

Power to accept Surrender of Shares In Articles

Power to accept the surrender of shares can be exercised only if the Articles expressly so provide.

Condition for a Valid Surrender of Shares

Surrender of shares in accordance with Articles is valid—

- (a) in case of partly paid up shares if it is accepted to avoid the formalities for a valid forfeiture only. [Bellerby v. Rowland & Marwood's Steamship & Co. Ltd. (1902)]
- (b) in case of fully paid up shares, if it is accepted in exchange of new shares of the same nominal value. [Rowellv, John Rowell & Sons Ltd. (1912)]

Invalid Surrender of Shares

The surrender of shares is invalid if—

- (a) it involves reduction of share capital
- (b) it amounts to a purchase by the company of its own shares
- (c) it releases the member from further liability in respect of shares. [Collector of Muradabad v. Equity Insurance Company, (1948)]

Effects of Surrender of Shares

Surrender of shares has the same effect as forfeiture of shares has.

Distinction between Forfeiture and Surrender of Shares

Forfeiture of shares differs from surrender of shares in the following respects:

Basis of Distinction	Forfeiture of Shares	Surrender of Shares
1. Meaning	Forfeiture of shares is compulsory termination of membership of a penalty for non-payment of a call.	Surrender of shares is a voluntary return of shares for the purposes of cancellation.
2. Instance	It is at the instance of company.	It is at the instance of member.
3. Purpose	Its purpose is to penalise the defaulter.	Its purpose is to avoid the formalities for a valid forfeiture.
4. Notice	Notice precedent to forfeiture is required.	No such notice is required.
5. Provision in the Act & Table A	Both the Act and Table A provide for forfeiture.	Both the Act and Table A are silent on surrender.



1.3.5. Buy Back of Shares [Section 77A]

Meaning of Buy-back of Shares

The term buy-back of shares implies the act of purchasing its own shares by a company.

Three Sources of Funds for Buy-Back [Section 77 A(1)] A company may purchase its own shares or other specified securities out of—

- (i) its free reserves; or
- (ii) the securities premium account; or
- (iii) the proceeds of any shares or other specified securities;

Provided that 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,

"Specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time.

Buy-back from Whom? [Section 77A(5)] The buy-back may be—

- (a) from the existing security holders on a proportionate basis; or
- (b) from the open market; or
- (c) from odd lots, that is to say, where the lot of securities of a public company, whose shares are listed on a recognised stock exchange, is smaller than such marketable lot, as may be specified by the stock exchange; or
- (d) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

Conditions for Buy-Back [Section 77A(2)]

1. **Authorised by Articles**—The buy-back must be authorized by the **Articles**
2. **Special Resolution/Board's Resolution**—The **special resolution** must be passed in the General Meeting of shareholders.
OR
The Board must pass a resolution at its meeting where the buy-back does not exceed 10% of the total equity paid up capital and free reserves of the company.
3. **Minimum Time Interval between Two buy-back**—No offer of buy back must be made within a period of 365 days from the date of preceding offer of buy-back.
4. **Overall Maximum Limit**—The buy-back of the shares must not exceed 25% of total paid-up capital and free reserves.
5. **Maximum Limit of Buy-back in any Financial Year**—The buy-back of equity shares in any financial year must not exceed 25% of its total paid up equity capital
6. **Maximum Debt-Equity Ratio**—The debt-equity ratio must not be more than 2:1 after such buy-back.

Here Debt = Secured + Unsecured Debt and Equity = Capital + Free Reserves
Free Reserves = Free Reserves as per Sec 372A + Securities Premium as per Sec 78.
7. **Fully Paid Shares**—All the shares for buy-back must be fully paid-up.
8. **Time Limit**—The buy-back must be completed within 12 months from the date of passing the Special Resolution/Board's Resolution.

- 9. Solvency Declaration**—The company must file solvency declaration with the Registrar and SEBI in the form of an affidavit signed by at least two directors of the company. The affidavit must state that the Board has made full inquiry into the affairs of the company as a result of which they have formed an opinion that the company is capable of meeting its liabilities and will not render insolvent within a period of one year from the date of declaration adopted by the Board [77A(6)].
- 10. Transfer of Certain Sums to Capital Redemption Reserve Account**—Where a company purchases its own shares out of free reserves, than a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account referred to in Clause (d) of the proviso to Sub-section (1) of Section 80 and details of such transfer shall be disclosed in the balance sheet.
- 11. As per SEBI Guidelines**—Buy-back must be as per SEBI Guidelines

Proportionate Buy-back

In case the number of securities tendered for buy-back are more than the number of securities to be bought back, the number of securities to be bought back from each member shall be determined as follows:

$$= \frac{\text{Acceptance tendered to a Member}}{\text{Total Acceptance tendered to all Members}} \times \text{No. of Securities to be bought back}$$

Extinguishment of Certificates within 7 days [Sec 77A(7)] Where a company buys-back its own shares, it must extinguish and physically destroy the securities so bought back within 7 days of the last date of completion of buy-back in the presence of merchant bankers or Registrar or Statutory auditor.

No Further issue within a Period of 6 Months [Section 77A(8)] Where a company completes a buy-back of its shares or other specified securities under this section, it must not make further issue of same kind of shares (including allotment of further shares under section 81 (1) (a) or other specified securities within a period of 6 months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

Register of Buy-back Securities [Section 77A(9)] Where a company buys back its securities under this section, it must maintain a register of the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.

Filing of Buy-back Return [Section 77(A)(10)] A company must, after completion of the buy-back under this section, file with the Registrar and the SEBI, a return containing prescribed particulars.

Provided that no return is to be filed with the SEBI by a company whose shares are not listed on any recognised stock exchange.

Prohibition of Buy-back in Certain Circumstances [Section 77B] No company shall directly or indirectly purchase its own shares or other specified securities—

- (a) through any subsidiary company including its own subsidiary companies; or
- (b) through any investment company or group of investment companies; or
- (c) if a default, by the company, in repayment of deposit or interest payable thereon, redemption of debentures or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institutions or bank, is subsisting; or
- (d) in case such company has not complied with provisions of Sections 159, 207 and 211.

Penalty for Default [Section 77A(11)] In case of default the company or its officer in default shall be punishable with imprisonment for a term upto 2 years, or with fine upto ₹ 50,000 or with both.



Procedure before Buy-back [Section 77A(3)] The notice of the meeting at which special resolution is proposed to be passed must be accompanied by an explanatory statement stating—

- (a) a full and complete disclosure of all the 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 invested under the buy-back; and
- (e) the time limit for completion of buy-back.

1.3.6. Reduction of Share Capital [Section 100 to 105]

Meaning of Reduction of Share Capital

Reduction of share capital may involve reduction in respect of that portion of:

- (a) issued capital which has been subscribed, called up and paid up, or
- (b) issued capital which has been subscribed but not called up.

To which Company the Restriction as to Reduction of Share Capital applies

The restriction as to reduction of share capital apply to the following two companies:

- (a) A company limited by shares
- (b) A company limited by guarantee having share capital.

Thus, such restrictions do not apply to unlimited companies whether having share capital or not and companies limited by guarantee not having share capital.

Manner of Capital Reduction

A company may reduce its share capital in any way and in particular:

- (a) by extinguishing or reducing the liability of members in respect of capital not paid up. e.g. where the shares of ₹ 100 each with ₹ 75 paid up are reduced to ₹ 75 fully paid up shares, the shareholders are relieved from liability on the uncalled capital of ₹ 25 per share.
- (b) by cancelling any paid up share capital which is lost or is unrepresented by available assets, with or without extinguishing or reducing liability of members.
- (c) by paying off any paid up share capital which is in excess of the wants of the company with or without extinguishing or reducing liability.

Example I: Where the fully paid shares of ₹ 100 each are reduced to ₹ 75 fully paid up shares and ₹ 25 are returned to the members. Thus, in this case nominal value of the share is reduced and not merely the paid up value.

Example II: Where the fully paid shares of ₹ 100 each are reduced to ₹ 75 paid up and ₹ 25 are returned to the members on the condition that when required, the company may call it up again. Thus, in this case the paid up value of share is reduced and not the nominal value.

Note: Interest of creditors is really involved only in the circumstances referred to in (a) and (c).

Procedure for Reduction of Capital

The procedure for reducing the capital is given below:

- 1. Authorised by Articles** The articles must authorise the company to reduce the share capital. If the articles do not so authorise, then these must be altered by a special resolution first.

Note: It is not enough to provide this authority in the Memorandum.

2. Special Resolution A special resolution must be passed at a general meeting.

3. Court's* Confirmation After passing the special resolution, the company has to apply to the court for an order confirming the reduction.

Mandatory and Discretionary Powers of the Court*: The mandatory and discretionary powers of the Court* are as under:

- (i) After the petition for the court's confirmation has been filed, the Court* must settle the list of creditors who are entitled to object in accordance with Section 101(2)(a) (e.g. the creditors having a debt or claim admissible on a winding up). [Section 101(2)(b)]
- (ii) For settling the list of creditors, the court* must ascertain the names of those creditors and the nature and amount of their debts or claims. [Section 101(2)(b)]
- (iii) 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. [Sec 101(2)(b)]
- (iv) Where a creditor entered on the list whose debt or claim is not discharged or has not determined does not consent to the reduction, the court* may dispense with the consent of that creditor if the company secures the payment of his debt or claim by appropriating the full amount or the amount fixed by the court. [Section 101(2)(c)]
- (v) 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 class(s) of creditors. [Section 101(3)]

Note: Special circumstances must be such as would convince the court* that with reasonable foresight it can be said the proposed reduction of capital would not adversely affect the relevant creditor and would not render him any worse off than if he had attended and objected to the application for confirmation.

[Re Lucanic Tempscule Billard Hall (London) Ltd., 1965 3 All E.R. 879]

- (vi) The court* may make an order confirming the reduction on such terms and conditions as it think fit if the court is satisfied that either the consent of every creditor who is entitled to object to the reduction, has been obtained or his debt or claim has been discharged or has been determined or has been secured. [Section 102(1)]
- (vii) The court* may order that the words 'And Reduced' be added to the name of the company for a certain period. [Section 102(2)(a)]
- (viii) The court* may require the company to publish, the reason for the reduction and the causes which led to the reduction. [Section 102(2)(b)]

4. Registration of Order and Minutes of Reduction

- (i) The Registrar must register the order and minute—
 - (a) on the production of an order of the court* confirming the reduction of the share capital, and
 - (b) on the delivery of a certified copy of the order and of a minute approved by the court*. [Section 103(1)]
- (ii) On the registration of the order and minute and not before, the resolution shall become effective. [Section 103(2)]
- (iii) The notice of registration must be published in such a manner as the court* may direct. [Section 103(3)]
- (iv) The Registrar shall issue a certificate which shall be conclusive evidence that all the requirements



of the Act as to the reduction have been complied with and that the share capital is such as is stated in the minute. [Section 103(4)]

- (v) The minutes shall be deemed to be substituted for the corresponding part of the memorandum thereby altering the memorandum within the meaning of Section 40. [Section 103(5) and (6)]

- 5. Liability of Members in Case of Reduced Share Capital [Section 104]:** On the reduction of share capital the extent of the liability of any past or present member on any call or contribution shall not exceed the difference between (a) the amount already paid on the share or the reduced amount if any which is deemed to have been paid thereon by the member and (b) the amount of the shares as fixed by the minute of the reduction.

In the event any creditor entitled to object to the reduction of capital is not entered on the list of creditors by reason of his ignorance and after such reduction, the company is unable to pay his debt or claim:

- (a) every member at the time of registration of court's* order for reduction, shall be liable to contribute for the payment of that debt or claim an amount not exceeding the amount which he would have contributed on the day before registration of the order.
- (b) In case the company is wound up, the court* on the application by the creditor and on proof of his ignorance may settle a list of contributories and make and enforce calls and orders on the contributories settled on the list as if they were ordinary contributories in a winding up.

It is further provided that, if any officer of the company conceals the name of any creditor entitled to object to the reduction, he shall be liable to be punished with imprisonment up to one year, or with fine or with both [Section 105].

[*Tribunal as per Companies (Second Amendment) Act, 2002.]

Distinction between Reduction of Share Capital and Diminution of Share Capital

Reduction of capital may involve reduction in respect of issued capital which has been subscribed but not called up and paid up, or issued capital which has been subscribed but not called up but diminution involves cancellation of that portion of the issued capital which has not been subscribed. [Section 94(1)(e)]

Reduction of share capital differs from the diminution of share capital in the following respects:

Basis of Distinction	Reduction of Share Capital	Diminution of Share Capital
1 . Relevant Section	Section 100 to 104	Section 94
2. Which capital is involved	It involves reduction in respect of issued capital which has been subscribed.	It involves reduction in respect of authorised capital.
3. Nature of resolution required	It requires a special resolution. [Section 100]	It requires an ordinary resolution. [Section 94]
4. Court's Confirmation	It requires Court's* confirmation. [Section 101]	It does not require Court's confirmation [Section 94(2)]
5. Alteration of M/A	It does not involve alteration of capital clause of M/A.	It involves alteration of capital clause of M/A.
6 . Order for 'and reduced' words	The court may order to add the words 'And Reduced' to the name of the company. [Section 102(3)]	No such provision exists in this case.

7. Documents to be filed with the Registrar	It requires the registration of the following with the Registrar: (a) the court's* order confirming reduction (b) minutes approved by the court	It requires only a notice to the Registrar.
8. Time limit for filing the documents with the Registrar	There is no time limit specified in the Act for filing the documents with the Registrar.	Notice to Registrar must be given within 30 days from the date of cancellation.
9. Can Creditors object?	Yes. Creditors can object since their interests are affected.	No. Creditors cannot object since their interest are not affected.

Cases not requiring Compliance of Sec. 100 to 104.

The compliance of Sec. 100 to 104 is not required in the following cases:

1. Purchase of own shares by a company in pursuance of an order made by CLB u/s 402 (Under section 402, the CLB has the power to direct the company to purchase the shares of any member and effect consequent reduction of capital in order to end oppression or mismanagement. The requirements of Sec. 100 to 104 are not required to be complied with in such a case).
2. Buy-back of shares u/s 77A
3. Redemption of Preference Shares u/s 80
4. Diminution or Cancellation of Capital u/s 94.
5. Forfeiture of Shares
6. Surrender of Shares

1.3.7. Debentures

Debenture includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of a company or not as defined in Sec. 2(12) of the Companies Act. This is an inclusive definition and amounts to borrowing of monies from the holders of debentures on such terms and conditions subject to which the debentures have been issued. Basically it is a document or certificate signed by the authorized officers of a company acknowledging money lent and guaranteeing repayment with interest and creating security on the assets of the company for due performance of its obligation. This is a debt instrument and is the commonest method of raising loan capital, as part of project financing. Debentures may be redeemable as envisaged in the Companies Act or mandatorily convertible wholly into the equity shares of a company as envisaged under FEMA. While the articles of a company should contain an enabling provision for issue of debentures and creation of security therefore by the Board, the quantum of such issue should be adequately covered by a borrowing resolution of its shareholders under section 293(1)(d) of the Companies Act, 1956 (the Act).

Issue of Debentures and creation of Security

Debentures are commonly issued in a similar manner as shares by means of a prospectus inviting applications, the money being usually payable by instalments on application, allotment and on specified dates. The power to issue debentures rests with the Board of Directors (Sec. 292). Debentures may be issued at par, at a premium or at a discount, unless the Articles specifically forbid issue of debentures at a discount.

The company must complete and keep ready for delivery the debenture certificates within 3 months of allotment, unless the terms of the issue provide a longer period (Section 113).



A company which issues debentures is under an obligation to create security therefor pursuant to section 117A of the Act by executing trust deed. The need for executing a trust deed will arise when a company wants to issue a prospectus or letter of offer to the public for securing subscription to its debentures and for this purpose should appoint one or more debenture trustees. The above documents should state that the debenture trustees have consented to be appointed as such as required by section 117B of the Act. Thus a debenture trustee enjoys a unique position of being an independent entity unconnected with the issuer of security but appointed to protect the interest of holders of debentures.

Provisions Regulating Issue of Debentures

The power to issue debentures can be exercised on behalf of the company at a meeting of the Board of Directors [Section 292(1)(b) of the Companies Act]. A public company may, however, require the approval of shareholders to borrow money in excess of the aggregate of its paid up capital and free reserves [Section 293 (1) (d)]. Consent of the shareholders would also be required for selling, leasing or disposing of the whole or substantially the whole of the undertaking of the company under section 293 (1) (a).

The attributes of a debenture are:

- a. A movable property.
- b. Issued by the company in the form of a certificate of indebtedness.
- c. It generally specifies the date of redemption, repayment of principal and interest on specified dates.
- d. May or may not create a charge on the assets of the company.

Section 372 A of the Companies Act also regulates inter-corporate loan and investments and stipulates the ceiling limits on investments and the amount of loan that can be borrowed by a company. The explanation clause of this section states that the loan shall include debentures.

Section 117 to Sections 123 of the Companies Act, 1956 regulate the provisions relating to debentures, appointment of debenture trustees, their duties, creation of Debenture Redemption Reserve Account, liability of trustees etc.

The debentures issued under the Act shall not carry any voting rights. In the case of public issue of debentures, there would be a large number of debenture holders on the register of the company. As such it shall not be feasible to create charge in favour of each of the debenture holder. A common methodology generally adopted is to create Trust Deed conveying the property of the company. A Trust deed is an arrangement enabling the property to be held by a person or persons for the benefit of some other person known as beneficiary. The Trustees declare the Trust in favour of the debenture holders. The Trust Deed may grant the Trustees fixed charge over the freehold and leasehold property while a floating charge may be created over other assets. The Company shall allow inspection of the Trust Deed and also provide copy of the same to any member or debenture holder of the company on payment of such sum as may be prescribed. Failure to provide the same would invite penalties by way of fine under the Act. Any provision contained in the Trust Deed, which exempts a Trustee from liability for breach of Trust, is void.

As per Section 125 (4) of the Companies Act, registration of a charge for purpose of issue of debentures is mandatory. Section 128 stipulates that where a company issues series of debentures which is secured by charge, benefit of which will be available to all debenture holders *pari passu*, the company shall file the prescribed particulars in Form 10 and 13 with the Registrar of Companies for registration of charge. These forms shall be filed within 30 days after the execution of the deed.

Appointment and Duties of Debenture Trustees

In terms of Section 117 B, it has been made mandatory for any company making a public/rights issue

of debentures to appoint one or more debenture trustees before issuing the prospectus or letter of offer and to obtain their consent which shall be mentioned in the offer document. The Debenture Trustees shall not:

- a. beneficially hold shares in a company.
- b. be beneficially entitled to monies which are to be paid by the company to the debenture trustees.
- c. enter into any guarantee in respect of principal debt secured by the debentures or interest thereon.

This section also lists the functions that shall be performed by the Trustees. These include:

- i. Protecting the interests of the debenture holders by addressing their grievances.
- ii. Ensuring that the assets of the company issuing debentures are sufficient to discharge the principal amount.
- iii. To ensure that the offer document does not contain any clause which is inconsistent with the terms of the debentures or the Trust Deed.
- v. To ensure that the company does not commit any breach of the provisions of the Trust Deed.
- v. To take reasonable steps as may be necessary to undertake remedy in the event of breach of any covenant in the Trust Deed.
- vi. To convene a meeting of the debenture holders as and when required.

If the debenture trustees are of the opinion that the assets of the company are insufficient to discharge the principal amount, they shall file a petition before the Central Government and the latter may after hearing the parties pass such orders as is necessary in the interests of the debenture holders. As per the SEBI (Debenture Trustees) Regulations, 1993, [hereinafter referred to as the 'Regulations'] a Debenture Trustee can be a scheduled bank, an insurance company, a body corporate or a public financial institution.

Debenture Trust Deed

A Debenture Trust Deed shall, interalia, include the followings:

- a. An undertaking by the company to pay the Debenture holders, principal and interest.
- b. Clauses giving the Trustees the legal mortgages over the company's freehold and leasehold property.
- c. Clauses that may make the security enforceable in the event of default in payment of principal or interest i.e. appointment of receiver, foreclosure, sale of assets etc.
- d. A clause giving the Trustees the power to take possession of the property charged when security becomes enforceable.
- e. Register of Debenture holders, meeting of all debenture holders and other administrative matters may be included in the Deed.

In addition thereto, the SEBI regulations have laid format of the Trust Deed in Schedule IV to the regulations.

Some of the important provisions would include:

- f. Time limit of creation of security for issue of debentures.
- g. Obligations of the body corporate towards the debenture holders.
- h. Obligations towards the debenture holders - equity ratio and debt service coverage ratio.
- i. Procedure for the inspection of charged assets by the Trustees.



Debenture Redemption Reserve

Section 117C of the Companies Act requires that every company issuing debentures should create DRR for the purpose of redemption of debentures to which adequate amounts should be credited from the profits of the company until debentures are redeemed. This is a mandatory provision. SEBI regulations also require companies issuing debentures to provide for DRR as required under the Companies Act.

The Act, however, does not stipulate the time period for creation of security. SEBI regulations provides for creation of security within six months from the date of issue of debentures and if a company fails to create the security within 12 months, it shall be liable to pay 2% penal interest to the debenture holders. If the security is not created even after 18 months, a meeting of the debenture holders will have to be called to explain the reasons thereof. Further, the issue proceeds will be kept in escrow account until the documents for creation of securities are executed between the Trustees and the company.

Even where debentures are compulsorily convertible into the equity shares of the debenture issuing company, as in the case of FEMA, creation of DRR is unavoidable till the date of conversion. However, after conversion of debentures, the amount in the DRR may be transferred to general reserve or in such other manner as the Board thinks fit and proper. The amount credited to DRR cannot be utilized except for the redemption of debentures. DCA Circular No. 9/2002 dated 18-4-2002 provides some relief as under in the matter of DRR in the case of banking Institutions, All India Financial Institutions, NBFCs and others keeping in view the genuine problems likely to be caused to these institutions :

- (a) No DRR is required for debentures issued by All India Financial institutions (AIFIs) regulated by RBI and banking companies for both public as well as privately placed debentures. For other FIs within the meaning of section 4A, DRR will be as applicable to NBFCs registered with RBI.
- (b) For NBFCs registered with RBI under section 45-1A of the RBI Act, [inserted by the RBI (Amendment) Act, 1997] the adequacy of DRR will be 50% of the value of debentures issued through public issue as per present SEBI (Disclosure and Investor Protection) Guidelines, 2000 and no DRR is required in the case of privately placed debentures.
- (c) For manufacturing and infrastructure companies, the adequacy of DRR will be 50% of the value of debentures issued through public issue and 25% for privately placed debentures.
- (d) Section 117C will apply to debentures issued and pending to be redeemed and such DRR is required to be created for debentures issued prior to 13.12.2000 and pending redemption subject to clarification issued herein.
- (e) Section 117C will apply to non-convertible portion of debentures issued whether they are fully or partly convertible. By another circular issued by DCA [General circular No. 4/2003 dated 16.1.2003] the requirement of DRR has been modified in the case of Housing Finance Companies. In the case of these companies registered with National Housing Bank under Housing Finance Companies (NHB) Directions, 2001 the adequacy of DRR will be 50% of the value of debentures through public issues and no DRR is required in the case of privately placed debentures.

It is also clarified by the DCA that since DRR will have to be carved out of profits of the company, there is no obligation to create DRR if there is no profit in a particular year. DRR is an insurance and it enables the issuer of security to redeem the debentures and fulfill its obligation. If, for any reason, the issuer of security fails to redeem the debentures, the aggrieved party may approach CLB/Tribunal which will issue a direction to the company to redeem the debentures forthwith together with interest. Failure to do so is punishable with imprisonment extending upto three years and fine of not less than five hundred rupees for each day of default (section 117C of the Act).

Default

In the event of failure on the part of the company to redeem the debentures on the date of maturity, the Company Law Tribunal may, on the application of any debenture holder, direct redemption of debentures forthwith by payment of principal and interest due thereon. If a default is made in complying

with the orders of the Tribunal, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to fine of not less than Rs.500/- for every day during which the default continues. (Section 117C) Further this offence is not compoundable under section 621A of the Act.

There are contradictions between the Companies Act and the SEBI regulations on issues relating to:

- a. Utilisation of Debenture Redemption Reserves. The Act provides that the Debenture Redemption Reserve will be used towards redemption of debentures only whereas the SEBI regulation states that these will be a part of the General Reserves, which can be utilised for the purpose of bonus issues.
- b. Any debentures issued with a maturity period of 18 months or less is exempted from the creation of Debenture Redemption Reserve Account, whereas no such exemption is provided under the Companies Act.
- c. No Public Issue/Rights Issue of Debentures shall be made by a company unless it has appointed one or more Debenture Trustees for such debentures whereas under SEBI guidelines, appointment of Debenture Trustees is compulsory only in case of debentures with maturity of 18 months or more.

A listed company though subjected to SEBI regulations must comply with stringent norms between the two legislations / regulations made there under.

Issue of Convertible Debentures or Raising of Loans [Sec. 81(3)]

With an Option to Convert Them into Shares

Scope of Sec. 81 (3)

Sec. 81 (3) permits a company to—

- (a) issue convertible debentures or loans; or
- (b) issue debentures or raise loans with an option to subscribe for new shares.

Conditions of Sec. 81 (3)

- (a) Power in terms of issue** — The terms of issue of such debentures or loans must contain term regarding conversion of such debentures or loans into shares.
- (b) Approval of CG** — The terms must be approved by Central Govt. before issue of such debentures or loans. However, the approval of Central Govt. is not required if the terms are as per Central Govt. Rules.
- (c) Special Resolution**— The terms must be approved by a special resolution.

Bonds

Bond is a negotiable certificate evidencing indebtedness. It is normally unsecured. A debt security is generally issued by a company, municipality or government. A bond investor lends money to the issuer and in exchange, the issuer promises to repay the loan amount on a specified maturity date. The issuer usually pays the bond holder periodic interest payments over the life of the bond.

Issue of Bonds

Bonds are issued by public authorities, credit institutions, companies and supranational institutions in the primary markets. The most common process for issuing bonds is through underwriting. When a bond issue is underwritten, one or more securities firms or banks, forming a syndicate, buy the entire issue of bonds from the issuer and re-sell them to investors. The security firm takes the risk of being unable to sell on the issue to end investors. Primary issuance is arranged by bookrunners who arrange the bond issue, have direct contact with investors and act as advisers to the bond issuer in terms of timing and price of



the bond issue. The bookrunner is listed first among all underwriters participating in the issuance in the tombstone ads commonly use to announce bonds to the public.

The bookrunners' willingness to underwrite must be discussed prior to any decision on the terms of the bond issue as there may be limited demand for the bonds.

In contrast, government bonds are usually issued in an auction. In some cases both members of the public and banks may bid for bonds. In other cases only market makers may bid for bonds. The overall rate of return on the bond depends on both the terms of the bond and the price paid. The terms of the bond, such as the coupon, are fixed in advance and the price is determined by the market.

In the case of an underwritten bond, the underwriters will charge a fee for underwriting. An alternative process for bond issuance, which is commonly used for smaller issues and avoids this cost, is the private placement bond. Bonds are sold directly to buyers and may not be tradeable in the bond market.

Different types of Bonds:

- 1) Zero coupon bond-This bond is issued at a discount and repaid at a face value. No periodic interest is paid at the time of maturity. The difference between the issue price and the redemption price represents the return of the holder. The maturity period of these bonds vary from 5 to 12 years. These bonds were first issued in India by Mahindra and Mahindra Ltd.
- 2) Deep discount bond-This bond is issued at a very high discount on its face value and face value is paid at the time of maturity. IDBI and SIDBI had issued this instrument. IDBI had issued deep discount bond of face value of ₹1 lac at a price of ₹2,700/- with a maturity period of 25 years. The bond appreciates to its face value over the maturity period of 25 years. Alternatively, the investor can withdraw from the investment periodically after 5 years.
- 3) Convertible Bond-A bond gives the investor the option to convert the bond into equity at a fixed conversion price.
- 4) Dual convertible bond-A dual convertible bond is convertible into either equity shares or debentures/preference shares at the option of the investor.
- 5) Stepped coupon bonds-Under stepped coupon bonds, the interest rates is stepped up or down during the tenure of the bond. The main advantage to the investor is the attraction of higher rate of interest in case general rise in interest.
- 6) Disaster Bonds-These are issued by companies and institutions to share the risk and expand the capital to link investors return with the size of investors losses, the smaller the return and vice-versa.
- 7) Easy exit bonds-Easy exit bonds are bonds which provide liquidity and easy exit route to the investor by way of redemption where investor can get ready encashment in case of need to withdraw before maturity.
- 8) Floating rate bonds and notes-In this case, interest is not fixed and is allowed to float depending upon market conditions. This instrument is used by the issuer to hedge themselves against the volatility in interest rates.
- 9) Capital Indexed Bonds- These bonds are inflation protection securities. Such bonds, therefore, provide good hedge against inflation risk. The return to the investors in these bonds is connected with the wholesale price index.
- 10) Commodity Bonds-Commodity bonds are bonds issued to share the risk and profitability of future commodity prices with the investors. For example, Petro bonds, gold bonds, silver bonds etc.
- 11) Industrial revenue bonds-These are issued by financial institutions in connection with the development of the industrial facilities. These may become attractive if certain income tax and wealth tax concessions are offered. The bond proceeds could be used to purchase or construct facilities which are subsequently leased or sold to the company.

1.3.8. Transfer and Transmission of Shares

Meaning of Transfer of Shares

Transfer of Shares means the voluntary conveyance of the ownership rights from a member who wishes to cease to be a member to a person who wishes to become a member. The shares or other interests of a member of company are movable properties transferable in the manner prescribed by the Articles of the company [Section 82]. The shares in a public company are freely transferable [Sec 111 A]. The articles of a public company cannot contain such absolute provision by which the right to transfer shares is altogether taken away. The right of a shareholder to transfer his shares in a company is absolute and inherent in the ownership of shares. [Thenappa Chettiar v. Indian Overseas Bank Ltd, (1943)13 Comp. as 2002]

Procedure for Transfer of Shares

In addition to comply with the provisions of the Articles, the following procedure must be followed before a company can lawfully register a transfer:

1. **Prescribed Form:** The instrument of transfer must be in the prescribed form i.e. Form No. 7B.
 2. **Presentation to the Prescribed Authority:** The instrument of transfer must be presented to the prescribed authority (i.e. the Registrar), before it is signed by the transferor or transferee and before any entry is made in it. The prescribed authority shall stamp or otherwise endorse on the instrument the date on which it is so presented.
 3. **Execution:** The instrument must—
 - (i) be duly stamped.
 - (ii) be executed by or on behalf of the transferor and the transferee
 - (iii) be completed in all respects
 - (iv) specify the name, address and occupation if any, of the transferee.
 - (v) be signed by both the transferor and the transferee.
 4. **Share Certificate/Letter of Allotment:** The instrument must be accompanied by share certificate or letter of allotment (if no such certificate is in existence).
 5. **Time Limit for Delivery:** The instrument must be delivered to the company for registration—
 - (i) In case of listed shares at any time before the date of closure of Register of Members for the first time after the date of the presentation to the prescribed authority, or within 12 months from the date of such presentation whichever is later.
 - (ii) In any other case, within 2 months from the date of presentation to the prescribed authority.
- Extension of Time Limit:** The Central Government is empowered to extend the aforesaid time limit on an application made either before or after the expiry of aforesaid period. [Section 108(1D)]
6. **Transfer by Legal Representative [Section 109]:** A legal representative of a deceased member although he may not be a member, can validly transfer shares.
 7. **Who can submit Transfer deed [Section 110]:** The transfer deed may be presented to the company by the transferor or transferee.
 8. **Notice in the Case of Transfer of Partly Paid Shares [Section 110]:** Where the transferor makes an application for registration of partly paid shares, transfer must not be registered unless the company gives notice of the application to the transferee and the transferee makes no objection to the transfer within 2 weeks from the receipt of the notice. [Section 110(2)]

Note: Notice to the transferee shall be deemed to have been duly given if it is despatched by prepaid registered post to the transferee at the address given in the instrument of transfer and



shall be deemed to have been duly delivered at the time at which it would have been delivered in the ordinary course of post. [Section 110(3)]

- 9. Time Limit for Registration of Transfer:** The Board of Directors considers the application and if found alright in all respects, registers the transfer. An endorsement is made on the back of the share certificate recognising the transferee as the new member. In Register of Members, the name of the transferor is strike off and the name of the transferee is entered. The share certificate is required to be despatched to the transferee within 2 months of the application for registration.

Notice of Refusal and Remedy against Refusal [Section 111]

- 1. Notice:** If a private company refuses to register a transfer, it must send the notice of refusal giving reasons to the transferor and the transferee, within 2 months of the date of delivery of the instrument of transfer.
- 2. Remedy:** The transferor or transferee may file an appeal with the Company Law Board as follows:

Refusal /failure	Time limit for Appeal
(a) Refusal to register the transfer	Within 2 months of the receipt of notice of refusal
(b) Failure to register within 2 months or for not giving reason for refusal	Within 2 months from the expiry of 2 months of date of delivery of instrument of transfer.

Note: There is no time limit in case of refusal by a public company.

- 3. Penalty:** For default in registration of transfer within 2 months or for not giving reason for refusal. The company and its every officer in default is punishable with fine upto ₹ 500 for every day of default.
- 4. Power of CLB:** The Company Law Board may either dismiss the appeal or direct the company to register the transfer within 10 days of the receipt of the order.
- 5. Penalty for Non-compliance of Order:** For default in complying with the CLB order, the company and its every officer in default is punishable with fine upto ₹ 10,000 and with a further fine of ₹ 1,000 for every day of continuing default.

Transfer of Securities of a Public Company [Section 111A]

- 1. The Board of directors** of a company or the concerned depository has no discretion to refuse or withhold transfer of any security. The transfer has to be effected by the company/depository automatically and immediately.
- 2. Right to Appeal:** Where the transfer of security effected in contravention of the SEBI Act, 1992 or SICA, 1985, a depository, company, participant or investor or SEBI may make an appeal to Company Law Board to rectify the register or records of the company or depository within 2 months from the date of transfer of securities or from the date on which the instrument of transfer or the intimation of transmission was delivered to the company as the case may be.
- 3. Power of CLB:** The Company Law Board—
 - (a) may direct the company or the depository to rectify the register or the records of ownership if after making enquiry, if it is satisfied that the contravention has taken place.
 - (b) may suspend the voting rights in respect of the securities subject to enquiry if enquiry has not yet completed.
- 4. Right of Transferee:** During the pendency of the application before the CLB, the transferee can transfer the security and such further transfer would entitle the transferee to voting rights also unless voting rights in case of transferee have also been suspended by CLB.

Certificate of Transfer [Section 112]

1. **Lodging Certificate:** Where a member wishes to transfer only a part of his shareholding or wishes to sell them to two or more persons, he is required to submit the share certificate with the company. This is known as lodging the certificate.
2. **Certification:** Where he has already submitted the share certificate alongwith an instrument of transfer for a part of his shareholding, he may request the company to certify on the instrument of the transfer that the share certification for the shares covered by the instrument of transfer has been lodged with the company. An act of noting on the instrument that share certificate in respect of shares to be transferred has been lodged with the company is called certification. An instrument of transfer shall be deemed to be certified if it bears the words 'Certificate lodged' or 'Certificate deposited' the words to the like effect. [Section 112(3)(a)]

Note: The company is under no obligation to certify any instrument of transfer of shares at all.

3. **Balance Ticket:** When only a part of the shares is transferred, the company issues a ticket for the balance of shares not transferred. Such a ticket is known as 'Balance Ticket'.
4. **What Certificate represents:** [Section 112(1)] Certification merely represents that the documents showing the prima facie title to the shares mentioned in the instruments have been produced to the company. It does not represent that the transferor has any title to the shares.
5. **Company's Liability:** The company will be responsible for the certification only if:
 - (a) the person issuing the instrument is authorised to issue such instrument on the company's behalf, and
 - (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.
6. **Liability in Case of Wrong Certification:** Where any person acts on the faith of an erroneous certification made by a company negligently, the company shall be liable to him in a manner as if the certification has been made fraudulently.

Practical Illustration: The secretary of X Ltd. after certifying the transfer negligently returns the original certificate to the transferor. If transferor pledges the same, the company shall not be liable to the pledgee because of two reasons:

- (i) it covers no duty to the pledgee,
- (ii) the immediate cause of his loss was not the issue of the certificate.

[Longman v. Bath Electric Tramways, (1905) Ch. 646]

Blank Transfer

Meaning of Blank Transfer

A transfer of shares is said to be blank if an instrument of transfer contains only the name and signature of the transferor and does not contain the name and signature of transferee and the date of sale.

Procedure for Blank Transfer

The transferor delivers to the buyer (a) share certificate; and (b) blank transfer deed.

Effect to Blank Transfer

(a) Option 1 — The buyer may become the owner of such shares

- (i) The buyer does not automatically become the owner of shares on receipt of the share certificate and the blank transfer deed,



- (ii) The buyer gets an implied authority to complete the transfer deed. He shall become the owner of shares only when —
- he completes the blanks in the blank transfer deed;
 - he delivers the share certificate and duly filled in transfer deed to the company for effecting transfer of shares in his name; and
 - the company registers the transfer of shares in the name of the buyer.
- (iii) When the name of the buyer is registered as a shareholder by the company, he shall acquire a good title to the shares notwithstanding the fact that shares were transferred to him under a blank transfer deed.
- (b) Option 2 — The buyer may transfer such shares**
- If the buyer does not intend to become the owner of such shares, and wants to further transfer such shares, he may do so merely by delivering the share certificate and blank transfer deed to a new buyer.
 - Similarly, the new buyer has the same 2 options, i.e., to become the owner shares, or to transfer such shares to another new buyer.

Transferee

- (a) The list holder of blank transfer deed will become the 'transferee' of shares, and no intervening buyer of shares shall be regarded as 'transferee'.
- (b) Until some buyer is registered as a shareholder, the original holder of shares (i.e., the transferor) shall continue to be the owner of the shares.

Validity Period

A blank transfer deed shall remain valid only for such period as is prescribed u/s 108.

Effects of Blank Transfers

1. Indefinite circulation of the instrument of transfer.
2. Avoidance of stamp duty on transfer.
3. Concealment of beneficial owners behind their nominees.
4. Evasion of tax by suppression of secret profit invested in holdings on blank transfer.

Present Position

Now, the blank instrument of transfer is required to be presented to the prescribed authority who will stamp the instrument alongwith the date of presentation. Such instrument can then remain in circulation for 12 months or upto the closure of the registrar of members whichever is later.

Forged Transfer

Meaning of Forged Transfer

The term 'forged transfer' means transfer of shares made on the basis of transfer deed on which the transferor's signatures are forged.

Forged transfer is void ab Initio

A forged transfer is a nullity (i.e., without any legal effect).

Rights of Parties

- (a) The transferee does not become the owner of such shares.
- (b) The original owner continues to be the shareholder.

- (c) Where a company has registered the transferee as a shareholder on the basis of a forged transfer, following consequences shall follow:
- (i) The original owner can compel the company to restore his name on the register of members.
 - (ii) The company may cancel the share certificate issued to the transferee, and consequently the transferee shall cease to be a member of the company,
 - (iii) Where the transferee has already transferred the shares to an innocent purchaser, the position will be as follows:
 - ✓ The company can refuse to register the new purchaser of shares, as a member.
 - ✓ However, the new purchaser of shares shall have a right to claim damages for the company.
 - ✓ The company shall have a right to recover damages from the person who had lodged the forged transfer deed.

Judicial Rulings

1. If a company registers a forged transfer and removes the name of the true owner from the Register of Members, the true owner can compel the company to restore his name to the register and can claim any dividend which may not have been paid to him during the intervening period. [Boston v. North Staffordshire Railway Co., 38 Ch. D. 456]
2. If a company registers a forged transfer and issues a new certificate to the subsequent buyer for value acting in good faith (i.e. without the knowledge of forgery), it would be liable to compensate him since it cannot deny the liability accruing from its own act. [**Balkin Consolidated Co. v. Tamkinser, (1982) A.C. 1961**]
3. If a transferee gets a certificate from the company on a forged transfer, he will be liable to indemnify the company against its liability to the true owner of the shares. [**Sheffield Corporation v. Barelly, (1905) B.C. 393**]
4. If a transferee without any negligence brings about a transfer he is liable to indemnify the company against its liability to the true owner of shares. [**Starkey v. Bank of England, (1903) A.C. 104**]
5. If a share certificate was issued fraudulently by forging the signatures of the directors, the share certificate was rendered void. Forgery is nullity and cannot be a source of a valid transfer of title and thus, it confers no rights upon a subsequent buyer and the company may deny being liable towards him. [**Rubben v. Great Fingal Consolidated Co.**]

Effects of Transfer

The transferee does not acquire a legal title to the shares until his name has been entered in the Register of Members. Position during the intervening period may be summarised as follows:

1. **Legal Title:** The transferor continues to be the legal owner of the shares but on the principle of equity he holds them in trust for the transferee.
2. **Call:** If any call is demanded by the company before transfer is registered, the transferor must pay the calls in the first instance and may later recover the amount from the transferee.
3. **Dividend:** If dividends are declared and paid before transfer is registered, the company must pay it to the transferor. The transferor is required to retain dividends where shares have been sold ex-dividend and is required to return dividends to transferee where shares have been sold-cum-dividend.



- 4. Voting Rights:** If voting rights are to be exercised before transfer is registered, the transferor must vote as the transferee directs where transferee has already paid the price and may vote as he likes where transferee has not paid the price.

Transmission of Shares [Sec 109]

Meaning of Transmission of Shares

Transmission of shares means the transfer of shares under the operation of law.

When does Transmission of Shares take place?

It takes place—

1. If a registered member dies, or
2. If a registered member is adjudged as insolvent, or
3. If a registered member being a company goes into liquidation.
4. If all the joint holders die where the shares are held jointly by 2 or more persons.

Effects of Transmission

1. Upon death, the shares of the deceased vest in his executors or administrators and the executors become liable for calls if shares are partly paid up.
2. Upon insolvency, the shares of the insolvent vest in the Official Assignee or the Receiver.
3. Upon liquidation of company, the shares vest in the Liquidator.
4. A person entitled to the shares on transmission becomes a member only when he makes an application in writing to the company and the company registers him as a member by entering his name in the Register of Members.

Other Provisions

1. No instrument of transfer is to be executed.
2. No stamp duty is payable.
3. It does not involve any consideration.
4. It is always subject to original liabilities attached to shares so transmitted.

Distinction between Transfer and Transmission

Transfer differs from transmission in the following respects:

Basis of Distinction	Transfer	Transmission
1. Results	Transfer is the result of deliberate act of a member.	Transmission is the result of operation of law on the death/insolvency of a member, or liquidation of a member being a company.
2. Instrument of transfer	Instrument of transfer is required to be executed.	No Instrument of transfer is required to be executed.
3. Stamp Duty	Stamp Duty is payable.	No Stamp Duty is payable.
4. Consideration	It generally involves consideration.	It does not involve any consideration.

1.4 INVESTMENTS, LOANS

1.4.1. Procedure for Inter-corporate loans, Investments, giving off guarantee and security

Investments

Meaning of 'investments' - The word 'Investments', in its natural connotation, would include any property or right in which money or capital is invested. However, we shall be using the word 'investments' in a limited sense to mean the investing of money in shares, stock, debentures or other securities. Investment in other assets does not seem to be covered under this head by the various provisions of the Companies Act in this regard.

Investments to be held in company's own name- According to sub-section (1) of section 49, investments made by a company (other than an investment company) on its own behalf shall be made and held by it in its own name.

The requirement that the investments made by the company must be held in its own name is confined to only those investments which are made by it on its own behalf. If the company makes investments on behalf of someone else, such investments need not be held in its own name. Thus, where the company is a trustee, the investment is supposed to be made on behalf of the beneficiaries of the trust and not on its own behalf. In such a case, there should be no objection to the investments being made by the company as the trustee but held in the name of the beneficiaries. Conversely, the mere fact that the trustee chooses to hold the shares in its own name cannot give rise to any legal inference that the trustee had made the investments on its own behalf.

Again, companies have been now allowed to hold investments in the name of a depository when such investments are in the form of securities held by the company as a beneficial owner.

Qualification shares in respect of nominee directors or nominee holders -Where a company has a right to nominate a director or directors on the Board of another company and the Articles of that company provide for 'share qualification' it would be open to the appointing or nominating company to hold the shares (i) in its own name, (ii) jointly in its own name and the name of appointee or nominee director, or (iii) exclusively in the name of the appointee or nominee.

Holding shares in a subsidiary in the name of nominee - As per section 49(3), a company may hold any share or shares in its subsidiary through nominee or nominees of the company if it is so required to ensure that the number of members of the subsidiary does not fall below the minimum number prescribed under the Act for public and private companies. It's through this enabling provision that a company can create a 100 per cent subsidiary.

The word "company" in the context will include a foreign company [Vide sections 53(1) and 4(6) of the Act].

Certificate or Letter of Allotment to be in the custody of the company - The certificate or letter of allotment relating to the shares or securities in which investments have been made by a company shall, except in two cases covered by subsections (4) and (5) be in the custody of such company or with the State Bank of India or a scheduled bank, being the bankers of the company [Section 49(6)].

Exemptions:

1. Sub-section (4) of section 49 exempts a company from the requirement of holding shares or securities on its own behalf and in its own name if its principal business consists of buying and selling of shares or securities.
2. In terms of the provisions of section 49(5), section 49(1) does not prevent a company:
 - (a) from depositing with the bank, being the bankers of the company, any shares or securities for collection of any dividend or interest payable thereon; or



- (b) from depositing with or transferring to, or holding in the name of, the State Bank of India or a scheduled bank, being the bankers of the company, shares or securities, in order to facilitate the transfer thereof. However, if within a period of 6 months from the date from which the shares or securities are transferred by the company to, or are first held by the company in the name of, the State Bank of India or a scheduled bank as aforesaid, no transfer of such shares or securities takes place, the company shall, as soon as practicable, after the expiry of that period, have the shares or securities retransferred to it from the State Bank of India or the scheduled bank or, as the case may be, again hold the shares or securities in its own name; or
- (c) from depositing with, or transferring to, any person any shares or securities, by way of security for the re-payment of any loan advanced to the company or the performance of any obligation undertaken by it.

Thus, it is not necessary for the company to hold the shares or stocks or debentures in its own name if they are deposited with the bank as aforesaid. A resolution of the Board of directors in this behalf is sufficient. The bank is entitled to have the shares or debentures registered in its own name with the specific purpose of collecting dividend or interest from the company whose shares or debentures are deposited with the bank. The company holding the investment in the name of the bank is only required to enter into a separate agreement with the bank that the latter will collect dividend and interest and credit the company with the amounts so collected. It may be noted that the deposit of shares, stocks and debentures with the bank need not be by way of a pledge but may be made for the specific object of enabling the banker to act as agent of the company to collect dividend and interest.

Where there is an agreement between a company being the seller of any shares held by it and the buyer of such shares, the company may agree with the buyer to transfer the shares temporarily to a designated party for the sole purpose of realising the purchase consideration on its behalf and to pass on the shares, by executing a transfer to the intended buyer. The designated party must necessarily be either the State Bank of India or a scheduled bank. However, to take the aforesaid benefit, the buyer and the seller must complete the transaction within a period of 6 months.

Register of investments not held in company's own name- When any shares or securities in which investments have been made by a company but are not held by it in its own name pursuant to permissible conditions in section 49, the company shall forthwith enter in a register maintained by it for the purpose particulars specified under sub-section (7) of section 49.

Penalty

If default is made in complying with any of the aforesaid requirements of subsections (1) to (8), the company and every officer of the company who is in default, shall be punishable with fine which may extend to 50,000 rupees.

Investments in other companies and bodies corporate/Inter-corporate loans and investments - Section 372A, inserted by Companies (Amendment) Act, 1999, contains the consolidated provisions with respect to inter-corporate loans and investments. Thus, the provisions, earlier contained in sections 370 and 372 have been combined together with certain modifications. Sections 370 and 372 have been rendered non-operational by the introduction of section 372A. The new section, viz., section 372A provides as follows :

(1) Ceiling on loans, guarantees, investments etc. - No company shall, directly or indirectly,—

- (a) make any loan to any other body corporate;
- (b) give any guarantee, or provide security, in connection with a loan made by any other person to, or to any other person by, anybody corporate; and
- (c) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate,

exceeding sixty per cent of its paid-up share capital and free reserves, or hundred per cent of its free reserves, whichever is more.

It may be noted that by combining the provisions of sections 370 and 372, fixing the ceiling of 60% of paid-up capital and free reserves or 100% of free reserves, whichever is more with respect to loans and guarantees etc. and investments instead of 30% with respect to loans and another 30% for investments as per the earlier provisions, the Amendment Act has granted more flexibility to the companies in choosing between lending and investments in other bodies corporate and at the same time retaining the overall combined ceiling of the erstwhile sections 370 and 372 in regard to loans and investments. However, in case of a company with a small capital base but large reserves, the ceiling now shall be 100 per cent of free reserves.

Approval by way of special resolution: Where the aggregate of the loans and investments so far made, the amounts for which guarantee or security so far provided to in all other bodies corporate, along with the investment, loan, guarantee or security proposed to be made or given by the Board, exceeds the aforesaid limit, no investment or loan shall be made or guarantee shall be given or security shall be provided unless previously authorised by a special resolution passed in a general meeting.

The special resolution, as aforesaid, must be passed through postal ballot [as per rule 4 of the Companies (Passing of the Resolution by Postal Ballot) Rules, 2001].

However, the Board may give guarantee, without being previously authorised by a special resolution, if—

- (a) a resolution is passed at a meeting of the Board authorising to give guarantee in accordance with the aforesaid provisions;
- (b) there exists exceptional circumstances which prevent the company from obtaining previous authorisation by a special resolution as aforesaid; and
- (c) the resolution of the Board under (a) above is confirmed within 12 months, in a general meeting of the company or the annual general meeting held immediately after passing the Board's resolution, whichever is earlier.

It may be noted that the aforesaid relaxation does not cover 'investments', 'loan' or 'security'.

Matters to be specified in the notice of special resolution: The notice of the special resolution as aforesaid must indicate clearly: (i) the specific limits; (ii) the particulars of the body corporate in which the investment is proposed to be made or loan or security or guarantee to be given; (iii) the purpose of the investment, loan or security or guarantee; (iv) specific sources of funding and such other details.

The Department of Company Affairs has, through a Circular warned companies against:

- (a) approving inter-corporate investments and loans much beyond the net-worth of the company;
- (b) blanket approval for inter-corporate loans and investments.

The Circular also requires the companies to specify the specific securities in which it proposes to make investments. However, in case of guarantees, the resolution can indicate the amount annually.

- (2) **Rate of Interest:** No loan to anybody corporate shall be made at the rate of interest lower than the prevailing 'bank rate'. [Bank rate means the rate at which the RBI lends to the commercial banks] being the standard rate made public by the Reserve Bank of India [sub-section (3)]
- (3) **Unanimous resolution of the Board and approval of the public financial institutions:** No loan or investment shall be made or guarantee or security given by the company in pursuance of sub-section (i) unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting and where any term loan is subsisting, the prior approval of the public financial institution referred to in section 4A is obtained.

No approval of the public financial institution (PFI) shall be necessary in the above case when



loan, investment, etc. covered by sub-section (1) is within the alternative limit of 60% of the paid-up capital and free reserves, and no default has occurred in repayment of the loan or payment of interest to the concerned public financial institution(s). It may be observed that possibly due to drafting error, the other condition of 100 per cent of the free reserves as contained in sub-section (1) has been left out. Taking the spirit of the provision it seems no permission as aforesaid would be required if loans, investments, etc. is also within 100 per cent of the free reserves provided no default has been made with regard to loan repayment or interest payments to the PFI.

(4) Register of Investments and Loans:

- (a) Every company shall keep a register showing the following particulars in respect of every investment or loan made, guarantee given or security provided by it in relation to anybody corporate under sub-section (1), namely :—
- (i) the name of the body corporate;
 - (ii) the amount, terms and purpose of the investment or loan or security or guarantee;
 - (iii) the date on which the investment or loan has been made; and
 - (iv) the date on which the guarantee has been given or security has been provided in connection with a loan.
- (b) The particulars of investment, loan, guarantee or security referred to in clause (a) shall be entered chronologically in the register aforesaid within seven days of the making of such investment or loan, or the giving of such guarantee or the provision of such security [sub-section (5)].

It is noticed that though by virtue of sub-section (8), particulars of rights issues need not be entered in this Register, it would be desirable to do so. Place of keeping the Register - The register referred to in sub-section (5) shall be kept at the registered office of the company concerned and: -

(a) shall be open to inspection at such office; and

(b) extracts may be taken therefrom and copies thereof may be required,

by any member of the company to the same extent, in the same manner, and on payment of same fees as in the case of the register of members of the company; and the provisions of section 163 shall apply accordingly [sub-section (6)]. If default is made in connection with this Register, then the company and every officer of the company who is in default, shall be punishable with fine extending to rupees five thousand and with a further fine up to rupees five hundred for each day of default after the first day.

(5) Guidelines: The Central Government may prescribe guidelines for the purposes of this section, i.e., inter-company loans, investment, guarantee, etc.

(6) Default in repayment of Deposits, etc.:- No company which has defaulted in complying with the provisions of section 58A shall, directly or indirectly, make any loan, give any guarantee or provide security or make any investment as above till the default is subsisting [sub-section (4)].

(7) Exemptions: Nothing contained in section 372A shall apply to any loan made, any guarantee given or any security provided or any investment made by—

- (i) a banking company, or an insurance company, or a housing finance company in the ordinary course of its business, or a company established with the object of financing industrial enterprises, or of providing infrastructure facilities;
- (ii) a company whose principal business is the acquisition of shares, stock, debentures or other securities;
- (iii) private company, unless it is a subsidiary of a public company;

- (iv) the company in shares allotted in pursuance of section 81(1)(a, i.e., rights issues;
- (v) any loan made by a holding company to its wholly owned subsidiary;
- (vi) to any guarantee given or any security provided by a holding company in respect of loan made to its wholly owned subsidiary; or
- (vii) to acquisition by a holding company, by way of subscription, purchase or otherwise, the securities of its wholly owned subsidiary [sub-section (8)].

(8) Penalty: If default is made in complying with the provisions of this section, other than sub-section (5) (i.e., other than with respect to the maintenance of Register), the company and every officer of the company, who is in default, shall be punishable with imprisonment which may extend to two years or with fine which may extend to fifty thousand rupees.

However, where any such loan or any loan in connection with which any such guarantee or security has been given or provided by the company, has been repaid in full, no punishment by way of imprisonment shall be imposed and where such loan has been repaid in part, the maximum punishment which may be imposed by way of imprisonment shall be appropriately reduced.

All persons who are knowingly parties to any such contravention shall be liable, jointly and severally, to the company for the repayment of the loan or for making good the same which the company may have been called upon to pay by virtue of the guarantee given or the securities provided by such company.

Explanations—For the purposes of section 372A,—

- (a) "loan" includes debentures or any deposit of money made by one company with another company, not being a banking company;
- (b) "free reserves" 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.

The Department of Company Affairs had clarified that the following investments would not attract the regulatory provisions of section 372. It may therefore be safely inferred that these exemptions shall continue to be available under section 372 A also :

1. Inter-corporate investments made by the exempted companies mentioned in sub-section (14) of section 372 [Now sub-section (8) of section 372A], and outstanding after the cessation of exemption under sub-section (14) would not come within the restrictions contained in section 372 (now sec. 372A) and the compliance of the said section would not, therefore, be required in this regard (Taxmann's Circulars and Clarifications, 1992 Edition, page 408).
2. Where a private company is converted into a public company or becomes a public company by virtue of the provisions of section 43A, the investment made by it prior to the date of its becoming a public company would not be hit by the provisions of either section 372(4) [now section 372A(1 and 2)] or section 373, and it would not, therefore, be necessary for the company to dispose of any of the said investments so as to bring them down to the percentage limit prescribed in section 372(2). [now section 372A(1)] (Taxmann 's Circulars and Clarifications, 1992 Edition, page 404).
3. The units issued by the Unit Trust of India under section 21 of the Unit Trust of India Act, 1963.
4. The restrictions contained in section 372 (now section 372A) are not applicable to acquisition of shares of one company by another company by way of gift (Taxmann's Circulars and Clarifications, 1992 Edition, page 408).

Can a subsidiary company invest in its holding company- Though sub-section (1) of section 372A is generally worded and therefore seems to permit investment by a subsidiary company in the shares of its holding company yet, inasmuch as section 42 prohibits such investment, a subsidiary company shall



not be allowed to invest in its holding company.

Implication of Pledge of Shares Held as Investment In an Associated Company to a Bank for Grant of Loan by the Bank to the Associated Company – According to the decision of the Supreme Court in *Lallan Prasad v. Rahmat Ali* AIR 1967 SC 1322 - a pawnee (here pledgee) has only a special property in the pledge but the general property therein remains in the pawner and wholly reverts to him on discharge of the debt. This pledge is in reality a guarantee for the loan to the associated company and as such the Board of the pledger company should pass an unanimous resolution for making the pledge, provided the limit under section 372A has not been exceeded.

Applicability of section 372A to section 25 company or a guarantee company not having share capital- The provisions shall apply to these companies even when there is no share capital. There is no difficulty since the computation shall be based upon free reserves, if any.

Inter-Company loans

Section 372A vis-a-vis section 295- It would be worthwhile to take note of the fact that the provisions of section 295 of the Companies Act dealing with "Loans to Directors, etc." will have an impact on loan by a company to another private company in which a director of the first company is a director or member of the private company. Prior approval of the Central Government will be necessary for such loan, etc. Similarly if any one or more directors of the lending company exercise 25% or more of the total voting power in any other body corporate, then giving of the loan etc. will be subject to previous approval of the Central Government in terms of section 295 of the Act.

1.4.2. Acceptance of Deposits, Renewal, Repayment, Default and Remedies

Meaning of deposits

Explanation to section 58A appearing after sub-section (10) of section 58A of the Companies Act, 1956 defines the expression 'deposit' to mean any deposit of money with and includes any amount borrowed by a company but shall not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India.

The expression 'deposit' has been further elaborated by Companies (Acceptance of Deposits) Rules, 1975. Rule 2(b) provides that 'deposit' means any deposit of money with and includes any amount borrowed by a company. However according to rule 2(b) the expression 'deposit' does not include:

- (i) any amount received from the Central Government or a State Government or any amount received from any other source, and whose repayment is guaranteed by the Central Government or State Government or any amount received from a local authority or a foreign Government or any other foreign citizen, authority or person;
- (ii) any amount received as a loan from any banking company, State Bank of India (along with its subsidiaries), a nationalised bank including a co-operative bank;
- (iii) any amount received as loan from any of the notified financial institutions (including Industrial Finance Corporation Ltd., State Financial Corporations, Shipping Development Fund Committee, Unit Trust of India, Industrial Development Bank of India, Rehabilitation Industries Corporation of India Ltd., State Trading Corporation of India Ltd., Minerals and Metals Trading Corporation of India Ltd., any electricity board set up under the Electricity (Supply) Act, 1948, Rural Electrification Corporation Ltd., Agricultural Finance Corporation Ltd., Industrial Reconstruction Bank (earlier Corporation) of India Ltd., the Industrial Credit and Investment Corporation of India Ltd., the National Industrial Development Corporation of India Ltd., the Tamil Nadu Industrial Investment Corporation Ltd., the State Industrial and Investment Corporation of Maharashtra Ltd., Life Insurance Corporation of India, General Insurance Corporation of India Ltd., and its subsidiaries, Gujarat Industrial Investment Corporation Ltd., any financial company wholly owned by the Central Government or State Government, Oil Industry Development Board, Housing Development Finance Corporation Ltd., any other financial company or Public Financial Institution which may be notified by the Central

Government in this behalf in consultation with the Reserve Bank of India);

- (iv) any amount received by a company from any other company;
- (v) any amount received from an employee of the company by way of security deposit;
- (vi) any amount received by way of security or as an advance from any purchasing agent, selling agent or other agents in course of or for the purposes of the business of the company or any advance received against orders for the supply of goods or properties or for the rendering of any service;
- (vii) any amount received by way of subscriptions to any shares, stock, bonds or debentures pending the allotment of the said shares, stock, bonds or debentures and any amount received by way of calls in advance on shares, in accordance with the articles of association of the company so long as such amount is not repayable to the members under the articles of association of the company. Bonds or debentures referred herein represent bonds and debentures issued by the company, (a) on the basis of security of immovable property of the company and (b) with an option to convert them into shares of the company. These are the bonds and debentures more fully described under clause (x) below:
- (viii) any amount received in trust or any amount in transit;
- (ix) any amount received from a person who, at the time of the receipt of the amount, was a director of the company or any amount received from a relative of a director or its member by a private company:

Provided that the director, relative of a director or member, as the case may be, from whom money is received, furnishes to the company at the time of giving the money, a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting from others.

Thus, now a public company can accept any amount from its Directors. The ceilings of section 58A and other restrictive provisions thereunder shall not be applicable to such deposits.

Deposits received in joint names of director and non-director/shareholder and non-shareholder:

There may be circumstances of deposits being received in joint names of a director and a non-director and in the name of a shareholder and a non-shareholder in the case of a private company. These deposits would be exempt deposits as per clarification given in Circular No. 1/1/80-CLV, dated 3-5-1980. Under this clarification deposits received from a firm, all the partners of which are not directors in the deposit accepting company will not be exempt. On the other hand if all the partners are also directors of the borrowing company then the deposit (borrowing) will be exempt. The same logic will apply to a private company accepting deposit from a firm, where all the partners of the firm are not shareholders of the private company. The deposit so taken will not be exempt. On the other hand, when all the partners of the lending firm are shareholders of the borrowing private company, the amount received will be exempt - vide Circular No. 3/13/84-CLX, dated 27-11-1984. [Adapted, in the light of revised rule].

Acceptance of Deposits by a private company through an Advertisement:

Section 3(1)(iii)(d) introduced by the Companies (Amendment) Act, 2000 renders a private company, a public company, if such a private company invites or accepts deposits from the public, other than its members, directors or their relatives.

- (x) any amount raised by the issue of bonds or debentures secured by the mortgage of any immovable property of the company or with an option to convert them into shares in the company provided that in the case of such bonds or debentures secured by the mortgage of any immovable property, the amount of such bonds or debentures shall not exceed the market value of such immovable property;



- (xi) any amount brought in by the promoters by way of unsecured loans in pursuance of stipulations of financial institutions subject to the fulfilment of the following conditions, namely :—
 - (a) the loans are brought in pursuance of the stipulation imposed by the financial institutions in fulfilment of the obligation of the promoters to contribute such finance;
 - (b) the loans are provided by the promoters themselves and/or by their relatives and not from their friends and business associates; and
 - (c) the exemption shall be available only till the loans of financial institutions are repaid and not thereafter;
- (xii) any amount received as loan from the National Dairy Development Board by companies owned by it directly or through its subsidiary companies.

The term 'financial institution' for the aforesaid sub-clause shall mean:

- (a) a public financial institution specified in or under section 4A of the Companies Act, 1956;
- (b) a State Financial, Industrial or Investment Corporation;
- (c) the State Bank of India or any of its subsidiary bank;
- (d) a nationalised bank;
- (e) the General Insurance Corporation of India; (f) the Industrial Reconstruction Bank of India;
- (g) any other institution which the Central Government may, by notification, specify in this behalf.

Deposit and loan : As per Explanation to section 58A and rule 2(b) referred to above, the expression 'deposit' has been defined to include any amount borrowed by a company. However, there had been a number of judicial decisions in the past bringing out distinction between a loan and a deposit. In *Abdul Hamid Sahib v. Rahmat Bi* AIR 1965 Mad. 417, it was observed that in a sense, deposit is also a loan with the difference that a loan is repayable the minute it is incurred. In the case of deposits repayment will depend on the maturity date fixed therein or the terms of agreement relating to the demand on the making of which the deposit becomes payable. In other words, unlike a loan which may become repayable instantly or on notice, there is no immediate obligation to repay in the case of deposits. It is repayable only on the basis provided in the Companies (Acceptance of Deposits) Rules.

In another case, the Supreme Court observed that the terms 'deposit' and loan' are not synonymous and whether a transaction is a deposit or a loan does not merely depend on the terms of documents, but has to be judged from the intention of the parties – *Annamalai v. Veerappa* AIR 1956 SC 12. Even the Limitation Act, 1963 provides for different periods of limitation for loan and deposit. In the case of a loan the period of limitation commences from the date when the loan is made, whereas in the case of deposits, it commences from the date when the demand is made.

It may also be noted that Rule 2(c) of the Companies (Acceptance of Deposits) Rules states that the term "depositor" includes any person who has given a loan to a company.

Deposit and Debenture: According to section 2(12) of the Companies Act, 1956, debenture includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not. A debenture is a document which either creates or acknowledges a debt. A debenture may be secured or unsecured. Where the debenture is unsecured, it will squarely fall within the definition of deposit. It is only the debentures which satisfy the conditions stipulated in Rule 2(b)(x) of the Companies (Acceptance of Deposits) Rules, which are excluded from the definition of deposits.

Invitation and acceptance of deposits

Section 58A and Companies (Acceptance of Deposits) Rules, 1975 made thereunder contain the restrictions and limitations subject to which deposits may be invited and accepted by companies. The

provisions of the section, as amended by the Amendment Act, 1988 and summary of the important rules made thereunder may be noted as follows:

1. Certain companies prohibited to invite deposits - No company with a net owned fund of less than Rupees one crore shall invite public deposits, [w.e.f. 28-11-2001]
2. Deposits not to be invited without issuing an advertisement- 'No company shall invite or accept any deposit except after the publication of an advertisement specifying therein the financial condition, management structure and other specified particulars of the company.

The advertisement shall be made in a leading English newspaper and in one vernacular (local language) newspaper circulating in the State in which the registered office of the company is situated. The advertisement must contain reference to the conditions subject to which deposits shall be accepted by the company.

The 'renewal of deposits' is 'acceptance of deposits' — Jagjivan HiralaDoshi v. Registrar of Companies [1989] 65 Comp. Cas. 553.

3. Deposits not allowed in case of default in repayment - The Companies (Amendment) Act, 1996 has added a new clause viz., clause (c) to sub-section (2) of section 58A whereby no company can invite or allow any other person to invite or cause to be invited on its behalf any deposit, if the company has made a default in the repayment of any deposit or part thereof and any interest thereupon in accordance with the terms and conditions of such deposit.

In order to check defaults in repayments of deposits or interest thereon, section 372A forbids such a company from making inter-company loans and investments till that default is made good.

4. Repayment of deposits- Every deposit received by a company, unless renewed in accordance with the Rules made under sub-section (1) of section 58A, shall be repaid in accordance with the terms and conditions of such deposits [subsection (3A) of section 58A added by the Amendment Act, 1988].
5. Declaration by the depositor- The form of application shall contain a declaration by the depositor that the money is not being deposited out of funds acquired by him by borrowing or accepting deposits from any other person.

The application shall be made in the form supplied by the company.

6. Nomination - A depositor may, at any time, make a nomination and the provisions of sections 109A and 109B, as far as may be, shall apply to the nomination."
7. Premature Repayment of Deposits: Under Rule 8(1) of the Companies (Acceptance of Deposits) Rules, 1975, no deposit shall be repaid within 3 months of its acceptance. Thereafter, interest is payable on premature withdrawals as follows:

(a) Upto 6 months	Nil
(b) After 6 months	1% less than the rate applicable to the period for which deposit has actually run

Thus, if a company makes repayment of a deposit after a period of 6 months but before the date of maturity, the rate of interest payable on such deposit shall be less by 1 % from the rate that is applicable for the period for which such deposit has run, for example, suppose that a deposit was received for a period of three years and the rate of interest was 8%. If such a deposit is repaid on the expiry of second year and if the rate of interest for a 2-year maturity deposit was 7%, then the interest payable will be 6% (7% - 1%).

However, if a premature repayment is made for—

- (a) complying with the provisions of Non-banking Non-financial Companies (Reserve Bank) Directions, 1966, or



- (b) complying with the provisions of Rule 3 of the Companies (Acceptance of Deposit) Rules, 1975, or
- (c) converting with the consent of depositors into secured debentures in accordance with applicable rules in regard to the issue of "Rights Debentures", or
- (d) to provide for war risk or other related benefit to the personnel of naval, military or air forces or to their families on an application made by the association or society formed by such personnel, during the period of emergency declared under article 352 of the Constitution,

then the aforesaid reduction in the rate of interest will not be made. Similarly there are regulatory provisions for renewing a deposit before its maturity to enable the depositor to have the benefit of a higher rate of interest. The renewal, in such a case, should be for a period longer than the unexpired period of the original deposit and the rate of interest as stipulated at the time of acceptance or renewal is reduced by 1 % for the expired period of the deposit and is paid or adjusted or recovered accordingly.

RBI Guidelines for premature payment of public deposits [Circular No. DNBS(PD) C.C. No. 44/02.02/2005, dated 5-10-2004] provide as follows:

- (i) Minimum lock-in-period- Minimum lock-in-period is 3 months.
- (ii) Problem companies - Problem companies are prohibited from making premature repayment of public deposits except the following:
 - (a) existing contractual obligations executed upto 5-10-2004.
 - (b) repayment to surviving depositors or to nominee in case of death of depositor.
 - (c) tiny deposits upto ₹10,000. In case of deposits above ₹10,000, premature withdrawal upto ₹10,000 can be paid before maturity to depositor for meeting expenses of emergent nature. All deposits standing in the name of sole/first depositor in the same capacity will be treated as one deposit for this purpose.
- (iii) Normally Run Companies-In case of normally run companies, after lock-in-period, premature repayment is at the sole discretion of the company and cannot be claimed as right, except when existing contract executed upto 5-10-2004 gives such a right. In case of death of depositor, premature repayment can be made even during lock-in-period.
- (iv) Interest for pre-mature repayment- (a) repayment within three months is prohibited (except in case of death of depositor). For premature repayment after 3 months but before 6 months, no interest will be payable, (b) in case of premature repayment of deposit/public deposit after 6 months interest payable will be 2% lower than the interest rate applicable to deposit for the period for which the deposit has actually run. If no interest rate was specified for that period, interest will be 3% lower than the minimum rate at which deposits are accepted by the company.

The companies shall intimate their depositors at least 2 months before the maturity of their respective deposits/public deposits, details of such maturity to ensure that matured deposits do not remain with company as unclaimed deposits.

- 8. Furnishing of Receipts to Depositors - Every company shall, on the acceptance or renewal of a deposit, furnish to the depositor or his agent a receipt for the amount received by the company within a period of eight weeks from the date of receipt of the money. The said receipt shall be signed by an officer of the company duly authorised by the company in this behalf.
- 9. A company cannot accept or renew deposits payable on demand.
- 10. Also, a company cannot accept deposits repayable before 6 months or after 36 months of the receipt. However, deposits for less than 6 months may be accepted provided such deposits do not exceed 10% of the paid-up capital and free reserves, and they are received against unsecured

debentures or from shareholders in case of a public company or were guaranteed by the directors of the company.

However, in no case shall a company accept deposits repayable before 3 months.

11. Interest on Deposits - No company shall invite or accept or renew any deposits in any form, on a rate of interest exceeding 12.5% p.a. at rests which shall not be shorter than monthly rests.
12. Ceiling on Deposits - A company shall not accept deposits over and above the following limits:
 - (a) 10 per cent of the paid up capital and free reserves, in the case of deposits in the form of any deposit against an unsecured debenture, deposit from a shareholder (not being a deposit accepted by a private company from its shareholders) or any deposit guaranteed by the Directors of the company;
 - (b) any other deposit not exceeding 25% of the aggregate of the paid-up share capital and free reserves of the company.

No Government company shall accept any deposits in excess of 35 per cent of its paid-up capital and free reserves.

Paid-up Capital and Free Reserves: It is essential to deduct the amount of unprovided depreciation from the aggregate of paid-up share capital and free reserves for determining the limits up to which deposits can be accepted by a company, for the purpose of Explanation to Rule 3 of the Companies (Acceptance of Deposits) Rules, 1975 (Circular No. 4/28/81 -CL-X, dated 2-9-1981). The limits up to which a company can accept deposits are to be computed with reference to aggregate of paid-up capital and free reserves as appearing in the latest audited balance sheet of the company and any change arising thereafter is to be disregarded (Circular No. 2/18/81-CL-X, dated 27-7-1981). But, there is no prescription in the Explanation to Rule 3 that latest audited balance sheet' means only the balance sheet of the company for a year in relation to which the audit has been completed before March 31st of the year in which the return is filed - Malayala Manorama Co. Ltd v. ROC [1990] 69 Comp. Cas. 339, 345/[1990] 3 Comp. LJ 167 (Ker.).

Meaning of Free Reserves: According to Rule 2(d) of the Companies (Acceptance of Deposits) Rules, 1975, the term 'free reserve' means "the balance in the share premium account, capital and debenture redemption reserves shown or published in the balance sheet of the company and created by appropriation out of the profits of company, but does not include the balance in any reserve created:

- (i) for repayment of any future liability or for depreciation in assets or for bad debts;
- (ii) by the revaluation of any assets of the company".

The Department of Company Affairs has clarified that the amount of surplus of profit and loss account appearing in the balance sheet of the company shall form part of the 'free reserve' (Communication No. 3/1 /80-CL.X, dated 3-2-1982).

The Department has further stated that the subsidy received under the Central Government Outright Grant & Subsidies Scheme, 1971 shall also be treated as free reserve provided the following conditions are satisfied:

- (i) the subsidy is received in cash;
- (ii) the subsidy has been utilised for the purpose for which it was received;
- (iii) the period of 5 years from the commencement of production has elapsed and the subsidy has not become recoverable in terms of the conditions of grant (Communication No. 3/5/ 84-CL.X, dated 5-12-1984).

Changes in paid-up capital subsequent to the close of the financial year: As already noted, the limits up to which a company can accept deposits are to be computed with reference to aggregate of



paid-up capital and free reserves as appearing in the latest audited balance sheet of the company and any change arising thereafter is to be disregarded (Circular No. 2/18/81-CL-X, dated 27-7-1981). The reason is that there are several elements other than paid-up capital which go into computation of net worth on the basis of which the limits laid down under Rule 3 of the Companies (Acceptance of Deposits) Rules for acceptance of deposits are worked out. By taking into account only the variation in the share capital of the company and at the same time ignoring the other components of net worth the position would get distorted (Communication No. 4/2/84-CLX, dated 25-7-1984 of the Department of Company Affairs). Explanation to Rule 3 of the Companies (Acceptance of Deposits) Rules, 1975 makes it clear that in arriving at the aggregate of paid-up capital and free reserves of the company, deduction should be made from such aggregate:

- (a) the amount of accumulated losses,
- (b) balance of deferred revenue expenses, and
- (c) intangible assets, if any, appearing in the latest audited balance sheet by reference to which the aggregate of paid-up capital and free reserves is to be determined for ascertaining the permissible amount of deposits.

13. Penalties for Contravention - Any deposit received in contravention of the provisions of the Act/ Rules must be paid back within 30 days from the date of acceptance of such deposit. The period of 30 days may be extended by the Central Government by another period but not exceeding 30 days.

In case of default, the company shall be subjected to fine which shall not be less than twice the amount not repaid and $\frac{1}{2}$ of the fine shall be paid to the depositor. In addition, every officer of the company, who is in default, shall be punishable with imprisonment for a term which may extend upto 5 years [Section 58A(5)].

Penalty for acceptance of deposit- Where the contravention relates to acceptance of deposit, the company may be subjected to fine which shall not be less than the amount of deposit so accepted.

Penalty for invitation of any deposit - Where contravention relates to the invitation of any deposit, the company shall be punishable with fine which may extend to ₹10 lakh but shall not be less than ₹50,000.

In both these cases of acceptance or invitation of deposit in contravention of the requirements of section 58 A and the rules made thereunder, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 5 years and shall also be liable to fine — H.H. Marthanda Varma & H.H. Bhupendra Narayana Singh v. Registrar of Companies [1988] 64 Comp. Cas. 125.

14. Consequences of Non-Refund - Where a company has failed to repay any deposit or part thereof in accordance with the terms and conditions of such deposit, the Company Law Board (now Tribunal*) may, if it is satisfied, either on its own motion or on the application of the depositor, that it is necessary so to do to safeguard the interests of the company, the depositors or the public, direct by order, the company to make repayment of such deposit or part thereof forthwith or within such time and subject to such conditions as may be specified in the order [Sub-section (9) added by the Amendment Act, 1988].

Besides, the company shall not be allowed to invite or allow any other person to invite on its behalf any deposit till the default in repayment of any deposit or interest thereon continues [Section 58A(2)(c)].

In Re, Thapar Agro Mills Ltd. [1997] 2 CLJ 270 (NR) the case before the CLB (now Tribunal') was that in view of the precarious financial position of the company the repayment of matured fixed deposits be further deferred. The applications were made by depositors who were not repaid the matured deposits. The CLB (now Tribunal') taking note of the precarious financial condition of the company and its potential

capability of repaying the deposits and having regard to the existence of non-encumbered assets of the company allowed the company a further period of two years to make the payment along with additional interest. It also directed that eventually if the company turns sick and a reference is made to BIFR, the company shall draw the attention of the BIFR to the Order of the CLB (now Tribunal*) in this respect.

Even where company has been declared as a sick company and reference has been registered with BIFR, in *Smt. Usha D. Rohrav. Electrex India Ltd.* [2000] 28 SCL 275 (CLB - Chennai) it was held that the company would be liable to repay deposits made by the depositors with the company.

While making an order for repayment, CLB (now Tribunal*) should give reasonable opportunity to all concerned including the company. As to whether the repayment should be ordered forthwith or within the extended time and whether any conditions should be imposed, it is necessary to keep in mind the interest of the company, the depositors and the public interest. While permitting time for repayment, interest of small depositors have to be kept uppermost in mind and management has to strain its resources to give priority to small depositors - *Modern Denim Ltd., In re* [1998] 15 SCL 436 (CLB - New Delhi). It was further observed that while considering proposal for extension of time for repayment:

- (i) needs of depositors who are in indigent circumstances like hospitalisation, old age, marriage in the family, etc., have to be kept in view.
- (ii) no proposal for repayment can extend to a period exceeding 3 years.
- (iii) the chairman of the company can be ordered to execute a personal guarantee in favour of the secretary, CLB (now Tribunal*) which shall be liable to be implemented in case of any deviation from the Schedule.

Any repayment scheme proposing a lesser rate of interest than contracted rate shall not be accepted - *Members of Public Holding Public Deposits in the Company v. DCM Financial Services Ltd.* [1998] 18SCL 1 (CLB-New Delhi)". Where reference to BIFR has been made because the company has become potentially sick, CLB (now Tribunal*) held that even though the company had not specifically sought re-scheduling of the deposits, it would not be appropriate to direct the company to repay all the deposits immediately - *Savita Jain v. Viniyoga Clothex Ltd.* [1998] 17 SCL 309 (CLB - New Delhi). CLB (now Tribunal*) in this case, further held that since the rehabilitation proposals were under consideration, the repayment of the deposits should be justifiably postponed for a period of 2 years from the date of maturity. However, the deposits of those persons who were in indigent circumstances like old age, serious sickness, other urgent family needs, etc., could be paid. Besides, company should continue to pay the current interest on deposits and clear the arrears of accumulated interest, if any, within one month from the date of receipt of copy of this Order.

In *Air Force Naval Housing Board v. KHSL Industries Ltd.* [1998] 16 SCL 631 (CLB - New Delhi), the company and the depositors agreed for a schedule of repayment and the company failed to comply with the first installment itself. The CLB (now Tribunal*), in order to ensure that the repayment did take place, as per the Schedule, ordered that, in the event of any default, Vice-Chairman/Director shall be identified as the 'officer in default'. It may be clarified that in the following circumstances, application under section 58A(9) of the Act will not lie :

- (i) Deposit made for booking/purchase of scooter, car, etc.
- (ii) Deposits accepted by financial companies like hire-purchase, finance company, a housing finance company, an investment company, a loan/mutual benefit financial company, an equipment leasing company, a chit fund company or a company, which receives deposits under any scheme; or arrangement by way of contributions/subscriptions or by sale of units/certificates.
- (iii) Deposits accepted by a sick industrial company covered by the Sick Industrial Companies (Special Provisions) Act, 1985, in respect of which the Board for Industrial & Financial Reconstruction, has specifically, by order, suspended the operation of any contract, agreement, settlement, etc. under section 22(3) of the said Act.



(iv) Deposits accepted by relief undertakings which are notified as such under the State laws.

Procedure for filing an application before the Company Law Board for nonpayment of matured deposits - The procedure for filing an application for non-payment of matured deposits or investments by a company before the Company Law Board (CLB) provides for filing Form No. 4 prescribed under the CLB Regulations 1991, in duplicate along with photocopy of deposit receipts accompanied by a demand draft of ₹50 drawn in favour of Pay and Accounts Officer, Department of Company Affairs (DCA) payable at New Delhi, Mumbai, Kolkata and Chennai, as the case may be. Each depositor is required to file separate Form No. 4. Those having more than one deposit in the same company may file only one Form No. 4 application. The jurisdiction of the Bench is as per the location of the registered office.

There are four CLB Benches located in New Delhi, Mumbai, Kolkata and Chennai with the Principal Bench in New Delhi.

Dealing with complaints relating to Deposits, Mutual Funds, Collective Investment Scheme, etc. [Press Note: 3/2001, dated 2-7-2001 issued by the Department of Company Affairs]

The Department of Company Affairs receives from general public a number of complaints relating to Deposits, Mutual Funds, Collective Investment Scheme, etc. in liquidation and also other investor complaints.

The Department of Company Affairs has informed the general public through this Press Note that there are four types of companies, namely:-

- (a) Banking Companies;
- (b) Non-Banking Financial Companies;
- (c) Non-Banking Non-Financial Companies (Listed); and
- (d) Non-Banking Non-Financial Companies (Unlisted).

The complaints relating to deposits in Banking Companies and Non-Banking Financial Companies are dealt with RBI. Investors complaints relating to Non-Banking Non-Financial Companies (Listed) are dealt with by the Securities and Exchange Board of India (SEBI). The complaints in respect of Non-Banking Non-Financial Companies (Unlisted) are dealt with by the Department of Company Affairs. The public is advised to approach these regulatory bodies for redressal of their grievances in the first instance itself. Similarly, complaints against companies in liquidation should be addressed to the concerned Official Liquidators attached to the High Courts.

In the case of deposits from Non-Banking Non-Financial Companies, the depositors should, in the first instance, approach the Company Law Board* and if the orders passed by the above Board are not honoured then they should approach to the concerned Registrar of Companies with a certified copy of the order of CLB.

Investors complaints of unlisted companies are dealt with by the Department of Company Affairs. On receipt of a complaint, the same is registered and number is given. The Department pursues the matter with the company and in the case of non-settlement of the complaint, the matter is referred to Registrar of Companies for prosecution.

Petition should be accompanied by a demand draft of the prescribed amount payable to Pay and Accounts Officer, DCA. It should be further accompanied by affidavits verifying application from all the petitioners drawn on non-judicial stamp paper of requisite value duly attested by notary public or Oath Commissioner.

It may be clarified that the depositors can, besides getting the relief under the Companies Act, take action against the defaulting companies under the normal civil law of the country.

Vide companies (Second Amendment) Act, 2002, Now Tribunal - Yet to take effect

15. Small depositors - Special provisions (Sections 58AA and 58AAA) - The Companies (Amendment) Act, 2000 has added two new sections, viz., sections 58AA and 58AAA, for the protection of small depositors. 'A small depositor' means a depositor who has invested in a financial year a sum not exceeding Rupees twenty thousand in a company and includes his successors, nominees and legal representatives. (Explanation to section 58AA)

- (a) The provisions contained in these sections are as follows - If any default is made by a company in repayment of any public deposits accepted from small depositors or part thereof or any interest thereupon, section 58AA makes it obligatory on the part of the company to give an intimation on monthly basis to the Company Law Board within 60 days from the date of default. Such intimation shall include particulars in respect of the names and addresses of each small depositor, the principal sum of deposits due to them and interest accrued thereupon.

The Company Law Board shall, on receipt of the intimation, exercise on its own motion, powers conferred upon it by sub-section (9) of section 58A and pass an appropriate order within a period of 30 days from the date of receipt of intimation from the company.

The Company Law Board may pass the above order after giving the small depositors an opportunity of being heard. However, it shall not be necessary for a small depositor to be present at the hearing of the proceedings.

- (b) Prohibition on companies to accept further deposits - Sub-section (4) prohibits a company to accept further deposits from 'small depositor' unless each small depositor, whose deposit has matured, had been paid the amount of the deposit and the interest accrued thereupon.

This prohibition will, however, not apply in the following cases:

- (i) where such deposit has been renewed voluntarily by the small depositor; or
- (ii) where repayment of the deposit has become impracticable due to the death of the small depositor or a competent court or authority has stayed its repayment.

- (c) Advertisement and Application Form - Where a company has defaulted in repayment of deposit or part thereof or any interest thereon to a small depositor, it shall state, in every future advertisement and application form for inviting deposits from the public, the total number of small depositors and amount due to them in respect of which such default has been made [Sub-section (5)].

- (d) Waiver of interest due to depositors - Where any interest accrued on deposits of the small depositors has been waived, the fact of such waiver shall be mentioned by the company in every advertisement and application form inviting deposits issued after such waiver [Sub-section (6)].

- (e) Loan for working capital to be used for repayment of deposits - If a company has accepted deposits from small depositors and subsequent to this obtains funds by way of loan for working capital from any bank, it shall first utilise such funds for the repayment of any deposit or any part thereof or any interest thereupon to the small depositor before applying such funds for any other purpose [Sub-section (7)].

It may be noted that the aforesaid provision mentions only loan raised from bank and not from any other source. Further, since the funds are raised for working capital, the same may not be permitted by the lending bank towards repayment of small depositors, there being no corresponding duty cast upon the bank.

- (f) Application form to contain statement- As per sub-section (8) of section 58AA, every application form issued by a company to a small depositor for accepting deposits from him shall contain a statement to the effect that the applicant has been apprised of—

- ❖ every past default by the company in repayment of deposit or interest thereon; and
- ❖ the waiver of interest as above and the reasons therefore.



It may be noted that the prohibition to accept any deposit from small depositors under sub-section (4) applies where there is a subsisting default. As against this, sub-section (8) dealing with issue of application form to small depositors relates to past default(s) which presumably are no longer subsisting.

[Note: It appears from the provisions that the companies may have two sets of forms for accepting deposits from public - one to be issued to the small depositors and the other for others. Alternatively, to escape the aforesaid regulatory provisions, a company may not accept deposits of ₹20,000 or less].

- (g) Penalty for Default - Sub-section (9) of section 58AA provides that whoever knowingly fails to comply with the provisions of this section or comply with any order of the Company Law Board shall be punishable with imprisonment which may extend to three years and shall also be liable to fine for not less than ₹500 for every day during which such non-compliance continues. Further, the punishment may be awarded to every director of the company as well as the company [Section 58AA(10)].

It may be noted that sub-section (10) does not draw any distinction between the executive and non-executive directors and deems every director to be guilty of the offence.

Section 58AAA makes every offence connected with or arising out of acceptance of deposits under section 58A or section 58AA to be cognizable offence under the Code of Criminal Procedure, 1973. But, no court shall take cognizance of any offence connected with or arising out of acceptance of deposits except on a complaint made by the Central Government or any officer authorised by it in this behalf.

Rule 8A of the Acceptance of Deposits Rules, 1975 (inserted by the Amendment Rules, 2001, w.e.f. 28-11 -2001) provides for payment of penal rate of interest on overdue deposits. The Rule provides as follows :

A penal rate of interest of eighteen per cent shall be paid for the overdue period in case of public deposits matured and claimed but remaining unpaid. In case of deposit made by a small depositor, the penal rate of interest shall be twenty per cent compoundable on an annual basis.

16. Maintenance of Liquid Assets - As per Rule 3A, every company shall before the 30th day of April of each year, deposit or invest, as the case may be, a sum which shall not be less than 15 per cent (w.e.f. 1st April, 1992) of the amount of its deposits maturing during the year ending on the 31st of March next following in any one or more of the securities prescribed in this regard. The amount so invested or deposited shall only be used in repayment of the deposits outstanding and repayable within next 31st March. At no time such investment or deposit shall fall below 10% of the deposits repayable within next 31st March.

Under rule 3A of the Companies (Acceptance of Deposits) Rules, 1975 liquid assets are deposits or investments made in:

- a current account or other deposit account with any scheduled bank free from any charge or lien.
- unencumbered securities mentioned in clauses (a) to (d) and (ee) of section 20 of Indian Trusts Act, 1882.
- unencumbered securities of Central Government or of any State Government.
- unencumbered bonds issued by the Housing Development Finance Corporation Ltd.

Companies are required to deposit or invest in such liquid assets before 30th April of each year, a sum not less than 15% of the amounts of deposits maturing during the year ending 31st March of next following year.

For the purpose of compliance, the securities will be reckoned at their market value. The liquid assets

can be used only for repayment of deposits maturing during the year. However, the amount remaining deposited/invested at any time shall not be less than 10% of the deposits maturing and remaining to be repaid until 31st March of that year.

Non-compliance of Rule 3A - not a continuing offence - Offence of violating rule 3A of Deposit Rules, 1975 is not a continuing offence and complaint against such an offence after expiry of six months would be barred by limitation - Sivandhi Adityan v. Additional Registrar of Companies [1995] 83 Comp. Cas. 616 (Mad.).

Register of deposits

According to Rule 7 of the Companies (Acceptance of Deposits) Rules, 1975, every company accepting deposits shall keep at its registered office one or more registers in which there shall be entered separately in the case of each depositor the following particulars, namely:—

- (a) name and address of the depositor;
- (b) date and amount of each deposit;
- (c) duration of the deposit and the date on which each deposit is repayable;
- (d) rate of interest;
- (e) date or dates on which repayment of interest will be made;
- (f) any other particulars relating to the deposit.

The register of deposit shall be kept for a minimum period of 8 years from the financial year in which the latest entry is made in the register.

Brokerage on deposits

With effect from 2-1-1986, a company can pay brokerage on deposits collected by, or through, a broker at a rate not exceeding the rates prescribed as under:

Deposits upto one year	1% of the deposits collected by or through brokers.
Deposits for a period of more than one year but upto 2 years	1½ of the deposits collected by or through brokers.
Deposits for a period exceeding 2 years	2% of the deposits collected by or through brokers.

The payment of brokerage should be only on one time basis.

Any person who is authorised by a company in writing to solicit deposits on its behalf and through whom deposits are procured will only be entitled to brokerage and payment of brokerage to any other person for procuring deposits shall be deemed to be not in conformity with the rules. [Explanation to rule 1(d)].

Exemptions

The provisions of section 58A do not apply to:

1. A banking company [Section 58A(7)].
2. Companies other than banking companies as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

Exemption of small scale units: In pursuance of its powers, the Central Government has, after consultation with the Reserve Bank of India, granted exemption from the applicability of the provisions of section 58A to the companies which are small scale units as per the parameters notified from time to time.



According to the Notification GSR No. 73(E), dated 2-2-1996, the exemption from the provisions of section 58A of the Act shall be available to small scale industrial units only if they fulfil all the following conditions, namely:

- (a) the paid-up capital of the company does not exceed rupees 25 lakhs;
- (b) the company accepts deposits from not more than 100 persons;
- (c) there is no invitation to public for deposits; and
- (d) the amount of deposits accepted by the company does not exceed rupees 20 lakhs or the amount of its paid-up capital, whichever is less.

3. Financial Companies as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

However, the Central Government cannot exempt the financial companies from the provisions relating to advertisement contained in section 58A(2)(&). The Central Government, in exercise of its aforesaid powers, exempted all classes of financial companies* from all the provisions of section 58A except the provisions relating to advertisement—vide Notification No. SO 523(E), dated 18-9-1975.

4. Companies exempted by the Central Government [Section 58A(8)J: The Central Government has been empowered to grant partial or total exemption from the provisions of section 58A for a specified period to a company (or a class of companies) after consultation with the Reserve Bank of India. The Central Government is also empowered to grant extension of time to any company (or a class of companies) after consultation with the Reserve Bank in complying with these provisions. The Department of Company Affairs has announced certain guidelines for filing applications under sub-section (8) of section 58.

Issue of Commercial Paper Exempted: The Department of Company Affairs has vide notification dated 29-12-1989 exempted the class of companies which fulfil the criteria under the Non-Banking Companies (Acceptance of Deposits through Commercial Paper) Directions, 1989 from the provisions of section 58A with respect to deposits received by non-banking companies by the issue of commercial paper as per the aforementioned Directions. The following conditions are required to be satisfied:

- (i) the companies comply with the terms and conditions stipulated from time to time by the Reserve Bank of India relating to the issue of such commercial paper; and
- (ii) the companies in their annual account disclose the maximum amount raised at any time during the financial year and the amount outstanding as at the end of the financial year.

Advertisement for inviting deposits [Rule 4]

Every company intending to invite deposits or allowing or causing any person to invite deposits on its behalf is required to issue an advertisement for the purpose in a leading English newspaper and in one vernacular newspaper circulating in the State in which the registered office of the company is situated. Each advertisement should contain the particulars as prescribed in Rule 4 of the Acceptance of Deposits Rules, 1975. The advertisement must be issued on the authority and in the name of the Board of directors of the company. It must also state the date on which the text was approved by the Board of directors. It must contain reference to the conditions subject to which the deposits shall be accepted by the company.

According to section 58B, an advertisement inviting deposits is a prospectus and consequently all the provisions of the Companies Act, 1956, applicable to the prospectus, are applicable to the advertisement inviting deposits.

Signing of Advertisement: The advertisement should be signed by a majority of the directors in the Board of the company, as constituted at the time the Board approved the advertisement, or their duly authorised agents, in writing and a copy of the same should be delivered to the Registrar of Companies for registration. Even a letter of authority is sufficient for this purpose and power of attorney is not necessary.

[Circular No. 23/75(1)714/75-CL (IV), dated 25-9-1975 issued by the Department of Company Affairs].

Period of validity of advertisement and delivery of the text to the Registrar: The advertisement shall remain valid for a period of 6 months from the date of the closure of the financial year in which it is issued or until the date the balance sheet is laid before the company in general meeting or where the Annual General Meeting is not held, the latest date on which the meeting should have been held, whichever is earlier. A fresh advertisement has to be made in each succeeding financial year for inviting deposits thereafter.

Statement in lieu of advertisement [Rule 4A]: Where a company intends to accept deposits without inviting or allowing or causing any other person on its behalf, to invite such deposits, it need not issue the advertisement. It is, however, required to file with the Registrar a statement in lieu thereof containing all the particulars required to be included in the advertisement under the Rules and signed (in the same manner as the advertisement for deposits is to be signed) before accepting any deposit.

The statement in lieu of advertisement shall be valid until the expiry of 6 months from the date of closure of the financial year in which it is so delivered or until the date on which the balance sheet is laid before the company in the annual general meeting, or, where the annual general meeting for any year has not been held, the latest day on which that meeting should have been held in accordance with the provisions of the Act, whichever is earlier.

Acceptance of deposits in joint names [Rule 8(2)]

Where depositors so desire, deposits may be accepted in joint names not exceeding three, with or without any one of the clause namely "either or survivor", "Number one or survivor", "any one or survivor" [This sub-rule (2) has been inserted by Companies (Acceptance of Deposits) Rules, 1992, Notification No. GSR 814(E), w.e.f. 19-10-1992].

Penal interest on overdue deposits

Rule 8A of the Companies (Acceptance of Deposits) Rules, 1975 (w.e.f. 28-11-2001) provides for payment of penal rate of interest on overdue deposits. The rule provides as follows:

A penal rate of interest of 18% shall be paid for the overdue period in case of public deposits matured and claimed but remaining unpaid. In case of deposit made by a small depositor, the penal rate of interest shall be 20% compoundable on an annual basis.

Return of deposits [Rule 10]

Every non-banking non-financial company is required to file with the Registrar on or before the 30th day of June of every year, a return of deposits in the prescribed form furnishing information contained therein as on 31st of March of that year duly certified by the auditors of the company. A copy of the return is required to be simultaneously furnished to the Reserve Bank of India. The form of return of deposits as prescribed in Rule 10 of the Deposit Rules has been revised w.e.f. 19-4-1985. All the returns of deposits as on 31st March, 1985 and subsequent years are to be filed subsequent to 10-4-1985 in the revised form.

Offence of not filing a return under rule 10 of the Companies (Acceptance of Deposits) Rules, 1975 is not punishable if no complaint is made within six months of 30th June - *Shree Dharma Sugar Industries (P.) Ltd. v. Registrar of Companies* [1989] 66 Comp. Cas. 337 (Kar.).



1.5 AUDITS UNDER COMPANIES ACT, 1956

1.5.1. Companies (Auditor's Report) Order, 2003 [CARO]

1. Short title, application and commencement

- (a) This order may be called the Companies (Auditor's Report) Order, 2003.
- (b) It shall apply to every company including a foreign company as defined in section 591 of the Act, except the following :—
 - ❖ a Banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);
 - ❖ an insurance company as defined in clause (21) of section 2 of the Act;
 - ❖ a company licensed to operate under section 25 of the Act; and
 - ❖ a private limited company with a paid-up capital and reserves not more than rupees fifty lakh and does not have loan outstanding exceeding Rupees Twenty Five lakhs from any bank or financial institution and does not have a turnover exceeding rupees five crores at any point of time during the financial year
- (c) It shall come into force on the 1st day of July, 2003.

2. Definitions

In this Order, unless the context otherwise requires:

- (a) "Act" means the Companies Act, 1956 (1 of 1956);
- (b) "chit fund company", "nidhi company" or "mutual benefit company" means a company engaged in the business of managing, conducting or supervising as a foreman or agent of any transaction or arrangement by which it enters into an agreement with a number of subscribers that every one of them shall subscribe to a certain sum of installments for a definite period and that each subscriber, in his turn, as determined by lot or by auction or by tender or in such other manner as may be provided for in the agreement, shall be entitled to a prize amount, and includes companies whose principal business is accepting fixed deposits from, and lending money to members.

3. Auditor's report to contain matters specified in paragraphs 4 and 5

Every report made by the auditor under section 227 of Act, on the accounts of every company examined by him to which this Order applies for every financial year ending on any day on or after the commencement of this Order, shall contain the matters specified in paragraphs 4 and 5.

4. Matters to be included in the Auditor's Report

he auditor's report on the account of a company to which this Order applies shall include a statement on the following matters, namely:—

- i. (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;
- (b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;
- (c) if a substantial part of fixed assets have been disposed of during the year, whether it has affected the going concern;

- ii. (a) whether physical verification of inventory has been conducted at reasonable intervals by the management;
- (b) are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such procedures should be reported;
- (c) whether the company is maintaining proper records of inventory and whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of account;
- iii. (a) has the company granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 301 of the Act. If so, give the number of parties and amount involved in the transactions; and
- (b) whether the rate of interest and other terms and conditions of loans given by the company, secured or unsecured, are prima facie prejudicial to the interest of the company; and
- (c) whether receipt of the principal amount and interest are also regular; and
- (d) if overdue amount is more than rupees one lakh, whether reasonable steps have been taken by the company for recovery/payment of the principal and interest;
- (e) has the company taken any loans, secured or unsecured from companies, firms or other parties covered in the register maintained under section 301 of the Act. If so, give the number of parties and amount involved in the transactions; and
- (f) whether the rate of interest and other terms and conditions of loans taken by the company, secured or unsecured, are prima facie prejudicial to the interest of the company; and
- (g) whether payment of the principal amount and interest are also regular; and
- iv. is there an adequate internal controls system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. Whether there is a continuing failure to correct major weaknesses in internal controls system;
- v. (a) whether particulars of contracts or arrangements referred to in section 301 of the Act have been entered in the register required to be maintained under that section; and
- (b) whether transactions made in pursuance of such contracts or arrangements have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time;
- (This information is required only in case of transactions exceeding the value of five lakh rupees in respect of any party and in any one financial year)
- vi. in case the company has accepted deposits from the public, whether the directives issued by the Reserve Bank of India and the provisions of sections 58A, 58AA or any relevant provisions of the Act and the rules framed thereunder, where applicable, have been complied with. If not, the nature of contraventions should be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal, whether the same has been complied with or not?
- vii. in the case of listed companies and/or other companies having a paid-up capital and reserves exceeding ₹50 lakhs as at the commencement of the financial year concerned, or having an average annual turnover exceeding five crores rupees for a period of three consecutive financial years immediately preceding the financial year concerned, whether the company has an internal audit system commensurate with its size and nature of its business;



- viii. where maintenance of cost records has been prescribed by the Central Government under clause (d) of sub-section (1) of section 209 of the Act, whether such accounts and records have been made and maintained;
- ix. (a) is the company regular in depositing undisputed statutory dues including Provident Fund, Investor Education and Protection Fund, Employees' State Insurance, Income-tax, Sales-tax, Wealth Tax, Service Tax, Custom Duty, Excise Duty, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.
(b) in case dues of income tax/sales tax/wealth tax/service tax/ customs duty/ excise duty/ cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the Department shall not constitute the dispute).
- x. whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year;
- xi. whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported;
- xii. whether adequate documents and records are maintained in cases where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities; If not, the deficiencies to be pointed out;
- xiii. whether the provisions of any special statute applicable to chit fund have been duly complied with? In respect of nidhi/mutual benefit fund/societies;
 - a. whether the net-owned funds to deposit liability ratio is more than 1:20 as on the date of balance sheet;
 - b. whether the company has complied with the prudential norms on income recognition and provisioning against sub-standard / doubtful / loss assets;
 - c. whether the company has adequate procedures for appraisal of credit proposals/ requests, assessment of credit needs and repayment capacity of the borrowers;
 - d. whether the repayment schedule of various loans granted by the nidhi is based on the repayment capacity of the borrower;
- xiv. if the company is dealing or trading in shares, securities, debentures and other investments, whether proper records have been maintained of the transactions and contracts and whether timely entries have been made therein; also whether the shares, securities, debentures and other investments have been held by the company, in its own name except to the extent of the exemption, if any, granted under section 49 of the Act;
- xv. whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company;
- xvi. whether term loans were applied for the purpose for which the loans were obtained;
- xvii. whether the funds raised on short-term basis have been used for long-term investment; If yes, the nature and amount is to be indicated;
- xviii. whether the company has made any preferential allotment of shares to parties and companies covered in the Register maintained under section 301 of the Act and if so whether the price

- at which shares have been issued is prejudicial to the interest of the company;
- xix. whether security or charges has been created in respect of debentures issued;
 - xx. whether the management has disclosed on the end use of money raised by public issues and the same has been verified;
 - xxi. whether any fraud on or by the company has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

5. Reasons to be stated for unfavourable or qualified answers

Where, in the auditor's report, the answer to any of the questions referred to in paragraph 4 is unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified answer, as the case may be. Where the auditor is unable to express any opinion in answer to a particular question, his report shall indicate such fact together with the reasons why it is not possible for him to give an answer to such question.

1.5.2. Statutory Auditors – Cost Auditors and Financial Auditors

Who can be appointed as an Auditor (Qualifications to be an Auditor)

Section 226 of the Act prescribes the qualifications and disqualifications for being appointed as a company auditor. An auditor of a company possessing the qualifications prescribed in section 226 of the Act is generally known as the statutory auditor of the company as he derives his duties, power and authority from the statute i.e., the Companies Act. According to section 226(1) "a person shall not be qualified as auditor of a company unless he is a chartered accountant within the meaning of the Chartered Accountants Act, 1949". It is further provided that a firm whereof all the partners practising in India are qualified for appointment as auditor, may be appointed by its firm name to be the auditor of a company. In this regard, it may be noted that under the Chartered Accountants Act, 1949, only a chartered accountant holding a certificate of practice can be engaged in the public practice of accountancy. Thus, it is only a practising chartered accountant who can be appointed as an auditor of a company.

Further, such a chartered accountant is also subject to the requirements of ethical conduct as contained in the Chartered Accountants Act. The High Court of Delhi in the case of the Council of the Institute of Chartered Accountants of India v. B. Ram Goel [2001] 29 SCL 257 has held the chartered accountant concerned as guilty for writing a letter to the shareholders of a company where he rendered professional service, for sale of their shares in that company (originally, the Council of the Institute held the chartered accountant as guilty).

In another case Institute of Chartered Accountants of India v. S.K. Jain [2001] 29 SCL 265, the same High Court held the chartered accountant concerned as guilty of gross negligence in certifying a statement of export of leather goods, without verifying facts from relevant books/documents of the concerned company.

Apart from practising chartered accountants, section 226(2) allows a holder of a certificate in an erstwhile Part B State which entitled him to act as an auditor of companies in the territories of that State, to be appointed as an auditor of companies registered anywhere in India.

Thus, an auditor of a company must either be:

1. a practising chartered accountant; or
2. the holder of a certificate in erstwhile Part B States entitling him to act as an auditor of companies.

Who cannot be appointed as an Auditor (Disqualifications)

The following entities or persons have been disqualified under section 226 of the Act from being appointed as an auditor of a company—



- (a) a body corporate;
- (b) an officer or employee of the company;
- (c) a person who is a partner or who is in the employment of an officer or employee of the company;
- (d) a person who is indebted to the company for an amount exceeding ₹1,000 or who has given any guarantee or provided any security in connection with the indebtedness of any third person for an amount exceeding ₹1,000.
- (e) a person holding any security of the auditee company when such security carries voting right.

A question may arise as regards this disqualification insofar as a firm is concerned. A firm is not a person in the eye of law and as such if any one partner happens to hold security, prima facie, that partner is disqualified but not the firm. However, having regard to the proviso to section 226(1) of the Act, wherein, it is stated that 'any partner so practising may act in the name of the firm', it appears that the identity of the firm becomes the identity of the partner. Accordingly, it seems that even if a single partner becomes disqualified under this ground, the firm in which he is a partner also becomes disqualified.

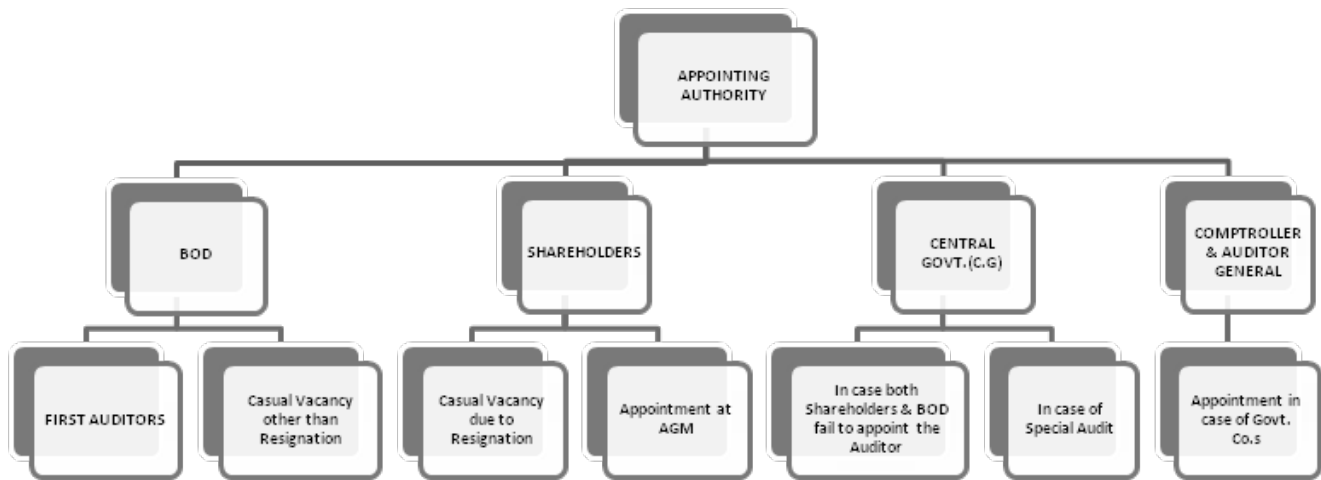
- (f) a person who by virtue of the above listed provisions is disqualified for appointment as auditor of any other body Corporate which is that company's subsidiary or holding company or a subsidiary of that company's holding company or would be so disqualified if the body corporate were a company.

Disqualification may come to an auditor if he ceases to be a member of the ICAI or is adjudged as having unsound mind or is an undischarged insolvent (vide sections 8 and 20 of the Chartered Accountants Act, 1949). Further, in a clarification issued by the Central Government, Department of Company Affairs, it has been stated that if a person is appointed as statutory auditor, he cannot simultaneously be appointed internal auditor of the company for the same period.

If after his appointment an auditor becomes subject to any of the disqualifications listed above, he shall be deemed to have vacated his office forthwith. Thus, after appointment as auditor of banking company, if the auditor takes loan from the bank (including any branch of the bank) exceeding rupees one thousand, he becomes disqualified and has to vacate the office of the auditor in the banking company. The council of the ICAI has decided that no auditor/audit firm who/which does not have the Peer Review Certificate issued by the Peer Review Board can carry on audit of listed companies in respect of accounting periods commencing from April 1, 2009. Also such auditor/audit firm is debarred from attesting the financial statements in respect of IPOs of companies - Source - The Hindu Business Line (N. Delhi Edition) of April 20, 2009.

The erstwhile Dept. of Company Affairs had issued the Circular No. 14/51/62-PR; it reads as under:

"It is the view of the Department that it would not be desirable practice for a practising Chartered Accountant X who is connected with the managing director of company, A or where X acts as auditor of company A, to be on the Board of Company B or to act or be employed as tax or financial advisor to company B, where companies A and B are in the same group, because he may find it difficult to exercise an independent judgment." It may be noted that the circular does not possess the legal force. It roots on subjective proposition of desirability.



Appointment of First Auditors

Section 224(5) lays down that the first auditor or auditors of a company shall be appointed by the Board of directors within one month of the date of registration of the company. The auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting. The company may, however, at a general meeting, remove any such auditor or auditors and appoint in his, their place any other person who has been nominated for appointment by any member of the company and of whose nomination notice has been given to the members of the company not less than fourteen days before the date of the meeting.

If the Board of directors fails to exercise its power, the company in general meeting may appoint the first auditor or auditors.

Sometimes, the first auditors of a company are named in the Articles of Association. Such appointment of auditors cannot be held valid since the Companies Act grants it no recognition. The first auditors would be validly appointed only by a resolution of the Board of directors or that of the company in the general meeting.

Appointment of subsequent Auditors

Subsequent auditor or auditors of a company are appointed every year by the members in annual general meeting by passing an ordinary resolution. Section 224(1) provides that “every company shall, at each annual general meeting, appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting, and shall, within seven days of the appointment, give intimation thereof to every auditor so appointed”. Sub-section (1A) requires the auditors so appointed to communicate his acceptance or refusal to the Registrar within a period of thirty days of the receipt from the company of the intimation of his appointment. Acceptance or refusal has to be communicated in writing and must be in the Form prescribed under the Act. It may be noted that this requirement of intimation and communication in writing about acceptance or refusal to accept is restricted to appointment made in the annual general meeting only.

Where the auditor appointed by the members does not accept the appointment, can the vacancy so caused be treated as a casual vacancy and the Board of directors be authorised by the shareholders to appoint new auditors? The matter was referred to the Research Committee of the Institute of Chartered Accountants of India which opined as follows:

‘The provisions of section 224 of the Act do not envisage changing the normal law of contract. Hence no appointment or reappointment is complete and effective if the auditor declines the same. Such a case is neither a vacancy caused by resignation nor a casual vacancy.

It further opined that the Companies Act clearly envisages that the appointment of the auditor should,



as a general rule, rest with the shareholders. The shareholders have to exercise this power in all cases, except in the case of filling casual vacancy or appointing the first auditors. This power cannot be delegated to the Board of directors.

As such, another general meeting has to be convened to appoint a new auditor.

Tenure of Appointment

Section 224(1) provides that an auditor is appointed from the conclusion of one annual general meeting until the conclusion of the next annual general meeting. But, if the annual general meeting is not held within the period prescribed by section 166, should the office of the auditor fall vacant by the date general meeting ought to have been held. Unlike the case of directors, the answer seems to be in the negative—the auditor is expected to continue in office till the annual general meeting is actually held and concluded. Thus, if an annual general meeting is adjourned, his tenure will extend till the conclusion of the adjourned meeting.

Further, section 227(2) requires an auditor to report on every balance sheet and the profit and loss account which are laid before the company in general meeting during the tenure of his office. Thus, it seems that the duty of an auditor cannot be regarded as one restricted to auditing the accounts only of a particular accounting year.

For instance: 'A' was appointed as the auditor at the seventh annual general meeting of a company- 'X' Ltd. However, due to certain reasons, he could not complete the audit. Later, the company convened its eighth annual general meeting, the agenda for which did not include adoption of audited accounts since they were not ready. Let us assume, auditor 'B' is appointed in place of 'A' in this meeting. The question that arises is whether B is entitled or required to audit accounts of the earlier year also, since the financial statements pertaining to that year are proposed to be laid before the 9th annual general meeting. In view of the provisions of section 224(1), read with section 227(2), the legal position seems to be that 'B' should report on the financial statement of the earlier year also.

Reappointment of retiring auditor

In accordance with the provisions of section 224(2) of the Act, a retiring auditor, by whatsoever authority appointed, shall be reappointed by passing an ordinary resolution except in the following circumstances—

1. Where he is not qualified for reappointment.
2. Where he has given the company notice in writing of his unwillingness to be reappointed.
3. Where a resolution has been passed at that meeting appointing somebody else instead of him or providing expressly that he shall not be reappointed.
4. Where a notice has been given of an intended resolution to appoint some person or persons in the place of retiring auditor, and by reason of death, incapacity or disqualification of that person or of all other persons, the resolution cannot be proceeded with.

He would also not be eligible to be appointed as the auditor where he holds the audit of specified number of companies or more than that on the day of the appointment in terms of section 224(1B) of the Act.

Where 25% or more of the subscribed capital of the company is held by public-financial institution(s) Government company(ies), etc. or a combination of them, the retiring auditor is to be appointed only by a special resolution.

It may be noted that the circumstances in (1) to (4) are different from the rest two. Assuming disabilities under (5) and (6) do not exist as also circumstances under (1) to (4) are not there, the retiring auditor will be reappointed by the members by passing ordinary resolution. The reappointment will not be automatic. It may also be noted that non-reappointment of the retiring auditor in the AGM is not removal of the auditor as contemplated in section 224(7) of the Act. It is simple retirement.

Rights of retiring auditor [Section 225(2) & (3)]

The rights given to retiring auditor, which follow the principles of natural justice and ensure that shareholders get all the relevant information before deciding upon the resolution that the retiring auditor shall not be reappointed or that a person other than the retiring auditor be appointed as auditors are as follows :

- (1) right to receive notice of the resolution.

The Karnataka High Court in *Ajit Kumar Iddya v. Institute of Chartered Accountants of India* [1994]80Comp.Cas. 197:[1994]3Comp. LJ564:[1994] 13 Corpt. LA 445 (Kar.) has held that the mode of serving the retiring auditor with a copy of the resolution appointing a new auditor is not prescribed by the Companies Act. The law does not compel the company to send such a notice by registered post. Institute has no control over companies and, therefore, cannot prescribe the mode of service. The guidelines of the Institute have no binding effect upon companies.

- (2) right to make a written representation to the company and request its notification to members of the company.

- (3) right to get his representation circulated among the members. (The fact that the representation has been received must be mentioned in any notice of the resolution given to members).

The company or any other aggrieved person may make an application to the CLB alleging that by his written representation, the auditor is abusing the rights conferred by this section to secure needless publicity for defamatory matters. The CLB may, on such an application, direct that the representation need not be circulated or read out at the meeting and award costs against the auditor though the auditor is not a part to the application.

- (4) right to get his representation read out at the meeting, if it has not been sent to the members because of delay or default on the part of the company.

- (5) right to be heard at the meeting.

Appointment by Special Resolution

Section 224A of the Act, provides that in the case of a company in which twenty-five per cent or more of the subscribed share capital is held, whether singly or in any combination, by:

- (a) a public financial institution or a Government company or Central Government or any State Government, or
- (b) any financial or other institution established by any provincial or State Act in which a State Government holds not less than fifty-one per cent of the subscribed share capital, or
- (c) a nationalised bank or an insurance company carrying on general insurance business;

the appointment of an auditor or auditors shall be made in the annual general meeting by a special resolution only.

However, indication in notice that appointment of auditor is in accordance with section 224A is itself sufficient to mean that the resolution is to be passed as special resolution *Subash Chand Agarwal v. Associated Limestone Ltd.* [1998] 92 Comp. Cas. 525 (CLB - New Delhi).

The DCA has clarified that the aforesaid sub-clauses (a) to (c) to section 224A(1) are not mutually exclusive.

The provisions of sub-section (1) of that section would, therefore, apply to all cases of shareholdings in any combination by any of the institutions mentioned in the three clauses.

Section 224A does not specify the date on which twenty-five per cent of the subscribed capital must be held by the specified bodies/institutions to require the appointment of the auditor by a special resolution. The DCA, Government of India, has clarified that the material date is the date of the annual



general meeting at which the special resolution is required to be passed.

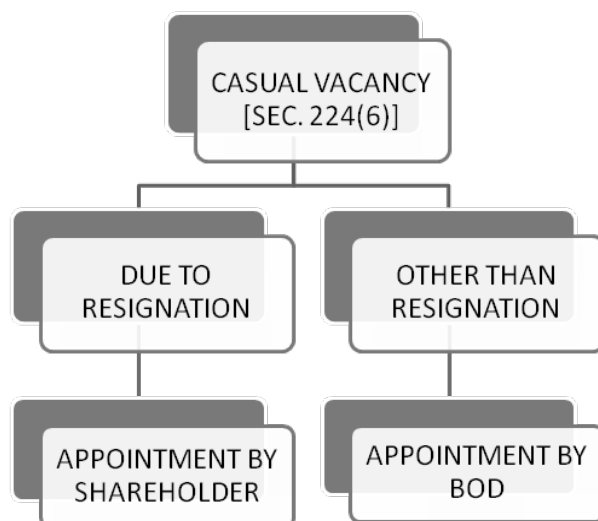
If the company fails to pass a special resolution, it shall be deemed that no auditor or auditors had been appointed by the company at its annual general meeting and the Central Government will be empowered to make the appointment.

Appointment by Central Government

Section 224(3) of the Act provides that where at an annual general meeting no auditor or auditors are appointed or re-appointed, the Central Government may appoint a person to fill the vacancy. For this purpose, the company is charged with the responsibility of intimating the above fact to the Central Government within seven days from the date of such meeting. The company and every officer of the company who is in default in this respect are punishable with fine which may extend to rupees five thousand.

Where appointment by the Central Government becomes necessary, an application is required to be made to the Regional Director. There is no prescribed form of application but the circumstances in which the company failed to appoint an auditor in its annual general meeting should be detailed. It may be of interest to note that section 224(1B) of the Act providing for ceiling on the number of company audit that an auditor can undertake does not mention the appointment by the Central Government. Question remains on whether the ceiling rule is inapplicable where Central Government is the appointing authority. Having regard to the provisions of section 619 of the Act which clearly provides for application of section 224(1B) for appointment of auditor in the Government companies, it seems reasonable to construe that the Central Government will be guided by the ceiling rule even for the appointment under section 224(3) of the Act.

Casual vacancy



A casual vacancy in the office of the auditor can be filled by the Board of Directors [Sec. 224(6)], provided such vacancy has not been caused by resignation of the auditor. In the case of a casual vacancy arising on account of resignation, only the company in general meeting can fill the vacancy. The expression 'casual vacancy' has not been defined in the Act. Taking its natural meaning, it stands for the vacancy created by the auditor ceasing to act after he was validly appointed and the appointment was accepted. This may arise due to variety of reasons which include death, resignation, disqualification, dissolution, of the firm of auditors, etc. The provision to require filling of casual vacancy caused by the resignation of the auditor by the annual general meeting is in consonance with the principle of auditor's independence. This process may bring out facts regarding the auditor's resignation to the notice and scrutiny of the shareholders. Any abuse of authority or financial impropriety by the

management that might have contributed to the resignation will be known. If the resigning auditor could be found to be conscientious and honest the general meeting may even request him to consider his decision and take appropriate steps to cure the evils, if any, in the management. The auditor appointed to a casual vacancy shall hold office till the conclusion of the next general meeting. However, it should be noted that a casual vacancy does not arise in the office of auditors on the expiry of one year of their appointment if the annual general meeting is not held in time.

Ceiling on audits (Restriction on number of audits)

The Companies (Amendment) Act, 1974 added two new sub-sections, viz., 224(1B) and 224(1C), with a view to restricting the number of companies in which a person can be appointed as an auditor. The idea probably is to prevent concentration of audits in few hands. Section 224 was further amended by the Amendment Act of 1988.

According to section 224(1B), an individual cannot be auditor of more than twenty companies at a time. Further, out of these twenty companies, not more than ten should be companies having a paid up share capital of ₹25 lakhs or more. In case the auditor is a partnership firm, the ceiling is twenty companies per partner of the firm. And where any partner is also a partner in any other firm or firms of auditors, the overall ceiling in relation to such a partner will be twenty.

Section 224(1B) has been amended by the Companies (Amendment) Act, 1988 to disallow the appointment of persons who are in full time employment elsewhere. Even in case of partnerships, such a partner shall be excluded from counting the number of audits per partner. However, although intention of the legislation seems to be as aforesaid, a drafting error of the section has resulted in unwarranted interpretations including that a person in whole-time employment elsewhere can be appointed auditor of specified number of companies. Also, another unintended interpretation is possible as regards an individual chartered accountant who is not employed elsewhere on whole time basis. There appears to be no bar to such an individual to hold any number of company audits.

Specified number of audits - In computing the specified number of audits, the following shall be taken into account:

- (i) all company audits where a person or a firm is appointed as joint auditor;
- (ii) audit of non-profit companies; and
- (iii) companies limited by guarantee and having share capital.

The following shall, however, be not taken into account:

- (a) Audit of private company (introduced by the Companies (Amendment) Act, 2000).
- (b) Branch audits- Thus, if X & Co. are the auditors of 'A Ltd.' and its ten branches, the assignment will be counted as only one audit. The DCA has also endorsed this view.
- (c) Guarantee companies not having share capital.
- (d) Special audits, investigations and audits of corporations set up under a separate Act.
- (e) Audits of foreign companies. Foreign companies fall outside the scope of section 224.

The company and its Board of directors, as the case may be, before appointing or re-appointing an auditor must obtain a certificate from the proposed auditor that the appointment or re-appointment, if made, will be in accordance with the limits specified in sub-section (1B) (discussed above). It is important to note that the ceiling rule provided by the Act does not mandate that in a firm of auditors each partner will sign audit reports for the number of companies specified for him. A Partner, can sign as many audit reports of companies as his firm is entitled to audit. A Proviso has been added in section 224(1B) to the effect that on and after the commencement of the Companies (Amendment) Act, 2000 i.e., w.e.f. 13-12-2000 no requirement contained in section 224(1B) will apply to a private company. It has few ramifications and they are as under:



1. Audits held in Private Companies irrespective of paid-up capital, will not be counted for determining whether the proposed auditor is exceeding the ceiling on the number of company audits held;
2. A private company is free to appoint or re-appoint any person (qualified under section 226 of the Act) who is in full-time employment elsewhere; and
3. The requirement in section 224(1) to obtain a written certificate as regards exceeding or not exceeding the ceiling on the number of company audits held by the proposed appointee to the office of the auditor will automatically become redundant insofar as a private company is concerned. It may be noted that this is the result of the amendment to section 224(1B) while the concerned requirement for certificate contained in section 224(1) remains unaltered.

In nutshell, so far ceiling rule is concerned, a private company will neither count nor be counted.

Appointment of auditors of Government Companies and certain other companies

Section 619 of the Act lays down special provisions regarding the appointment of auditors of Government companies. The section provides that the auditor of such a company shall be appointed or re-appointed by the Comptroller and Auditor General of India (CAG) who is given power to direct the manner in which the company's accounts shall be audited and to give instructions to him in regard to any matter relating to the performance of his functions as such. He may also conduct a supplementary or test audit of such company's accounts by persons authorised by him in this behalf. For the purposes of such audit he has the power to require information or additional information to be furnished to the persons so authorised, on such matters and in such form, as he may direct.

The auditor must submit a copy of his audit report to the CAG who has the right to comment upon or supplement the audit report in such manner as he may think fit and the same should be placed in the annual general meeting at the same time and in the same manner as the audit report.

The Companies Amendment Act, 1974 introduced section 619B according to which the provisions of section 619 of the Act, as stated above, also apply to a company in which the Central Government or any State Government or any Government corporation hold either singly or jointly not less than fifty-one per cent of the paid up share capital.

A person should keep these provisions in mind while accepting an appointment as the auditor of a company since a circular of the CLB states that, "the onus of complying with the provisions of section 619B lies with the concerned companies. All the same it would be necessary on the part of the auditors appointed/re-appointed under section 224 of the Act to ensure, before accepting the appointment/re-appointment that the company concerned is in fact outside the ambit of section 619B of the Act. It is needless to mention that in the event of the company being already hit by section 619B of the Act, any appointment or re-appointment of auditors by the company concerned under section 224 of the Act would be ab initio void".

Resignation of Statutory Auditor

The auditor may resign as an auditor of the company for any reason. Only the shareholders can fill such a vacancy. This provision is to uphold the independence of the auditor. The shareholders should know the reason of resignation of the auditor. It is possible that the board of directors is not cooperating with him or that the board might create a situation that he is not in a position to continue as an auditor. Perhaps he comes across a situation of a mis-statement in financial statements and does not want to take the risk.

It is also possible that he is resigning to take up a bigger audit or intends to become a director of the company or for that matter he is retiring from practice.

Whatever the reason, it is only the shareholders who can fill the vacancy caused by the resignation of an auditor.

If a statutory auditor has resigned during financial year, generally it will also be clearly understood between

the auditor and management as to who will complete the audit and from what date the resignation will take place and from what date the new auditor appointment letter will be issued after appointing him in the EGM.

This is because unless the new auditor gets no objection certificate from old auditor, he cannot commence the audit of the new client (ICAI Guidelines).

Moreover the new auditor has to inform the ROC by way of intimation about his new assignment.

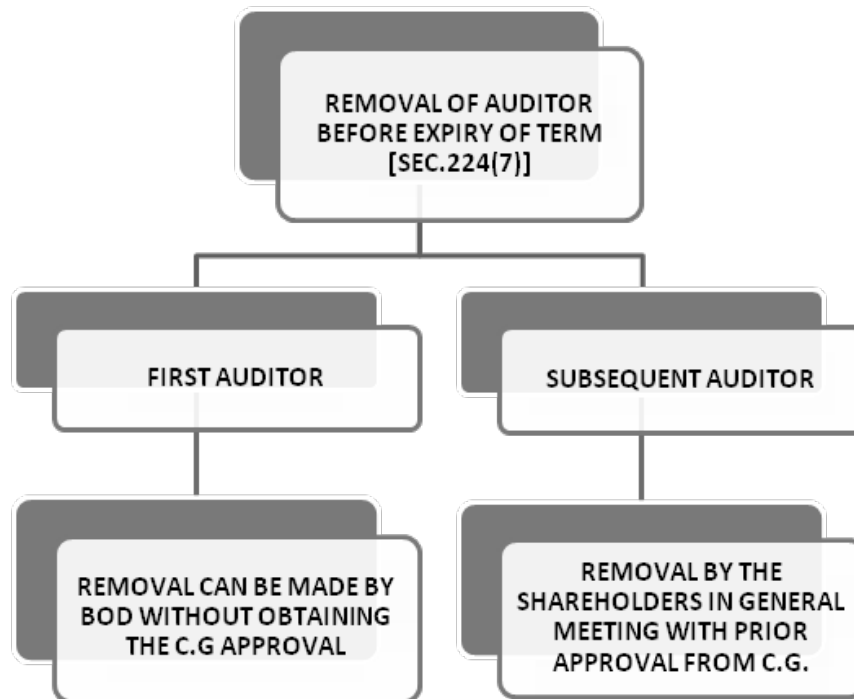
The right course would be:-

1. First the old auditor resign
2. Convene board meeting on the issue
3. Take acceptance of the new auditor that he is free to take the appointment if appointed by EGM
4. Hold an EGM and appoint new auditor in place of old auditor who resigned
5. Send new auditor intimation of his appointment in EGM formally and then take his acceptance
6. The new auditor will then get NOC from old auditor, file intimation of his new assignment to roc and then commence his audit.

Removal of an Auditor

In order to make the removal of independent and conscientious auditors difficult, the Act has laid down specific procedure in this regard. The procedure contains many safeguards to ensure the independence of auditors.

Removal before expiry of the term



An auditor may be removed, at any time before the expiry of his term in the following manner:

1. First auditor - First auditor, appointed by the Board of directors may be removed by merely passing an ordinary resolution. However, a nomination notice from a member of the company of at least 14 days is required for the appointment of any other person in his place.



2. Subsequent auditors - For removal of subsequent auditors before the expiry of the term, besides passing an ordinary resolution, prior permission of the Central Government must be obtained. Thus, it is difficult to remove an auditor before the expiry of his term since adequate grounds must exist to prove that such auditor is unsuitable for continuing as the auditor.

In *Basant Ram & Sons v. Union of India* the Delhi High Court upheld the removal of the auditors before expiry of the term as such removal had the approval of shareholders, and prior approval of the Govt. of India. Besides, there existed a chequered history of litigation between the petitioners and the company and the Petitioners' objections to certain transactions were raised only-when they had fallen foul with the management and to resist their removal. [2001] 29 SCL 119.

In a more recent case, the same High Court upheld the removal when illegality of removal procedure was contended by the petitioner, as according to him the decision was already taken by the Board and only subsequently approvals of the Central Government and of the general meeting were obtained. The Court was of the view that legally laid down procedure has been followed. The earlier decision of the Board does not matter - *Devinder K. Jain v. Union of India* [2007] 78 SCL 268.

In both (1) and (2) mentioned above, the procedure laid down in sub-sections (2) and (3) of section 225 shall have to be complied with. There is no requirement of any special notice in case of removal under section 224(7) and the Board of directors itself can initiate the removal process. The prior approval of the Central Government may be taken even after passing the Board resolution to remove but it must be before the general meeting decision and actual act of removal. It may even be permissible for the general meeting to pass a resolution to remove an auditor, subject to approval taken from the Central Government, before actually issuing the removal communication.

Appointing a new auditor in place of retiring auditor

For retiring an auditor, at the expiry of his term, though only an ordinary resolution is required but section 225 lays down the following procedure which must be observed before an auditor can be retired :

1. Special notice of such a resolution must be given providing expressly that the retiring auditor shall not be re-appointed.
2. On receipt of notice of such a resolution, the company must forthwith send a copy thereof to the retiring auditor.
3. Where notice is given of such a resolution and the retiring auditor makes with respect thereto representations in writing to the company (not exceeding a reasonable length) and requests their notification to members of the company, the company must, unless the representations are received by it too late for it to do so—
 - (a) in any notice of the resolution given to members of the company, state the fact of representations having been made;
 - (b) send a copy of the representations to every member of the company to whom notice of the meeting is sent.

In case a copy of the representations is not sent as aforesaid because they were received too late or because of the company's default, the auditor may require that the representations be read out at the meeting. The auditor also has the right to be heard at the general meeting.

However, the copies of the representations need not be circulated or read out in the meeting if, on the application of the company or any other aggrieved person, CLB, is satisfied that the auditor is abusing his right to secure unnecessary publicity for defamatory matters. In such a case, CLB may even order that the auditor should meet the company's costs in making the application either fully or partly. The procedure given above about sending the copy of the notice for removal of the auditor, its prompt circulation and rights of the auditor to make written and oral representations apply equally to mid-term removal of the first auditor as also the removal of the auditor appointed in the annual general meeting, under sections 224(5) and 224(7) of the Act. Though the wording of section 224(7) does not make a

mention of the requirement of a notice, having regard to the provisions of section 225(2), read with section 225(4), it seems clear that a notice is certainly required to remove an auditor appointed in the annual general meeting. The only additional procedure is the requirement of obtaining prior approval of the Central Government.

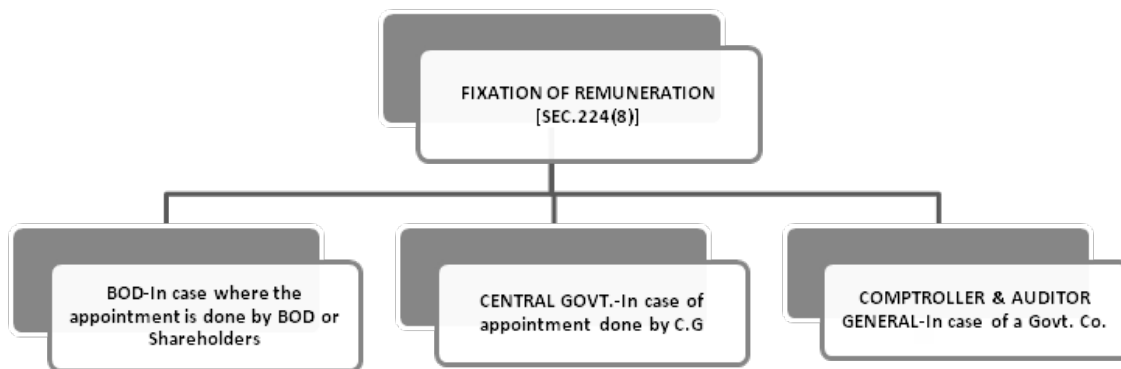
The Guidance Note issued by the ICAI in this regard, inter alia, suggests as follows:

1. It would not be sufficient for the incoming auditor to accept a certificate from the management of the company that the applicable provisions of the Companies Act have been complied with. It is necessary for him to verify relevant records of the company to ascertain whether in fact applicable provisions have been complied with. Where the company is unwilling to allow the incoming auditor to verify the relevant records, the incoming auditor should not accept the audit assignment.
2. The incoming auditor should verify the following:
 - (i) Whether a member of the company has given special notice of the resolution as required under section 225(1) at least 14 days before the date of the general meeting. A true copy of this notice should be obtained.
 - (ii) Whether this special notice has been sent to the members of the company as required under section 190(2).
 - (iii) Whether this special notice has been sent to the retiring auditor forthwith as required under section 225(3).
 - (iv) Whether representation received from the retiring auditor, if any, has been sent to the members of the company as required under section 225(3).
 - (v) Whether the representation received from the retiring auditor has been considered at the general meeting and the resolution proposed by the special notice has been properly passed at the general meeting.

A copy of the relevant minutes of the general meeting, duly certified by the Chairman of the meeting, should also be obtained by the incoming auditor for his record.

3. The incoming auditor should also communicate with the outgoing auditor in writing before accepting the audit assignment to inquire whether any professional reason exists for him not to accept the audit. This emanates from the provisions of the Chartered Accountants Act, 1949.

Remuneration of Auditors



Regarding remuneration of auditors, section 224(8) provides as follows :

1. In the case of an auditor appointed by the Board of directors or the Central Government, his remuneration may be fixed by the Board or the Central Government, as the case may be.



2. In all other cases, it must be fixed by the company in general meeting or in such manner as the company in general meeting may determine. In this category the appointment of auditor under sections 619 and 619B is also covered where the appointment is made by the CAG.

The expression 'remuneration' includes any sums paid by the company in respect of the auditor's expenses in carrying out his duties.

Notice that, it is not necessary that the amount of remuneration be specified by the company in its general meeting. It would be enough if the manner in which the remuneration is to be fixed is laid down in the general meeting. It is also not essential that the remuneration be fixed in the same general meeting in which the auditor is appointed.

However, an auditor may receive separate remuneration for services rendered other than the audit work, e.g., for advising on taxation matters, writing up the accounts, etc. Such a remuneration does not ordinarily require the sanction of the general meeting. However, a separate disclosure of all amounts paid to the auditor in different capacities is required to be made in the Profit and Loss Account under Part II of Schedule VI, classified as below:

1. As auditor.
2. For—
 - (a) taxation matters;
 - (b) company law matters;
 - (c) management services;
 - (d) other services;
 - (e) reimbursement of expenses.

Rights of the Company Auditor

To enable the auditor to discharge his duties effectively, the Act gives him certain rights. They are:

- (a) Right of access to books and account, etc. -As per section 227(1), every auditor of company has a right of complete access at all times to the books, accounts and vouchers of the company, wherever kept. The term 'Vouchers' includes all documents, correspondence, agreements, etc., which support any of the transactions or data disclosed in the financial statements, directly or indirectly. Similarly, the term 'books' includes the financial, statutory, and statistical books. The phrase 'all times', however, implies only to the normal business hours.
- (b) Right to obtain Information or Explanation - Section 227(1) also entitles the auditor of a company "to require from the officers of the company such information and explanations as the auditor may think necessary for the performance of his duties as auditor". This right of an auditor has been strengthened by casting a corresponding duty on the officers of the company vide section 221. Section 221 makes it obligatory for the officers of a company to furnish without delay information sought by the auditor in connection with audit of the company.

A failure of the officer to provide the information will entail penalty provided it was wilfully done. The penalty may involve imprisonment up to six months or a fine up to rupees fifty thousand or with both.
- (c) Right to inspect Branch Accounts - Section 228(2) provides that where the accounts of any branch office are audited by a person other than the company's auditor, the company's auditor shall be entitled to visit the branch office, if he deems it necessary to do so for the performance of his duties as auditor. He shall also have access at all times to the books and accounts and vouchers of the company maintained at the branch office.

However, in case of a banking company having a branch office outside India, it shall be sufficient,

if the auditor is allowed access to such copies of, and extracts from, the books and account of the branch as have been transmitted to the principal office of the company in India.

Branch Audit Exemption Rules - Section 228(4) of the Act has, however, empowered the Central Government to make rules providing for exemption of any branch office from the requirement of statutory audit.

The matters that are to be taken into consideration by the Central Government in making the rules are as under:—

- (a) the arrangement made by the company for the audit of accounts of the branch office by a person otherwise qualified for appointment as branch auditor even though such person may be an officer or employee of the company;
- (b) the nature and quantum of activity carried on at the branch office during a period of three years immediately preceding the date on which the branch office is exempted from the provisions of this section;
- (c) the availability at a reasonable cost of a branch auditor for the audit of accounts of the branch office ;
- (d) any other matter which in the opinion of the Central Government justifies the grant of exemption to the branch office from the provisions of this section.

Accordingly, the Central Government has prescribed the Companies (Branch Audit Exemption) Rules, 1961.

It is, therefore, legally possible for some of the branches remaining outside the scrutiny of statutory audit. If for any company, some of the branches are not audited because of the aforesaid Exemption Rules, the auditor should state that fact by specifying the number or naming the branch(es) which have not been audited while reporting under section 227(3) of the Act.

Section 2(9) of the Act has defined “branch office” as under:—

- (a) any establishment described as a branch by the company; or
- (b) any establishment carrying on either the same or substantially the same activities as that carried on by the head office of the company; or
- (c) any establishment engaged in the production, processing or manufacture, but does not include any establishment specified in any order made by the Central Government under section 8. Section 8 empowers the Central Government to declare any establishment of a company as not a branch either generally or for a specified purpose.

It is recognised that all significant branches should be audited.

- (d) Right to receive notices, etc. - Section 231 provides that all notices of and other communications relating to any general meeting of a company, which any member of the company is entitled to have sent to him, shall also be forwarded to the auditor of the company.
- (e) Right to attend general meeting - Under section 231 the auditor has the right to attend any general meeting and be heard, at any general meeting which he attends, on any part of the business which concerns him as auditor. The auditor may make any statement or explanation with regard to the accounts as he may deem fit.

Section 230 makes it obligatory that the auditor's report be read at the general meeting and also shall be open to inspection by any member of the company.

- (f) Right to remuneration - An auditor is entitled to his remuneration on the completion of his work. The above-mentioned rights of an auditor are his statutory rights and cannot be limited or abridged either by the Articles or resolution of the members. Any provision of this nature is ultra vires and hence void - *Newton v. Birmingham Small Arms Co.* [1906]2Ch.378.



- (g) Auditors' lien** - In terms of the general principles of law, any person having the lawful possession of somebody else's property, on which he has worked, may retain the property for non-payment of his dues on account of the work done on the property. On this premise, auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fees, for work done on the books and documents. The Institute of Chartered Accountants in England and Wales has expressed a similar view on the following conditions:
- (i) Documents retained must belong to the client who owes the money.
 - (ii) Documents must have come into possession of the auditor on the authority of the client. They must not have been received through irregular or illegal means. In case of a company client, they must be received on the authority of the Board of directors.
 - (iii) The auditor can retain the documents only if he has done work on the documents assigned to him.
 - (iv) Such of the documents can be retained which are connected with the work on which fees have not been paid.

Under section 209 of the Act, books of account of a company must be kept at the registered office. These provisions ordinarily make it impracticable for the auditor to have possession of the books and documents. However, under the Act, further provisions are there-under which books of account could be kept at a different place, pursuant to a Board's resolution of which notice must be given to ROC. If in a company, Board passes such a resolution and hands over the books of account to the auditor and makes the necessary notification to the ROC, the auditor may in such circumstances, exercise the right of lien for non-payment of fees. However, as per section 209 he must provide reasonable facility for inspection of the books of account by directors and others authorised to inspect under the Act. Taking an overall view of the matter, it seems that though legally auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints. His working papers being his own property, the question of lien on them does not arise.

Statement on Standard Auditing & Assurance Practices-3 (SSAP-3) issued by the ICAI on Documentation also states that, "working papers are the property of the auditor. The auditor may at his discretion make portions of or extracts from his working papers available to his clients. The auditor should also adopt reasonable procedures for custody and confidentiality of his working papers and should retain them for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal or professional requirements of record retention".

Duties of Company Auditor

The Companies (Amendment) Act of 1965 introduced two sub-sections (1A) and (4A) in section 227 of the Act.

It may be noted that sub-section (1A) requiring certain inquiries to be made by the auditor is independent both of sub-section (1) which narrates the powers of auditors, and of sub-sections (2) and (3) which state the function and duties of the auditors. It is merely a directive to the auditor to make certain specific enquiries. In the circumstances, it would be presumed that the Legislature by its introduction did not intend to extend the scope of audit report or its form generally. This view is strengthened by the introduction of sub-section (4A). It empowers the Central Government to extend the scope of the audit report in respect of a particular class or description of companies by requiring a statement on such matters as may be specified by the Central Government by a general or special order to be included therein.

It could be said that the effect of the introduction of sub-section (1A) is that the auditor should make a report to the members in case he finds that answer to any of the matters under inquiry is adverse. But he has to enquire into all the matters specified in the sub-section. In case of any adverse finding showing adverse functioning of the company, the auditor should report the same in bold letters or in italics [vide ' section 227(3)(e)].

Scope of Audit Report under section 227 - Sub-sections (2) and (3) of section 227 provide that it is the duty of the auditor to report to the members of the company on the accounts examined by him and on every balance sheet and profit and loss account and every other document declared by the Act to be part of, or annexed to, the balance sheet and the profit and loss account, laid before the company in general meeting during the tenure of his office; also that the report shall confirm the position, envisaged in the under-mentioned manner in which the requirements are to be met.

Sub-section (2) under clauses (i) and (ii) specifically requires that the auditor should report whether in his opinion and to the best of his information and according to the explanations given to him, the said accounts give the information required by the Act, in the manner so required and that the balance sheet gives a true and fair view of the company's affairs at the end of financial year and the profit and loss account gives a true and fair view of the profit or loss for the financial year.

Sub-section (3) requires that the auditor shall report on the following matters:

- (a) Whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for audit-The significance of such a requirement is that the auditor must obtain due satisfaction about the scope of work carried out by him and affirm that in the discharge of his duties he has maintained professional standards of diligence and care.

Justice Lindley in his famous judgment, in the London and General Bank case, propounded his view. The relevant passage from the judgment is quoted below:

"An auditor, however, is not bound to do more than exercise reasonable care and skill in making enquiries and investigations. He is not an insurer; he does not guarantee that the books do correctly show the true position of the company's affairs; he does not guarantee that his balance sheet is accurate according to the books of the company, if he did, he would be responsible for an error on his part, even if he were himself deceived without any want of reasonable care on his part say, by the fraudulent concealment of a book from him."

Lopes L.J. held in his judgment in the case of Kingston Cotton Mills that auditors must not be made liable for not tracking out ingeniously and carefully laid scheme of fraud when there is nothing to arouse their suspicion and when those frauds have been perpetrated by the tried servants of the company and have been undetected for years by the directors.

Thus, for the collection of information, the auditor is entitled to rely upon trusted servants of the company; he can accept representations made by them either orally or in writing, provided reasonable care was taken to ensure that the data or information furnished are true and could be trusted to have been prepared in the course of the working of the company. If, however, there are any circumstances that should arouse suspicion, it would be the auditor's duty to probe it to the bottom. So long as there is no such suspicion, he is only expected to exercise normal caution and care.

- (b) Whether in his opinion, proper books of account as required by law have been kept by the company, so far as appears from his examination of those books and proper returns adequate for the purpose of his audit have been received from branches not visited by him - The term 'proper books of account' is defined indirectly under sub-section (1) of section 209 wherein it is stated that a company shall not be deemed to have kept proper books of account in respect of matters specified in sub-sections (1) and (2) of section 209, if there are not kept such books as are necessary to give a true and fair view of the state of affairs of the company or branch office, as the case may be, and to explain its transactions. The Companies (Amendment) Act, 1988 further requires that the proper books of account shall not be deemed to be kept if such books are not kept on accrual basis and according to the double entry system of accounting.

Further, in section 541(2), it is provided that a company that is being wound up shall be deemed not to have maintained proper books of account if it had not kept:

- (i) such books of account as are necessary to exhibit and explain the transactions and financial



position of the business of the company including books containing entries made from day to day in sufficient detail of all cash received and all cash paid; and

- (ii) where the business of the company has involved dealing in goods, statement of annual stock-taking and (except in the case of goods sold by way of ordinary retail trade) of all goods sold and purchased, showing particulars of goods and those of buyers and sellers in sufficient detail to enable those goods and those buyers and sellers to be identified.

In the circumstances, proper books of account as required by law are those which contain a record of all the transactions specified both in section 209 and section 541(2) in a manner that they present a true and fair view of the state of affairs of the financial position and profitability of the company.

The cost records prescribed under section 209(1)(d) also form part of books of account required to be maintained under law.

- (bb) Whether the report on the accounts of any branch office audited wider section 228 by a person other than the company's auditor has been forwarded to him as required by section 228(3)(c) and how he has dealt with the same in preparing the auditor's report - The Research Committee of the ICAI had obtained the views of a senior Counsel on this matter and an extract there from is given below:

"Having regard to the scheme of sub-section (2), it is clear that though the company in general meeting appoints a branch auditor, the company's auditor still has a certain measure of responsibility in respect of the accounts and papers of the branch. This is shown by the fact that he has a right to visit the branch and has access to the papers and documents of the branch. He must discharge this responsibility by looking into the branch auditor's report and satisfying himself that, having regard to the report and what he has seen of the branch and documents of the branch, affairs of the branch are in order."

- (c) Whether the company's balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and returns - The work of an auditor culminates in the verification of statements of account. It is apparent that the duty, in this regard, would not be properly discharged if he fails to verify them on making a reference to the books of account before proceeding to make a report thereon. When the auditor reports that proper books of account have been kept and the accounts are in agreement therewith, he confirms that he has discharged the specific duty in this regard imposed on him by the law. If proper books of account have not been kept and if there is a discrepancy in the statements of account and the entries as they appear in the books, he should refer to such a position in his report.
- (d) Whether, in his opinion, the profit and loss account and balance sheet have complied with the accounting standards referred to in sub-section (3C) of section 211.

The Companies (Amendment) Act, 2000, has added two new matters in section 227(3) for auditor's report. Clauses (e) and (f) are the additions.

While **clause (e)** requires the auditor to state in thick type or in italics the observations and comments of the auditors which have any adverse effect on the functioning of the company, **clause (f)** requires a statement in the audit report on whether any director is disqualified from being appointed as director under section 274(1)(g) of the Act.

Clause (e) requires the auditor to put in thick letters or in italics such of the components of his report including any on section 227(1A) and on C(AR)0 [vide section 227(4A)], on the accounts which bear adverse finding/opinion. For example, if proper books of account were not maintained, it amounts to a serious lapse in the accounting records keeping and may be highlighted by using thick letters or italics. In effect, this requirement is, perhaps motivated by the anxiety to draw specific attention of users of the financial statements, on highly adverse matters in auditor's report. Also to be noted that this clause does not have the word "whether" to start with. So, it is not an independent clause.

It is not enough that reporting in bold/italics is meant only on the report that the auditor submits to the company. The company, in turn, has to ensure that auditor's report circulated to the shareholders and others also contain these matters in bold/ italics.

Clause (f) reads as under:

"Whether any director is disqualified from being appointed as director under clause (g) of sub-section (1) of section 274 of the Act." This clause has been inserted by the Companies (Amendment) Act, 2000 specifying that a person who is already a director of a public company and such a company has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April, 1999 or has failed to repay its deposits or interest thereon on due date or redeem its debentures on due date or pay dividend (obviously after declaration) and such failure continues for one year or more, is disqualified from being appointed as a director in any company. It further states that such person shall not be eligible to be appointed as a director of any other public company for a period of five years from the date of the failures mentioned above. The drafting of the clause suggests that the disqualification is twofold - such a person as is referred to above will be disqualified (i) for appointment as a director in any company including a private company and (ii) he will be barred from appointment as a director in a public company for a period of five years from the date of failure to file the documents or pay the amounts as above.

Cost Audit [section 233B]

It is an audit process for verifying the costs of manufacture or production of an article on the basis of accounts as regards utilisation of material or labour or other items of costs, maintained by the company. Under the provisions of section 233B of the Act, such an audit shall ordinarily be conducted by a Cost Accountant within the meaning of the Cost and Works Accountants Act, 1959.

The cost auditor shall be appointed by the Board of directors of the company which is required under clause (d) of sub-section (1) of section 209 of the Act to include in books of account, the particulars referred to therein, if the Central Government so directs. The cost auditor has the same powers and duties as prescribed under section 227(1) of the Act for the auditors appointed under section 224. The Board of the company shall appoint the cost auditor with prior approval of the Central Government. As the Central Government has the power to approve the appointment, it has the concurrent power to disapprove any proposal of appointment on due consideration of facts surrounding the proposal.

The Revised Procedure for Appointment of Cost Auditor :-

The MCA, by General Circular No. 15/2011, dated 11-4-2011, has announced the revised procedure for appointment of cost auditor under section 233B(2) of the Act. The important matters in the revised procedure are as under:

1. The Audit Committee of the Board shall be the first point of reference for this appointment where the company has an Audit Committee; otherwise the Board of Directors, as in the past will initiate the process. The Audit Committee shall see that the recommendee does not suffer from any disqualification under section 233B(5) read with sections 224 and 226 of the Act. The Audit Committee as well as the recommendee should ensure that he does not exceed the ceiling on number of cost audit that he can hold at the time of appointment. The Audit Committee shall also take a certificate from the recommendee that he stands in arm's length relationship with the company and his independence is not affected.
2. The company shall e-file its application with the Central Government in Form 23C within 90 days of the commencement of the financial year. The application shall be deemed to be approved unless contrary is heard within 30 days of filing the application. If within aforesaid 30 days the Central Government directs the company to resubmit the application with further details/more information, the deeming will run for 30 days from the date of resubmission.
3. After expiry of the 30 days of deeming approval, the company can issue the formal letter of appointment to the recommendee.



4. Upon receipt of formal letter of appointment the cost auditor shall inform the Central Government in the prescribed form. No time for this has been provided, which implies that it should be done within a reasonable time.
5. The company shall disclose full particulars of the cost auditor and the due date and actual date of filing the cost audit report in its annual report for that financial year.
6. The revised procedure takes effect from 1st April, 2011.

The company as well as the cost auditor are subject to penalties for any violation of the requirements of these procedures.

According to sub-section (1) of section 233B, the cost auditor appointed under this section is expected to conduct the audit in such manner as may be specified in the order issued by the Central Government. Further, as required by sub-section (4) read with Rules 4(7) and 5 of the Cost (Audit Report) Rules, 2001 he must forward his report to the Central Government and to the company within 180 days of the closing of the year to which the audit related. The report is to be given in the form prescribed for the purpose. (Vide G.S.R. 924(E), dated 27-12-2001 of the D.C.A., Govt. of India). Rule 4(2) of the Cost (Audit Report) Rules, 2001 requires the cost auditor to reply to the Central Government within thirty days of receipt of any communication seeking clarifications on the cost audit report submitted by him.

The Government has issued Cost Audit (Report) Rules, 2001 specifying the form of the report and the additional information which should be included therein in the form of annexures. The Rules have also laid down the various points on which the cost auditor should make his observations and give his conclusions.

The cost auditor must further report on the adequacy of cost accounting records maintained by the company as prescribed by the Government under section 209(1)(d) of the Act to confirm that they give a true and fair view of the cost of production, cost of sales and margin on the product. If there is any additional information, that he would like to furnish, he may include it in an annexure to the report. The Government has issued notification under section 209(1)(d) as regards various industries, e.g., cement, cycles, etc. With each notification a schedule is attached containing detailed items under which the cost of production must be analysed to arrive at the total cost. Each company concerned is required to make available to the cost auditor, relevant cost accounting records, cost statements, other books and documents annexures and proforma to the report, duly completed within one hundred thirty five days from the close of the financial year of the company. The company and every officer of the company including persons mentioned in section 209(6) of the Act are responsible to render necessary assistance to the cost auditor to complete the cost audit and submit his report in time. By Notification No. GSR 148(E), dated 8-3-2006. The Ministry of Company Affairs" has amended the Cost Audit (Report) Rules, 2001 to enable e-filing of the report and to insert a new Form I in the Rules. The existing 'Form' is now fitted as Form II.

Authentication of the Annexures and Proforma of the Cost Audit Report-The Board of directors of the company shall approve the annexures and proforma before the cost auditor submits the same to the Central Government. These should be signed by at least one director of the company and the company secretary where there is one, otherwise these should be signed by at least two directors of the company. Any default by the company in these regards attracts punishment for the company and officers responsible which may extend to rupees five thousand and for continuing default further fine of rupees five hundred for each day of the contravention excluding the first day. For failure of the cost auditor to submit his report, a fine up to rupees five thousand is leviable.

The Government's view, so far as it can be ascertained from the pronouncements is that cost audit will not be required annually, but only for the financial year or years specified in the order.

The copy of the cost audit report sent to Central Government should also be sent to the company concerned simultaneously. The company shall, within 30 days from the date of the receipt of the copy of the report, furnish the Central Government with full information and explanations on every reservation

or qualification contained in such report. The Central Government, after consideration of the report and the information and the explanations furnished by the company, may seek further explanation from the company if it so needs. The Central Government may direct the company concerned to circulate to members along with the notice of the general meeting to be held for the first time after submission of the relevant cost audit report, the whole or part of the report as it may specify. The cost auditor has to provide clarification to the Government, on the same being sought, within thirty days of the receipt of the requirement.

Cost Audit to be in addition to financial audit- Cost audit requirement under section 233B is in addition to the audit conducted by an auditor appointed under section 224 of the Act. Unlike statutory financial audit, cost audit is to be conducted only if the Central Government makes an order for a particular year and for a specified company or specified class of companies. The order for cost audit can be made only in respect of companies engaged in the production, processing, manufacturing or mining activities. The Central Government has framed, and may from time to time frame rules in respect of industries of the nature referred to above providing maintenance of particulars relating to utilisation of material or labour or other items of cost in the books of account.

Ceiling on Cost Audits - Section 233B, as amended by the Companies (Amendment) Act, 1988 has extended the provisions of section 224(1B) to cost audits. Accordingly, the ceiling on number of audits as specified there under shall apply to cost audits also. Thus, like a statutory financial auditor, a cost accountant cannot be auditor of more than twenty companies out of which not more than ten should be companies having a paid-up share capital of ₹25 lakhs or more. In case the cost auditor is a partnership firm of cost accountants, the ceiling is twenty companies per partner of the firm. And where any partner is also a partner in any other firm or firms of cost auditors, the overall ceiling in relation to such a partner will be twenty. It may be noted that the number of cost audits for the purpose of ceiling does not include cost audit of private companies.

Section 224(1B) as amended by the Amendment Act, 1988 disallows the appointment of persons who are in full time employment elsewhere. Even in case of partnerships such a partner shall be excluded from counting the number of audits. The Board of directors other than of a private company should obtain a written certificate from the person proposed to be appointed as cost auditor that his appointment if made shall be within the aforesaid limits.

Appointment of a firm of cost accountants as cost auditors - A firm of cost accountants can also be appointed as cost auditors if all the partners of the firm are practising cost accountants and the firm itself has been constituted with the previous approval of the Central Government as required under Regulation 113 under the Cost and Works Accountants Act, 1959. In such a case, the cost audit report may be signed by any one of the partners of the firm for and on behalf of the firm. The audit report cannot however be signed merely by affixing the firm's name."

Cost Auditor cannot be internal auditor- The DCA has clarified that since the cost auditor is required to comment on the scope and performance of internal audit as per the provisions of the Cost (Audit Report) Rules, it would tend to militate against proper and dispassionate discharge of the duties of the cost auditor if he was also the internal auditor of the company for the same period for which he is conducting the cost audit. The Department is therefore of the view that the cost auditor should not also be the internal auditor of a company for the period for which he is conducting the cost audit.

Disqualifications - A person cannot be appointed as a cost auditor of a company if he attracts any of the disqualifications listed in sub-sections (3) and (4) of section 226 and u/s 233(B) of the Act. Thus, the following entities/persons cannot be appointed as cost auditors:

- (i) A body corporate;
- (ii) an officer or employee of the company;
- (iii) a person who is a partner or who is in the employment of an officer or employee of the company;
- (iv) a person who is indebted to the company for an amount exceeding ₹1,000 or who has given any



guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding ₹1,000;

- (v) a person holding any vote carrying security of the company;
- (vi) a person who is disqualified to be the cost auditor of its subsidiary or holding company or of another subsidiary of its holding company;
- (vii) a person appointed under section 224 as an auditor of a company [Section 233B(5)(b)]

If a person appointed for conducting the audit of cost accounts of a company becomes subject, after his appointment, to any of the aforesaid disqualifications, he shall on and from the date on which he becomes so subject, cease to conduct the audit of the cost accounts of the company [Section 233B(5)(c)].

Additional disqualifications - In addition to the aforesaid disqualifications the Institute of Cost and Works Accountants of India has notified that any cost accountant who accepts an appointment as the cost auditor of a company in the following situations shall be deemed to be guilty of professional misconduct.

- (a) if he is an employee of the company's auditor appointed under section 224;
- (b) if he is an employee of any of the partners of a firm of chartered accountants which is appointed as company's auditor under section 224.

Penalties - Section 233B(11) provides that a company is liable to be punished with fine which may extend to rupees five thousand for any default in complying with the provisions of section 233B. It further provides that every officer of the company who is in default, is liable to be punished with imprisonment for a term which may extend to three years, or with fine which may extend to fifty thousand rupees, or with both. In this regard rule 8(2) of the Cost (Audit Report) Rules, 2001 deals with penalty for non-compliance with rules 6 and 7 of the aforesaid Rules, which relate to furnishing of the cost records to the cost auditor in time and authentication of the Annexures etc. of the cost audit report. The company and every officer in default of the company are punishable with fine which may extend to rupees five thousand with further fine of rupees five hundred for every day of continuing default. This penal provision under rule 8(2) is restricted to violation of rules 6 and 7 and is different from the penal provision of section 233B(11). However, there is overlapping in these penal provisions in so far as providing assistance to the cost auditor is concerned. Therefore, the penal provisions in the Rules are largely redundant as for default covered by section 233B(6) and rule 6 as stated above. These need to be harmonised. Rule 8(1) of the aforesaid Rules provide for punishment of the cost auditor for any default in complying with rules 4 and 5 which relate to form of the report and time span for submission of the report. The punishment is a fine which may extend to rupees five thousand. Section 233B, however, does not contain any penal provision for the cost auditor. Under this circumstance, the penal provision of the rules will apply to the cost auditor for the non-compliances of rules 4 and 5. It may be noted that section 233 provides for penalty on the statutory auditor for non-compliance with sections 227 and 229 of a sum which may extend to rupees ten thousand. These two penal provisions - one applicable to the statutory auditor and the other to the cost auditor are strikingly different and inequitable. This aspect also needs urgent attention of the law makers.

Where a company and its auditor had applied for extension of time to submit report, but no reply was received from Government and fact of labour problem was proved by documentary evidence, it could be said that the company had acted honestly and diligently and delay in submitting cost records/ audit report was beyond its control and thus, it could not be punished for offence under section 233B (11) - *M. Meyyappan v. Registrar of Companies* [2003] 42 SCL 758 (Mad.).

1.5.3. Companies (Cost Accounting Record) Rules, 2011 and Companies (Cost Audit Report) Rules, 2011

Companies (Cost Accounting Record) Rules, 2011

In exercise of the powers conferred by clause (b) of sub-section (1) of section 642 read with clause (d) of sub-section (1) of section 209 of the Companies Act, 1956 (1 of 1956),

- 1. Short Title and Commencement-** (1) These rules may be called The Companies (Cost Accounting Records) Rules, 2011. (2) They shall come into force on the date of their publication in the Official Gazette.
- 2. Definitions and Interpretations.** - In these rules, unless otherwise so provided,---
 - (a) "Act" means the Companies Act, 1956 (1 of 1956);
 - (b) "Compliance Report" means compliance report duly authenticated and signed by a cost accountant in the prescribed form of compliance report;
 - (c) "Cost Accountant" for the purpose of these rules means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and - 2 - Works Accountants Act, 1959 (23 of 1959) and who is either a permanent employee of the company or holds a valid certificate of practice under subsection (1) of section 6 and who is deemed to be in practice under subsection (2) of section 2 of that Act and includes a firm of cost accountants;
 - (d) "Cost Accounting Standards" means the standards of cost accounting, issued by the Institute;
 - (e) "Cost Records" means books of account relating to utilisation of materials, labour and other items of cost as applicable to the production, processing, manufacturing or mining activities of the company;
 - (f) "Form-A" means the form prescribed in these rules for filing compliance report and other documents with the Central Government in the electronic mode;
 - (g) "Form-B" means the form of the compliance report and includes Annexure to the compliance report;
 - (h) "Generally Accepted Cost Accounting Principles" means the principles of cost accounting issued by the Institute;
 - (i) "Institute" means the Institute of Cost and Works Accountants of India constituted under the Cost and Works Accountants Act, 1959 (23 of 1959);
 - (j) "Manufacturing Activity" includes any act, process or method employed in relation to
 - ❖ transformation of raw materials, components, sub-assemblies, or parts into semi-finished or finished products; or
 - ❖ making, altering, repairing, fabricating, generating, composing, ornamenting, furnishing, finishing, packing, re-packing, oiling, washing, cleaning, breaking-up, demolishing, or otherwise treating or adapting any product with a view to its use, sale, transport, delivery or disposal; or
 - ❖ constructing, reconstructing, reconditioning, servicing, refitting, repairing, finishing or breaking up of any products.
 - (k) "Mining Activity" includes any act, process or method employed in relation to the extraction of ores, minerals, oils, gases or other geological materials from the earth's crust, including sea bed or river bed.
 - (l) "Processing Activity" includes any act, process, procedure, function, operation, technique, treatment or method employed in relation to



- (i) altering the condition or properties of inputs for their use, consumption, sale, transport, delivery or disposal; or
 - (ii) accessioning, arranging, describing, or storing products; or
 - (iii) developing, fixing, and washing exposed photographic or cinematographic film or paper to produce either a negative image or a positive image; or
 - (iv) printing, publishing, finishing, perforation, trimming, cutting, or packaging; or
 - (v) pumping oil, gas, water, sewage or any other product; or
 - (vi) transforming or transmitting, distributing power or electricity; or
 - (vii) harboring, berthing, docking, elevating, lading, stripping, stuffing, towing, handling, or warehousing products; or
 - (viii) preserving or storing any product in cold storage; or
 - (ix) constructing, reconstructing, reconditioning, repairing, servicing, refitting, finishing or demolishing of buildings or structures; or
 - (x) farming, feeding, rearing, treating, nursing, caring, and stocking of living organisms; or
 - (xi) telecasting, broadcasting, telecommunicating voice, text, picture, information, data or knowledge through any mode or medium; or
 - (xii) obtaining, compiling, recording, maintaining, transmitting, holding or using the information or data or knowledge; or
 - (xiii) executing instructions in memory to perform some transformation and/or computation on the data in the computer's memory.
- (m) "Product" means any tangible or intangible good, material, substance, article, idea, know-how, method, information, object, service, etc. that is the result of human, mechanical, industrial, chemical, or natural act, process, procedure, function, operation, technique, or treatment and is intended for use, consumption, sale, transport, store, delivery or disposal.
- (n) "Product Group" in relation to tangible products means a group of homogenous and alike products, produced from same raw materials and by using similar or same production process, having similar physical or chemical characteristics and common unit of measurement, and having same or similar usage or application; and in relation to intangible products means a group of homogenous and alike products or services, produced by using similar or same process or inputs, having similar characteristics and common unit of measurement, and having same or similar usage or application.
- (o) "Production Activity" includes any act, process, or method employed in relation to –
- (i) transformation of tangible inputs (raw materials, semi-finished goods, or sub-assemblies) and intangible inputs (ideas, information, know how) into goods or services; or - 4 –
 - (ii) manufacturing or processing or mining or growing a product for use, consumption, sale, transport, delivery or disposal; or
 - (iii) creation of value or wealth by producing goods or services.
- (p) "Turnover" means gross turnover made by the company from the sale or supply of all products or services during the financial year. It includes any turnover from job work or loan license operations but does not include any non-operational income;
- (q) All other words and expressions used in these rules but not defined, and defined in the Act and rules made under clause (d) of sub-section (1) of section 209 of the Act shall have the same meanings as assigned to them in the Act or rules, as the case may be.

- 3. Application-** (1) These rules shall apply to every company, including a foreign company as defined under section 591 of the Act, which is engaged in the production, processing, manufacturing, or mining activities and wherein, the aggregate value of net worth as on the last date of the immediately preceding financial year exceeds five crores of rupees; or wherein the aggregate value of the turnover made by the company from sale or supply of all products or activities during the immediately preceding financial year exceeds twenty crores of rupees; or wherein the company's equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India.

Provided that these rules shall not apply to a company which is a body corporate governed by any special Act;

Provided further that these rules shall not apply to the activities or products covered in any of the following rules,-

- (a) Cost Accounting Records (Bulk Drugs) Rules, 1974
- (b) Cost Accounting Records (Formulations) Rules, 1988
- (c) Cost Accounting Records (Fertilizers) Rules, 1993
- (d) Cost Accounting Records (Sugar) Rules, 1997
- (e) Cost Accounting Records (Industrial Alcohol) Rules, 1997
- (f) Cost Accounting Records (Electricity Industry) Rules, 2001
- (g) Cost Accounting Records (Petroleum Industry) Rules, 2002
- (h) Cost Accounting Records (Telecommunications) Rules, 2002

4. Maintenance of records-

- (1) Every company to which these rules apply, including all units and branches thereof shall, in respect of each of its financial year commencing on or after the 1st day of April, 2011, keep cost records.
- (2) The cost records referred to in sub-rule (1) shall be kept on regular basis in such manner so as to make it possible to calculate per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly/quarterly/half-yearly/annual basis.
- (3) The cost records shall be maintained in accordance with the generally accepted cost accounting principles and cost accounting standards issued by the Institute; to the extent these are found to be relevant and applicable. The variations, if any, shall be clearly indicated and explained.
- (4) The cost records shall be maintained in such manner so as to enable the company to exercise, as far as possible, control over the various operations and costs with a view to achieve optimum economies in utilization of resources. These records shall also provide necessary data which is required to be furnished under these rules.
- (5) All such cost records and cost statements, maintained under these rules shall be reconciled with the audited financial statements for the financial year specifically indicating expenses or incomes not considered in the cost records or statements so as to ensure accuracy and to reconcile the profit of all product groups with the overall profit of the company. The variations, if any, shall be clearly indicated and explained.
- (6) All such cost records, cost statements and reconciliation statements, maintained under these rules, relating to a period of not less than eight financial years immediately preceding a financial year or where the company had been in existence for a period less than eight



years, in respect of all the preceding years shall be kept in good order.

- (7) It shall be the duty of every person, referred to in sub-section (6) and (7) of section 209 of the Companies Act, 1956 (1 of 1956), to take all reasonable steps to secure compliance by the company with the provisions of these rules in the same manner as he is liable to maintain accounts required under sub-section (1) of section 209 of the said Act.

- 5. Form of the Compliance Report** - Every company to which these rules apply shall submit a compliance report, in respect of each of its financial year commencing on or after the 1st day of April, 2011, duly certified by a cost accountant, along with the Annexure to the Central Government, in the prescribed form.
- 6. Time limit for submission of Compliance Report** - Every company shall submit the compliance report referred to in rule 5 to the Central Government within one hundred and eighty days from the close of the company's financial year to which the compliance report relates.
- 7. Authentication of Annexure to the Compliance Report** - The Annexure prescribed with the compliance report, as certified by the cost accountant, shall be approved by the Board of Directors before submitting the same to the Central Government by the company.
- 8. Penalties** - (1) If default is made by the cost accountant in complying with the provisions of these rules, he shall be punishable with fine, which may extend to five thousand rupees.
- (2) If a company contravenes any provisions of these rules, the company and every officer thereof who is in default, including the persons referred to in sub-section (6) of section 209 of the Act, shall be punishable as provided under sub-section (2) of section 642 read with sub-sections (5) and (7) of section 209 of Companies Act, 1956 (1 of 1956).
- 9. Savings-** The supersession of the Cost Accounting Records Rules, shall not in any way affect- a) any right, obligation or liabilities acquired, accrued or incurred thereunder;
- b) any penalty, forfeiture or punishment incurred in respect of any contravention committed thereunder; and
- c) any investigation, legal proceeding or remedy in respect of any such right, privilege, obligation, liability, penalty, forfeiture or punishment as aforesaid, and; any such investigation, legal proceeding or remedy may be instituted, continued or enforced and any such penalty, forfeiture or punishment may be imposed as if those rules had not been superseded.

Companies (Cost Audit Report) Rules, 2011

In exercise of the powers conferred by clause (b) of sub-section (1) of section 642 read with sub-section (4) of section 233B, and sub-section (1) of section 227 of the Companies Act, 1956 (1 of 1956), and in supersession of the Cost Audit Report Rules, 2001, except as respects things done or omitted to be done before such supersession, the Central Government hereby makes the following rules, namely:-

1. Short Title and Commencement-

- (1) These rules may be called The Companies (Cost Audit Report) Rules, 2011.
- (2) They shall come into force on the date of their publication in the Official Gazette.

2. Definitions and Interpretations. - In these rules, unless otherwise so provided,---

- (a) "Act" means the Companies Act, 1956 (1 of 1956);
- (b) "Cost Auditor" means an auditor appointed to conduct an audit of cost records, under sub-section (2) of section 233B of the Act;
- (c) "Form-I" means the Form prescribed in these rules for filing cost audit report and other documents with the Central Government in the electronic mode;

- (d) "Form-II" means the Form of the cost auditor's report and includes auditor's observations and suggestions, and Annexure to the cost audit report;
- (e) "Form-III" means the Form of the performance appraisal report;
- (f) "Product" means any tangible or intangible good, material, substance, article, idea, know-how, method, information, object, service, etc. that is the result of human, mechanical, industrial, chemical, or natural act, process, procedure, function, operation, technique, or treatment and is intended for use, consumption, sale, transport, store, delivery or disposal.
- (g) "Product Group" in relation to tangible products means a group of homogenous and alike products, produced from same raw materials and by using similar or same production process, having similar physical or chemical characteristics and common unit of measurement, and having same or similar usage or application; and in relation to intangible products means a group of homogenous and alike products or services, produced by using similar or same process or inputs, having similar characteristics and common unit of measurement, and having same or similar usage or application;
- (h) "Report" means cost audit report duly audited and signed by the cost auditor in the prescribed form of cost audit report;
- (i) All other words and expressions used in these rules but not defined, and defined in the Act and rules made under clause (d) of sub-section (1) of section 209 and sub-section (4) of section 233B of the Act shall have the same meanings as assigned to them in the Act or rules, as the case may be.

3. Application –

- (1) These rules shall apply to every company in respect of which an audit of the cost records has been ordered by the Central Government under sub-section (1) of section 233B of the Act.
- (2) Every company as specified in sub-rule (1) shall, within ninety days of the commencement of every financial year, file an application with the Central Government seeking prior approval for appointment of the cost auditor, through electronic mode, in the prescribed form, alongwith the prescribed fee as per the Companies (Fees on Applications) Rules, 1999, and requisite enclosures.
- (3) Every cost auditor appointed under sub-rule (2) shall, within thirty days of receipt of letter of appointment, inform his appointment to the Central Government through electronic mode, in the prescribed form, alongwith the requisite enclosures.
- (4) Notwithstanding anything contained in sub-rule (2) and (3) above, every company and every cost auditor shall follow the procedure prescribed vide Ministry of Corporate Affairs' General Circular No. 15/2011 [File No. 52/5/CAB-2011] dated April 11, 2011.

4. Form of the Report –

- (1) Every cost auditor, who conducts an audit of the cost records of the company, shall submit the report along with auditor's observations and suggestions, and Annexure to the Central Government in the prescribed form and at the same time forward a copy of such report to the company.
- (2) The cost audit report submitted on or after 1st day of April, 2012, irrespective of the financial year of the company to which it relates, shall be in the form prescribed under these rules.
- (3) Every company as specified in sub-rule (1) of rule 3 shall, keep and maintain cost details, statements, schedules, etc. for each unit and each product or activity comprised in each product group, duly authenticated by atleast two Directors of the company and the cost auditor.



- (4) The cost details, statements, schedules, etc. of every company, as specified in sub-rule (3), relating to a period of not less than eight financial years immediately preceding a financial year, or where the company had been in existence for a period less than eight years, in respect of all the preceding years shall be kept in good order:
 - (5) Every cost auditor, who submits a report under sub-rule (1), shall also furnish performance appraisal report, duly authenticated by the cost auditor, to the Board/Audit Committee of the company in the prescribed form.
 - (6) Every cost auditor, who submits a report under sub-rule (1), shall also give clarifications, if any, required by the Central Government on the cost audit report submitted by him, within thirty days of the receipt of the communication addressed to him calling for such clarifications.
- 5. Time limit for submission of Report** – Every cost auditor shall forward his report referred to in sub-rule (1) of rule 4 to the Central Government and to the concerned company within one hundred and eighty days from the close of the company's financial year to which the report relates.
- 6. Cost Auditor to be furnished with the cost accounting records etc.** – Without prejudice to the powers and duties the Cost Auditor shall have under sub-section (4) of section 233B of the Act, the company and every officer thereof, including the persons referred to in sub-section (6) of section 209 of the Act, shall make available to the cost auditor, such cost accounting records, cost statements, other books and documents, and Annexure to the Report, duly completed, as would be required for conducting the cost audit, and shall render necessary assistance to the cost auditor so as to enable him to complete the cost audit and submit his report within the time limit specified in rule 5.
- 7. Authentication of Annexure to the Cost Audit Report** – The Annexure prescribed with the cost audit report shall be approved by the Board of Directors before submitting the same to the Central Government by the cost auditor. The Annexure, duly audited by the cost auditor, shall also be signed by the Company Secretary and at least one Director on behalf of the company. In the absence of Company Secretary in the company, the same shall be signed by at least two Directors.
- 8. Penalties –**
- (1) If default is made by the cost auditor in complying with the provisions of rule 4 or rule 5, he/she shall be punishable with fine, which may extend to five thousand rupees.
 - (2) If a company contravenes any provisions of these rules, the company and every officer thereof who is in default, including the persons referred to in sub-section (6) of section 209 of the Act, shall be punishable as provided under sub-section (2) of section 642 read with sub-sections (5) and (7) of section 209 and sub-section (11) of section 233B of Companies Act, 1956 (1 of 1956).
- 9. Savings-** The supersession of the Cost Audit Report Rules, 2001, shall not in any way affect-
- a) any right, obligation or liabilities acquired, accrued or incurred thereunder;
 - b) any penalty, forfeiture or punishment incurred in respect of any contravention committed thereunder; and
 - c) any investigation, legal proceeding or remedy in respect of any such right, privilege, obligation, liability, penalty, forfeiture or punishment as aforesaid, and; any such investigation, legal proceeding or remedy may be instituted, continued or enforced and any such penalty, forfeiture or punishment may be imposed as if those rules had not been superseded

1.6 DIVIDENDS

Dividend - Meaning

The dictionary meaning of 'dividend' is "sum payable as interest on loan or as profit of a company to the creditors of an insolvent's estate or an individual's share of it". In commercial usage, however, 'dividend' is the share of the company's profits distributed among the members (Barjor Hoshangi Vakil v. Mettur Chemical & Industrial Corporation Ltd [1963] 33 Comp. Cas. 932).

Thus, we may say that corporate earnings and profits not retained in the business, and when distributed among shareholders, are known as 'dividend'.

The term 'dividend' is also used to include distribution of the company's assets, in cash or in specie, which remain with the liquidator after he has realised all the assets and discharged all the liabilities, in the event of its winding up.

In CIT v. Girdhar Das & Co. (P.) Ltd. [1967] 21 Comp. L. J., the Supreme Court defined the expression 'dividend' as follows:

- "As applied to a company which is a going concern, it ordinarily means the portion of the profits of the company which is allocated to the holders of shares in the company.
- In the case of winding-up, it means a division of the realised assets among creditors and contributories according to their respective rights."

With the introduction of sub-section (14A) in section 2, by the Companies (Amendment) Act, 2000, the term 'dividend' includes any interim dividend. This definition assumes that the term should be understood only in its commercial sense and has only widened its scope to include "interim dividend", the expression which did not earlier find a place in the Act except in Table A.

However, issue of bonus shares by capitalising accumulated profits is not construed as dividend.

The Institute of Chartered Accountants of India has defined 'dividend' as "a distribution to shareholders out of profits or reserves available for this purpose". (Vide -Guidance Note on Terms used in Financial Statements).

1.6.1. Profits and ascertainment of Divisible Profits

Profits v. Divisible Profits

Meaning of Divisible Profits - All the profits of a company cannot be said to be divisible. Only those profits which can legally be distributed to the shareholders of the company in the form of dividend are called as 'divisible profits'. However, specific definition of 'divisible profits' has not been laid down even by the Companies Act.

In Buenos Ayres Great Southern Rly. Co., In re [1947] Ch. 384 'divisible profits' were described to mean the profits which the directors consider should be distributed after making provision for past losses, reserves and for other purposes.

The following four considerations may govern the determination of divisible profits :

- Principles of Accounting,
- Provisions of Memorandum and Articles,
- Provisions of the Companies Act, and
- Legal Decisions.

'Profits available for Distribution' v. 'Profits available for dividend'- The term 'profits available for distribution' and 'profits available for dividend' have different meanings and should not be confused. The first term means the maximum profits which the law allows a company to distribute to the shareholders by way



of dividend. The latter term implies the profits which the directors consider should be distributed after making provision for past losses, for transfer to reserve or for other purposes.

If the directors have on some fair basis taken a decision as to the proportion of profits which should be distributed by way of dividend, the Courts do not interfere in this matter even if there are larger profits and more dividend could have been paid (*Stewart v. Sashalite Ltd.* [1936] 2 All ER 1481). The Courts do not compel directors to declare a dividend against their judgment.

Sources out of which dividends may be paid

According to section 205, dividends may be declared out of the following three sources:

1. Current profits.
2. Past reserves created out of profits or credit balance in the profit and loss account brought forward.
3. Out of moneys provided by Government, if any.

Out of current profits - Dividends may be declared out of the profits of the company for the current year after providing for depreciation.

However, the Central Government may, if it thinks necessary so to do in public interest, allow any company to declare or pay dividend for any financial year out of the profits of the company for that year or any previous financial year or years without providing for depreciation [Proviso (c) to section 205(1)].

Compulsory transfer of profits to reserves [Section 205(2A)] - A company must transfer a prescribed percentage of its profits (usually, not exceeding 10 per cent) to its reserves before declaring dividends. According to the Rules framed by the Central Government in this behalf, a company has to transfer a percentage of its profits for that year to its reserves as specified below:

1. Where the dividend proposed exceeds 10 per cent but not 12.5 per cent of the paid up capital, the amount to be transferred to the reserves shall not be less than 2.5 per cent of the current profits;
2. Where the dividend proposed exceeds 12.5 per cent but does not exceed 15 percent of the paid up capital, the amount to be transferred to the reserves shall not be less than 5 per cent of the current profits;
3. Where the dividend proposed exceeds 15 per cent, but does not exceed 20 per cent of the paid up capital, the amount to be transferred to the reserves shall not be less than 7.5 per cent of the current profits; and
4. Where the dividend proposed exceeds 20 per cent of the paid-up capital, the amount to be transferred to reserves shall not be less than 10 per cent of the current profits.

It may be noted that no transfer to reserve is required if the rate of dividend proposed is 10% or less. The rates of dividend for the different slabs mentioned above refer to the rates of equity dividend and the part of the dividend which holders of participating preference shares are entitled to after receiving the fixed percentage of dividend that such shares carry. The profit out of which the dividend will be paid should be after charging depreciation for the year and any arrear of depreciation or carry forward loss, whichever is lower, taxes and statutory transfer to reserve like investment allowance reserve or development rebate reserve. The reserve stipulated in section 205(2A) is a free reserve.

A company can make a transfer of more than 10 per cent to reserves voluntarily provided it ensures the minimum distribution specified in Rule 3 of the Companies (Transfer of Profits to Reserves) Rules, 1975. The minimum distribution is the rate of dividend equal to the average of the rates of dividend for the last 3 financial years. Where bonus shares have been issued during the financial year, minimum distribution would be construed as the average of the amount of dividend for the last three financial

years. Where, however, the net profits after tax for the financial year are lower by 20 per cent or more than the average net profits after tax of the last two financial years, it will not be necessary to ensure the minimum distribution for making a higher transfer to reserve. Where no dividend is declared, the transfer to reserves should be lower than the average amount of dividends declared during the last three financial years. A newly incorporated company is not allowed to transfer more than 10 per cent of its profits to reserves. The requirement of transfer to the reserves equally applies to declaration/payment of interim dividend in view of provisions of sub-sections (1A) and (1C) introduced by the Companies (Amendment) Act, 2000. The Board of directors has to estimate the "Current Profits" for the year in which interim dividend is declared.

Out of past reserves - Dividends may be declared out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with the provisions of section 205 of the Act and remaining undistributed. However, the Central Government may, if it thinks necessary so to do in the public interest, allow any company to declare or pay dividend for any financial year out of the profits of the company for that year or any previous financial year or years without providing for depreciation.

Section 205A(3) inserted by the Companies (Amendment) Act, 1974 requires that dividend can be declared out of reserves only in accordance with the rules framed by the Central Government in this behalf. However, where a company wishes to declare a dividend otherwise than as per these rules it may do so with the previous approval of the Central Government. The credit balance, if any, carried in the profit and loss account will be available for declaration of dividend without restriction if such balance was carried after charging depreciation, tax etc. in the previous year(s).

The rules framed by the Central Government in this regard provide that in the event of absence or inadequacy of profits in any year, dividend may be declared by the company out of accumulated past profits provided the following conditions are satisfied:

1. The rate of the dividend declared does not exceed the average of the rates at which dividend was declared by it in the 5 years immediately preceding that year or 10 per cent of its paid-up capital, whichever is less.
2. The total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves does not exceed an amount equal to 1/10th of the sum of its paid-up capital and free reserves and the amount so drawn must first be utilised to set off the losses incurred in the financial year before any dividend in respect of preference or equity shares is declared.
3. The balance of reserves after such drawal does not fall below 15 per cent of its paid-up share capital.

Section 205A(3) begins with words 'where owing to inadequacy or absence of profits in any year'. Therefore, the pre-condition for the application of the said provision is that there is an 'inadequacy or absence of profit in the year' in which the company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by it to the reserve - Nestle India Ltd., In re [2009] 89 SCL 454/ 147Comp.Cas.712(Delhi).

It may be noted that though interim dividend is also a dividend, profit earned in the past and kept in reserves cannot be used to pay interim dividend. This position appears to be clear from the very wording of aforesaid sub-section (3) which deals with declaration of dividend "in any year". It has got to be annual (final) dividend and not the interim dividend.

Funds provided by Government- A company can also declare dividends out of the funds provided by the Central Government or a State Government for payment of such dividend in pursuance of a guarantee given by that Government.

Depositing dividend declared in a separate bank account- As per sub-section (1A) of section 205 inserted by the Companies (Amendment) Act, 2000, any dividend i.e., whether interim or annual, when



declared, the amount thereof shall have to be deposited in a separate bank account within five days of declaration. Sub-section (1B) of section 205 introduced by the Companies (Amendment) Act, 2000 further states that the amount of dividend including interim dividend, deposited in a separate bank account as above shall be used for payment of interim dividend. When sub-section (1A) is read in conjunction with sub-section (1B), it seems that the legislative intent in this regard has not been correctly brought out. Sub-section (1A) requires deposits of any dividend declared in a separate bank account obviously to segregate it from the other bank account(s) of the company so that the declared dividend can be paid without any difficulty and the payment is to be effected in terms of the declaration. If it is annual dividend, the payment shall be made of that dividend out of the special bank account and same will be the case with interim dividend. There is no question of annual dividend declared and deposited in the separate bank account to be used for payment of interim dividend. The drafting of sub-sections (1A) and (1B) is patently deficient. Sub-section (1A) basically empowers the Board of directors to declare interim dividend and both sub-sections (1A) and (1B) should have dealt with interim dividend only without adding the word "dividend". If annual dividend is also to be deposited in a separate bank account, the same could have been done either by adding one more sub-section in section 205 or by suitably modifying section 207. Anyway, the sub-sections mentioned in this paragraph provide for : -

- (a) power of the Board of directors to declare interim dividend,
- (b) deposit of any dividend declared in a separate bank account, within five days of declaration, and
- (c) payment of the dividend declared out of the separate bank account.

It is apparent that for declaration of interim dividend approval of the general meeting is not required. It may also be observed that this separate bank account need not be with a scheduled bank, though this lacuna also appears to have come out of oversight in the drafting.

Provision for Depreciation

According to section 205, depreciation must be provided before any dividend can be declared out of profits of any financial year falling after the commencement of the Companies (Amendment) Act, 1960.

As to how much depreciation should be provided for determining the divisible profits, section 205(2) provides that depreciation must be provided either:

- (a) to the extent specified in section 350, or
- (b) in respect of each item of depreciable asset, for such an amount as is arrived at by dividing 95 per cent of the original cost by the specified period, or
- (c) on any other basis approved by the Central Government by which 95 per cent of the original cost of each such depreciable asset can be written off on the expiry of the specified period, or
- (d) in respect of any other depreciable asset for which no rate of depreciation has been laid down by the Act or the Rules made thereunder, on such basis as may be approved by the Central Government by general or special order.

Depreciation under section 350- According to section 350 the amount of depreciation is to be calculated with reference to the written down value of the assets as shown by the books of the company at the end of the financial year expiring at the commencement of this Act or immediately thereafter and at the end of each subsequent financial year, at the rate specified in Schedule XIV. The Companies (Amendment) Act, 2000 now allows provision of depreciation on straight line basis also as per the rates contained in Schedule XIV. However, if any asset is sold, discarded, demolished or destroyed for any reason before depreciation of such asset has been provided for in full, the excess, if any, of the written

clown value of such asset, over its sale proceeds or as the case may be, its scrap value, shall be written off in the financial year in which the asset is sold, discarded, demolished or destroyed. This will equally apply when depreciation is provided in accordance with (b) or (c) above.

The above provisions of section 350 do not state the specific methods to arrive at the value of the assets. The section merely prescribes the reference to which the mode of calculation will apply and extent of depreciation to be provided as computed in terms of Schedule XIV to the Act. Schedule XIV, however, requires the depreciation methods used, and depreciation rates/the useful lives of the assets to be disclosed.

Arrears of depreciation and past losses - Legal position regarding arrears of depreciation may be summarised as follows:

1. Where a company has not provided for depreciation for any financial year after the commencement of the Companies (Amendment) Act, 1960, this should be done before any dividend is declared. Such arrears of depreciation may be provided out of the current profits or the profits of previous financial years, remaining undistributed.
2. Where a company has incurred any loss in any previous financial year or years falling after the commencement of the Companies (Amendment) Act, 1960, then the lower of the following two amounts, namely,—
 - (a) the amount of the loss, or
 - (b) the amount of depreciation provided for that year or those years, should be set off against:
 - (i) the profits of the company for the year for which dividends are proposed to be declared or paid, or
 - (ii) against the profits of the company for any previous financial year or years; arrived at in both cases after providing for depreciation, or
 - (iii) against both.

Proviso (b) to section 205(1) of the Act which provides as above does not seem to convey the requirement in a very clear manner. Ordinarily, a profit or loss is determined after providing for depreciation. This is intended here also as the proviso refers to the amount of depreciation provided. Accordingly, when one has to find out the lesser of:

- (a) the loss, and
- (b) the depreciation content of the loss; it may only bring confusion. To clarify a practical situation is given below:

Assume that the profit in a particular previous year was ₹500 before providing for depreciation. If depreciation provided for was ₹1,200 for that year, then there will emerge a loss of ₹700. The comparison is to be made with the figure of loss, i.e., ₹700 and the depreciation provided, viz. ₹1,200; the loss of ₹700 being lower, this requires to be offset against current year's profit after depreciation. There cannot be a situation where the loss can be lesser than the depreciation, when there was originally a loss situation, say of ₹200 before providing for depreciation of ₹1,200, then the loss after providing for depreciation is ₹1,400 and in that circumstance only ₹1,200 need be offset and not ₹1,400. This situation perhaps is again not in conformity with the spirit of the proviso, because it fails to require offsetting of ₹200 of actual loss or ₹1,400 of actual loss after depreciation. This deficiency in the proviso need urgent correction to require offsetting of the entire carried forward loss arrived after charge of depreciation.

Views of the Company Law Department on depreciation

1. Re-computation of specified period-Specified period once computed need not be recomputed. The companies may, therefore, continue to charge depreciation at the old SLM (Straight Line Method) rates (in spite of new rates of depreciation prescribed under Schedule XIV) in respect of



the already acquired assets against which depreciation has been provided in earlier years on SLM basis [Circular No. 2 of 1989, dated 7-3-1989].

2. Can depreciation be provided at rates higher than Schedule XIV rates?

The Department has opined that the rates as contained in Schedule XIV should be viewed as the minimum rates, and, therefore, a company shall not be permitted to charge depreciation at rates lower than those specified in the Schedule in relation to assets purchased after the date of applicability of the Schedule. However, if on the basis of a bona fide technological evaluation, higher rates of depreciation are justified, they may be provided with proper disclosure by way of a note forming part of annual accounts [Circular No. 2 of 1989, dated 7-3-1989].

Insertion of Schedule XIV has in effect, resulted in delinking of computation of depreciation under the Companies Act from depreciation calculated under the Income-tax Act. Non-compliance of the provisions of Schedule XIV to the Act will tantamount to a default under the Companies Act and shall thus attract penal consequences. This will be so, even though depreciation is provided as per the Income-tax Act. However, in general, the rates of depreciation under Income-tax Act are higher than the rates under Schedule XIV. To that extent companies may provide the higher rates as under the Income-tax Act. But if Schedule XIV rates are higher, say for example, in case of data processing machines (including computers) the rate of depreciation is 40% (WDV rate) but under Income-tax Rules it is 20%, depreciation at 40% (i.e., Schedule XIV rates) only will be applicable.

3. Depreciation on immovable properties held as investments -The Company Law Department has also opined that adequate depreciation must be provided for on all assets that depreciate. Thus, even where immovable property is held as an investment, depreciation should be provided unless the company deals in buying and selling of properties.

Different methods of depreciation for different types of assets -Companies are free to adopt different methods of depreciation for different types of assets. However with regard to a particular asset the same basis must be consistently adopted from year to year. Thus, a company may charge depreciation on straight line method in respect of buildings and adopt the written down value method for plant and machinery.

Where an asset has already been reduced to 5 per cent or less of its original cost, it would not be statutorily necessary to provide for further depreciation every year till the asset is sold, discarded, demolished or destroyed.

Pro rata depreciation - Note 4 to Schedule XIV provides for provision of depreciation on pro rata basis in respect of assets which are purchased during a financial year. The provision was incorporated to check a large scale malpractice of purchasing the assets towards the end of the financial year but charging depreciation for the full year. Likewise, where any asset has been sold, discarded, demolished or destroyed, the depreciation on such assets shall be calculated on a pro rata basis. Thus, in the case of assets purchased, sold, discarded or destroyed during a financial year, depreciation will be calculated from the date of purchase or, as the case may be, upto the date on which such asset has been sold, discarded, demolished or destroyed.

With regard to pro rata depreciation, the Research Committee of the ICAI has expressed the view that a company may group additions and disposals in appropriate time period(s), e.g., 15 days, a month, a quarter, etc., for the purpose of charging pro rata depreciation in respect of additions and disposals of its assets keeping in view the materiality of the amounts involved¹.

A question that may arise in this regard is whether depreciation is to be charged on pro rata basis even in respect of those assets for which a depreciation rate of 100% has been prescribed in Schedule XIV. In this regard, it is reasonable to draw a distinction between low-cost items (which can be fully written off in the year of acquisition on ground of materiality) and those items for which a depreciation rate of 100% is prescribed. In respect of the items falling in the latter category, the requirement for providing depreciation on pro rata basis seems to be as much as in respect of other assets for which lower rates are prescribed.

Depreciation for double or triple shift working shall be provided:

- (a) only when the concern has actually so worked uniformly throughout the year;
- (b) in case the concern has not worked uniformly, as in (a) above, extra shift depreciation shall be provided in proportion to the number of days for which the concern worked extra shift which it bears to the normal number of working days during the year.
‘Normal working days’, for this purpose, shall be:
 - (i) in the case of a seasonal factory or concern, the number of days on which the factory or concern actually worked during the year or 180 days, whichever is greater;
 - (ii) in any other case, the number of days on which the factory or concern actually worked during the year or 240 days, whichever is greater.
- (c) no extra shift depreciation shall be charged on assets marked N.E.S.D. (meaning ‘No Extra Shift Depreciation’) and also in respect of items of machinery and plant specified under Note 6 to Schedule XIV to which the general rate of depreciation of 15 per cent applies.

1.6.2. Declaration of dividend on preference and equity shares

The Companies Act does not give any specific power to the companies registered thereunder to declare and pay any dividend. The power to pay dividend is inherent in a company and is not derived from the Companies Act or the Memorandum or Articles of Association although the Articles of Association generally regulate the manner in which dividends are to be declared. It may, however, be noted that section 86, as amended by the Companies (Amendment) Act, 2000, allows companies to issue equity shares with differential rights as to dividend.

Regulation 85 of Table A requires that the dividend is to be declared in the general meeting but the amount/rate of dividend declared cannot exceed the amount/rate recommended by the Board. If Table A has been adopted as Articles of the company or regulation 85 has been included in any independent Articles of Association or has not been excluded therefrom, then only the aforesaid position prevails. The recommendation of final dividend or declaration of interim dividend has to be made by the Board and not by any Committee of the Board. It is desirable that where an Audit Committee exists, the final accounts of the company be reviewed by that Committee before the Board makes the recommendation or the declaration.

Proportion in which dividend is payable- When the shares are fully paid, no special difficulty arises as regards the proportion of dividend, because all the shares will be entitled to dividend at the rate at which it is declared. Problems, however, may be experienced if outstanding shares are neither fully paid nor paid in equal proportion, e.g., some shares are fully paid while some shares are partly paid or where fresh issue of shares has been made during the year for which dividend is to be declared. Section 93 of the Act provides that a company may, if so, authorized by its articles, pay dividend in proportion to the amount paid up on each share. Regulation 88 of Table A is the basis for the provision. Taking the logic of section 93 read with Regulation 88 of Table A in case of fresh issue of shares during the year, dividend on these shares can be paid in a composite proportion to the time period for which these shares were outstanding during the year and the amount paid-up thereon. For example, existing equity shares which were there for the full year and were fully paid were to receive a dividend of rupees four per share, then shares issued during the year – and remaining outstanding for only six months with a paid-up amount of rupees five per share will be entitled to only rupee one as dividend. Where Table A has been excluded and the company's independent article does not contain any provision about payment of dividend in proportionate manner, then dividend has to be paid at the same rate calculated on the face value of the shares to all the outstanding shares irrespective of their paid up value or date of fresh issue.

Dividend on preference shares - The distinguishing feature of a preference share is that its holder is entitled to a dividend of a fixed amount, usually expressed as a percentage of the nominal or paid-



up value of the share, before any dividend is paid on the ordinary shares. If there are two or more classes of preference shares, the shareholders of the class which has priority are similarly entitled to their preferential dividend before any dividend is paid in respect of the other class. But these rights in respect of dividends are subject to two qualifications. In the first place, preference shares are part of the company's share capital, and are not loans; consequently, preference dividends can be paid only if the company has earned sufficient profits. Secondly, a dividend becomes payable to the shareholder only when it is declared in the manner laid down by the company's articles. Thus, unless the preference dividends for the year or other period is properly declared, the preference shareholders cannot sue the company for it'. If the company is able to pay the dividend without endangering its business, and the directors or equity shareholders prevented such payment, the preference shareholders may be entitled to a remedy on the ground that they are being treated unfairly, but they are not entitled to treat the preference dividend as a debt and sue for its payment in the first instance. However, if the Articles specified the way in which the company's profits shall be applied, and this includes payment of the preference dividend, the preference shareholder has a contractual right to its payment, and can sue for it even though it has not been declared - *Evling v. Israel & Oppenheimer Ltd*, [1918] 1 Ch. 101.

The terms of issue of preference shares usually provide that the preference dividend shall be paid out of 'profits' or out of 'profits available for dividend'. The meaning of the two expressions is the same, namely that the dividend may be declared out of the net profits after provision has been made for all proper matters according to the company's wishes - *Re Buenos Ayres Great Southern Rly. Co. Ltd.* [1947] Ch. 384, [1947] 1 All ER 729. Consequently, if the company has suffered trading losses in earlier years, it was held that the company could write the losses off against the current year's profits, even though this reduced the residual profits to a level which was insufficient to pay current year's preference dividend - *Long Acre Press Ltd. v. Odhams Press Ltd.* [1930] 2 Ch. 196; [1930] All ER Rep. 237. Furthermore, if the directors have power by the Articles to transfer any part of the profits to reserves before a dividend is declared, they may make such transfers, even though the residual profits will be insufficient to pay the preference dividend". But transfer to reserves cannot be made if they will benefit equity shareholders exclusively. Thus, a transfer to reserve cannot be made in order to provide money to maintain the equity share dividend at a minimum rate in future years when trading profits may be small

Also if the articles specify the order in which profits shall be applied, and the payment of the preference dividend precedes the setting aside profits to reserves or any similar appropriation, the preference shareholders are entitled to be paid their dividend for the current year and the unpaid dividends for earlier years (if any) before other appropriations are made - *Evling v. Israel Oppenheimer Ltd.* (supra).

Cumulative preference dividend - Preference dividend is usually expressed to be cumulative by the terms of issue of the shares. This means that if the profits available for dividend in one year are insufficient to pay the preference dividend in full, the unpaid balance¹ of the dividend is carried forward and is payable out of the profits of later years. In other words, no dividend may be paid on the equity shares or junior classes of preference shares until the preference dividends for all past years and the current year have been paid in full to the preference shareholders having a prior claim. If preference shares of the same class have been issued at different times and the dividend is in arrear in respect of some shares for more years than it is in respect of others, the total arrears must be satisfied rateably when a dividend is eventually paid.

Non-cumulative preference dividend - The terms of issue of preference shares may, of course, provide that the preference dividend shall be non-cumulative, but this is rare in practice. If the dividend is non-cumulative, it is payable only out of the profits for the year in question so that if those profits are for any reason insufficient, the unpaid balance of the dividend for that year is not carried forward to be paid out of the profits of future years.

Participation in residual profits - A preference shareholder as such is entitled only to his fixed preference dividend out of the company's distributed profits, and there is no implication that he is also entitled to a share in the residual profits of the company left after that dividend has been paid*. Secondly, where the terms of issue of preference shares provided that they should carry a cumulative preference

dividend of ten per cent, it was held that their holders were not entitled to share rateably in distribution of residual profits with the ordinary shareholders, even though the Articles provided that 'subject to any priority that may be given on the issue of any new shares, the profits of the company available for distribution... shall be distributed as dividend among the members in accordance with the amounts paid on the shares held by them respectively'.

However, when preference shareholders are expressly given the right to share in distribution of residual profits after payment of their preference dividend, their shares are known as participating preference shares. The participation then may be limited to the profits of the company remaining after it has paid both the current year's preference dividend and a specified dividend of its equity shares, or it may extend to the whole of the residual profits after payment of the fixed preference dividend.

Arrears of preference dividend in a winding-up - Unpaid preference dividend for " periods preceding the winding-up of a company are not payable out of its assets in a " winding-up, even though the company has earned sufficient profits to pay them - *Re London Indian Rubber Co.* [1858] LR 5 Eq 519, unless :

- (a) The dividends have been declared, in which case they will be debts owing from the company and will be payable in the winding-up immediately after all its other debts have been discharged; or
- (b) The articles or terms of issue provide that the profits of the company while a going concern shall be applied in making specified payments which include the payment of preference dividend, but in this case the arrears can be paid only if sufficient profits have been earned; or
- (c) The articles or terms of issue provide that unpaid preference dividend shall be paid in a winding-up.

Dividend on equity shares - Equity shareholders are entitled to be paid a dividend on their shares only after all preference dividends have been paid to date. Although the equity shareholder stands behind in priority for payment of the dividend, he generally enjoys the privilege of higher dividends. The preference dividend is fixed and cannot be increased, however large the company's profits may be, unless the preference shares carry the right to participate in surplus profits. Except in that case, therefore, the whole of the residual profits of the company after paying the preference dividend may be paid out as a dividend to the equity shareholders either immediately or in later years (including the bonus issue). The equity shareholders are further compensated by enjoying the voting power at general meetings.

Default in complying with section 80A - Under section 205(2B), a company which fails to comply with the provisions of section 80A of the Act regarding redemption of preference shares shall not declare any dividend on its equity shares, so long as such default continues.

Equity shares with differential rights - The Companies (Amendment) Act, 2000 has introduced a new variety of equity shares [vide sections 2(46A) and 86 of the Act] which may have differential rights to govern such shares. As these shares may have differential dividend rights, whether with or without voting rights, it is to be seen that dividend on these shares is declared/paid in accordance with rules framed by the Central Government.

Declaration of dividend - Articles commonly contain provisions on the declaration of dividend, and it is the usual practice to leave it to the general meeting to sanction or declare the final dividend. Section 173(1) of the Companies Act, 1956 also requires that the declaration of the dividend should be shown as an ordinary business at an annual general meeting of a company. Similarly, there is a reference to dividend in section 217 where under directors are required to mention in their report to the shareholders the amount, if any, which they recommend should be paid by way of dividend. Therefore, it could be assumed that the intention of the legislature is to empower the annual general meeting to declare dividend. In *Raghu Nandan Neotia v. Swadeshi Cloth Dealers Ltd.* [1964] 34 Comp. Cas. 570, the Calcutta High Court held that the cumulative effect of all the provisions of the Act is



that declaration of dividend should be made at the annual general meeting. Likewise in *Kanti Lai v. Commissioner of Income-tax* [1956] 26 Comp. Cas. 357 (Bom.), the Bombay High Court held that it is well established and the law is clear that a dividend can only be declared by the shareholders of the company. Articles of companies usually contain provisions with regard to declaration of dividend on the pattern of regulations 85 to 94 of Table A of the Companies Act. Under Regulation 85, the power to declare a dividend vests with the general meeting, but it has no power to declare a dividend exceeding the amount recommended by the Board of directors.

Should the dividends be declared only at an annual general meeting ? - From the aforesaid discussion, it is clear that dividend is usually declared at an annual general meeting of the company. However, a company which could not declare dividend at an annual general meeting may do so at a subsequent general meeting. But if a dividend is so declared at the general meeting, neither the company nor the directors can declare a further dividend for the same year (Circular No. 22, issued by Department of Company Affairs, dated 25-10-1975). Also, there can be no declaration of dividend for past years, in respect of which the accounts have already been closed at previously held annual general meeting - *Raghu Nandan Neotia v. Swadeshi Cloth Dealers Ltd.* (supra).

Revocation of final dividend - Ordinarily, a dividend once declared, cannot be revoked, except with the consent of the shareholders, for a declaration of dividend creates a debt to the shareholders in whose favour it is declared. Thus, if a dividend is declared and the amount is credited or paid to the shareholders as dividend, the character of the credit or payment as dividend cannot be altered by a subsequent resolution - *Kishinchand Chellaram v. C/T* [1962] 32 Comp. Cas. 1046, 1050 (SC).

But, where a dividend has been illegally declared, or where, events like war, imposition of fresh taxes, fire to properties etc. intervene after the declaration and it is advisable to conserve the remaining assets, the Board of directors will be justified in revoking the declaration of dividend.

Interim dividend

A part of profits may be distributed before the accounts are finally passed and the declaration of the dividend sanctioned in the annual general meeting. Such dividends are called 'Interim dividend'. The 'interim dividend' is thus a dividend paid between two annual general meetings of the company. Sub-section (1A) of section 205 (added by the Amendment Act, 2000) empowers the Board of Directors of a company to declare interim dividend. Regulation 86 of Table A of Schedule I to the Companies Act provides:

"The Board may from time to time pay to the members such interim dividends as appear to it to be justified by the profits of the company."

Till the passing of the Companies (Amendment) Act, 2000, there was no provision in the Companies Act (except Reg. 86 of Table A)* relating to interim dividend. The Companies (Amendment) Act, 2000 has introduced sub-section (14A) in section 2 whereby 'interim dividend' is now part of 'dividend' and accordingly all provisions of the Companies Act relating to 'dividends' have become applicable to 'interim dividend' also.

- To put things beyond doubt, section 205 has also been amended to provide for the following: The Board of Directors may declare interim dividend and the amount of -dividend including interim dividend shall be deposited in a separate bank account within five days from the date of declaration of such dividend.
- The amount of dividend including interim dividend so deposited above shall be used for payment of interim dividend.
- The provisions contained in sections 205, 205A, 205C, 206, 206A and 207, as far as may be, also apply to any interim dividend.

Provisions of the Companies Act, applicable to interim dividend- Apart from what has already been stated, the following further provisions arising out of sub-sections (1B) and (1C) of section 205 of the Act may be noted:

- (i) The interim dividend is to be paid out of the amount deposited in a special bank account from the date of the Board meeting in which the dividend was declared to the registered shareholder(s) or to his order or to his banker.
- (ii) Depreciation on depreciable assets to be provided for the full year.
- (iii) If there is a carried forward loss from past years, the amount of the loss or the depreciation content of the loss, whichever is lower, should be first adjusted against estimated profits available for distribution as interim dividend.
- (iv) If any amount of interim dividend remains unpaid/unclaimed on expiry of thirty days from the date of declaration by the Board of directors, then within seven days thereof, the unpaid/unclaimed amount is to be transferred to a special account in a scheduled bank, to be called "Unpaid interim dividend account of.....Company Limited/Company (Private) Limited."
- (v) Where (iv) above has not been complied with in full or in part, the company shall pay interest at the rate of twelve per cent per annum on the amount not transferred to the special bank account from the day of default, until the transfer is made and the interest as above shall accrue to the benefit of members of the company whose amounts remain unpaid in proportion to the amount remaining unpaid.
- (vi) Any amount remaining unpaid/unclaimed in the special bank account for seven years shall be transferred to the Investor Education and Protection Fund established under section 205C of the Act.
- (vii) Where, on the record date, any application for transfer of shares received remained undisposed, the interim dividend applicable to the concerned shares shall be transferred to the special bank account opened for unpaid/unclaimed dividend, unless the transferor has authorised the company to make the payment to the transferee. Any offer of right shares or fully paid-up bonus shares relatable to shares under transfer shall remain in abeyance. ?
- (viii) Every director of the company who is knowingly a party to any non-payment of interim dividend after declaration within the specified thirty days shall be punishable with simple imprisonment up to three years and fine of rupees one thousand per day for the days of default. Further, the company itself shall be liable to pay simple interest at eighteen per cent per annum for the period of default. However, no offence will be deemed to have arisen if conditions (a) to (e) of proviso to section 207 of the Act exist(s). (Vide section 207 of the Act).

Procedure for payment of interim dividend - A company desirous of declaring interim dividend should follow the procedure given below:

1. Verify that the Board of Directors has declared the interim dividend.
2. Ascertain whether profits for the part of the financial year up to the time of proposed declaration are sufficient to justify payment of interim dividend. Availability of profits should be ascertained after taking into account depreciation and compulsory transfer to reserves. Auditor's opinion should also be obtained.
3. Intimate the stock exchange(s) about the Board meeting to consider the payment of interim dividend.
4. Resolution of the Board of directors should state the rate of dividend, deposit of interim dividend in a separate account within five days from the date of its declaration, the date in reference to which shareholders registered in the Register of Members are to receive interim dividend, record date or the period of closure of the Register of Members and transfer books, date of posting of dividend warrants, etc. The Secretary may be authorised to take necessary action in this regard.
5. Inform the Stock Exchange of the date of the closure of Register of Members.
6. At least seven days before the closure of the Register of Members or the record date fixed, publish



a notice in this regard in a newspaper circulating in the district in which the registered office of the company is situate.

7. Open a separate 'Interim Dividend Account' with a Bank and issue necessary instructions to the Bank.
8. Post 'Dividend Warrants' within 30 days from the declaration of interim dividend.
9. Dividend warrants to non-resident shareholders should be posted after securing necessary permission of the Reserve Bank as per the provisions of FEMA, 1999. However, if dividend balancing rule is applicable to the company paying dividend, no foreign exchange will be released.
10. Depreciation and transfer to reserves vis-a-vis interim dividend- On a plain and conservative reading of the provisions of section 205(1C) relating to applicability of provisions regulating 'dividend' to interim dividend, it has been stated in the procedure given above that quantum of interim dividend is to be ascertained, inter alia, after taking into account depreciation and transfer of profit to reserves. Actual book entry is not then required. There is no unanimity on this interpretation of the law. Corporate entities generally prefer to declare interim dividend, ignoring depreciation and transfer to reserves. The key to this interpretation lies in the words 'as far as may be' in section 205(1C) of the Act. The requirements of section 205 apply to interim dividend as far as they may be practicable to apply. Requirements for providing depreciation and compulsory transfer of profits to reserves are all contained in section 205 of the Act. [Vide sub-sections (1) and (2A)]. In both the cases the requirement relates to the concerned 'financial year'. The expression 'financial year' has been defined in section 2(17) of the Act to mean the 'period in respect of which any profit and loss account is laid before the annual general meeting'. Therefore, financial year would mean the whole period for which the profit and loss account is prepared for laying before the AGM. Interim dividend is declared before the expiry of such whole period and as such the question of meeting the requirements of sub-sections (1) and (2A) of section 205 insofar as declaration of interim dividend is concerned may not arise. Even then it would be prudent to provide depreciation for the full financial year concerned to safeguard against any possibility of payment of dividend out of capital. A judicial decision is needed to come to a conclusion on this controversial issue.

Does declaration of interim dividend require ratification by the AGM?

As the current definition of dividend given in section 2(14A) includes interim dividend, an area of lack of clarity has arisen having regard to the provisions of section 173(1)(a) of the Act, which requires declaration of dividend to be considered by the AGM. Prima facie, it may appear that though interim dividend has already been declared by the directors and paid off still the same has to come before the AGM, as a specific item. This seems to be stretching the matter too far based on technicality. When annual financial statements come for consideration of the AGM, declaration [and payment of interim dividend are clearly reflected therein. If such financial statements are approved, it automatically meets the stretched requirements of section 173(1)(g) of the Act. Besides, it is the Board of directors, which under full authority of the Act (not merely of the Articles) has declared and paid the interim dividend, it is again to recommend the final dividend in terms of Regulation 85 of Table A (if not excluded) and it can be presumed that the Board, while declaring the final dividend must have taken into account, the interim dividend already paid. Any irregularity or lack of application of mind by the Board would be noticed in the AGM and the AGM may disapprove the recommendation of the Board and ask it to recast the annual financial statements in light of its observations.

A communication No. 8/15/(205A)/79-CLV, dated 18-7-1981 by the Department of Company Affairs has observed that interim dividend paid by the Board needs to be regularized in the next following Annual General Meeting. This communication does not possess statutory basis.

Payment of dividend

Dividend payable to whom - Section 206 provides that no dividend shall be paid by a company in respect of any share therein except:

- (a) to the registered holder of such share or to his order or to his bankers; or
- (b) in case a share warrant has been issued in respect of the share in pursuance of section 114, to the bearer of such warrant or to his bankers.

Thus, if a shareholder has issued a mandate for the payment of dividend on his shares to a bank, the company paying the dividend to the bank accordingly, would get a good discharge for the payment so made and the dividend shall be deemed to have been paid to the shareholder in cash as contemplated under sub-section (3) of section 205 of the Act.

Payment of dividend in case of sale of shares -As noted above, the dividend is required to be paid to the registered shareholder. The company, therefore, does not recognise anybody except the person whose name is shown as the shareholder in the Register of Members of the company and is not bound to pay the dividends to the purchaser even though the transaction between the seller and purchaser has been completed-Chuni Lal Khusaldas Patel v. U.K. Adhyaru [1956] 26 Comp. Cas. 168 (SC). However, the Companies (Amendment) Act, 1988 inserted a new section, namely section 206A' which provides that in the case of shares, the transfer deed in respect of which has been lodged with the company and is pending registration at the time of payment of dividend, the dividend shall be paid to the transferee only in case the transferor has given a mandate in writing to that effect. In case no such mandate has been given, the dividend in respect of such shares should be transferred to the 'unpaid dividend account'.

Dividend is to be paid in cash-Sub-sections (3) and (5)(b) of section 205 of the Companies Act, 1956 contain guidelines for payment of dividend. Sub-section (3) provides that no dividend shall be payable except in cash. However, the sub-section does not prohibit the capitalisation of profits or reserves of a company for the purpose of issuing fully paid up bonus shares or paying up any amount, for the time being unpaid on any shares held by the members of the company.

Sub-section (5)(b) lays down that any dividend payable in cash may be paid by cheque or warrant sent through the post directed to the registered address of the shareholder entitled to the payment of the dividend or in the case of joint shareholders, to the registered address of that one of the joint shareholders which is first named in the Register of Members or to such person and to such address as the shareholder or the joint shareholders may in writing direct.

The Deptt. of Company Affairs has clarified that dividend can also be transmitted electronically to the shareholders after obtaining their consent in this regard and asking them to nominate specific bank account number to which dividend due to them should be remitted. In fact, the Deptt. has advised that the practice should be encouraged since it will ensure not only timely payment but also will protect investors against loss of dividend warrants in transit—Deptt.'s Circular No. 5/99 dated 12-5-1999.

Time within which dividends to be paid-Section 207 casts an obligation on the company to pay dividend, which is declared to the shareholder entitled therein within 30 days from its declaration. The term 'payment' implies the act of posting of dividend warrant or cheque as provided under the law irrespective of the fact whether the shareholder concerned receives it or not. Thus, the offence under the section takes place when there is failure to pay or a cheque or a warrant therefor is not posted to the registered address of the shareholder. The section makes the failure to post within 30 days and not the non-receipt of the warrant by a shareholder, an offence. Therefore, the obligation to pay within the prescribed time is satisfied once the dividend is paid or a cheque or a warrant therefor is posted at the registered address of the shareholder. On such posting, the post office becomes the agent of the shareholder and the loss of the dividend warrant during transit thereafter is at the risk of the shareholder - Hanuman Prasad Gupta v. Hira Lai [1970] 40 Comp. Cas. 1058 (SC). It may be noted that this obligation to make the payment of the dividend applies to interim dividend as well.



Right to complain - Where shares are lodged for registration of transfer, as long as shares are not transferred, complaint for non-payment of dividends can be lodged by transferor and not by transferee [G.R. Desai v. Registrar of Companies [1998] 18 SCL 55 AP].

Penalty for default - Section 207 provides for penalty for non-payment of dividend or non-posting of warrant in respect thereof within the prescribed period of 30 days. The section makes every director of the company who is knowingly a party to the default punishable with simple imprisonment which may extend to 3 years and with fine of ₹1000 for every day the default continues. Besides, the company shall pay simple interest @ 18 per cent per annum during the period default continues. The offence is not compoundable under section 621 A.

The provision under section 207 contemplates the implication of any director of the body corporate only in the event of such director being knowingly a party to the default - N. Kumar v. M.O. Roy, Assistant Director, S.F.I.O. [2007] 80 SCL 55 (Mad.).

However, in NEPC India Ltd v. R. O. C [1999] 97 Comp. Cas, 500 (Mad.); it was held that to invoke penal provisions of section 207, the complaint must have been filed within one year of the issue of show-cause notice. In view of section 468 of Criminal Procedure Code, 1973, a complaint under section 207 filed more than one year after the date of issue of show-cause notice shall prima facie be time barred - N. Kumar v. MO. Roy, Assistant Director, S.F.I.O. [2007] 80 SCL 55 (Mad.).

When default is excusable - The proviso to section 207 provides for certain circumstances where the default shall be excusable. These circumstances are:

- (a) Where the dividend could not be paid by reason of the operation of any law. However, if dividend cannot be paid by operation of law, its non-deposit in the special account shall be an offence - Consolidated Pneumatic Tools Co. (P.) Ltd, v. ROC [1989] 65 Comp. Cas. 259 (Bom.).
- (b) Where a shareholder has given direction to the company regarding the payment of the dividend and those directions cannot be complied with.
- (c) Where there is a dispute regarding the right to receive the dividend.
- (d) Where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder.
- (e) Where, for any other reason, the failure to pay the dividend or to post the warrant within 30 days was not due to any default on the part of the company.

Jurisdiction for purposes of complaint -In Hanuman Prasad Gupta v. Hira Lal [1956] of 2 Comp. LJ 136, it was held by the Allahabad High Court that a complaint for failure to pay dividend could be filed by an aggrieved shareholder in a court having jurisdiction over his own place of address, where the dividend has to be paid. This decision was reversed by the Supreme Court, which held that the failure to pay the dividend or post the dividend warrant would arise only at the place of the registered office of the company, and the Court having jurisdiction over that place alone could have jurisdiction to entertain the complaint—Hanuman Prasad Gupta v. Hiralal [1970]2Comp.LJ195.

As a matter of policy also, it would be dangerous and intolerable if numerous shareholders, residing in numerous different places, choose to file complaints against the company in Courts having jurisdiction over the places of their residence.²

Dividend Warrants

Clause (b) of sub-section (5) of section 205 specifically provides that any dividend payable in cash may be paid by cheque or warrant and it shall be deemed to have been paid when the cheque or warrant therefor is posted to the registered address of the shareholder entitled to the payment of dividend.

'Dividend warrant' is an order by the company to its banker to pay the amount specified therein to the shareholder whose name is written therein. The warrant is crossed as "payee's account only" and, therefore, the banker makes the payment to the shareholder not in cash but by crediting his banker's

account. The shareholder may, at his discretion thereafter draw the amount of the warrant from his account that his banker is maintaining and with whom he deposits the warrant for collection.

By Notification No. GSR 598(E) dated 28th July, 1994, the DCA has directed that if the amount of the dividend payable to a shareholder is in fraction then fifty paise and above shall be rounded off to a full rupee and less than fifty paise shall be ignored.

Loss of dividend warrant - If a dividend warrant issued to but not received by a shareholder is encashed by an unauthorised person either directly or through a banker, the company is not protected, however, bona fide the payment may have taken place, because in such case the dividend cannot be said to have been paid to the registered holder within the meaning of section 2063. Thus, the consequences of loss through wrong payment will fall on the company.

Dividend mandate

The shareholders who desire that their dividends be credited direct to their bank accounts have to make the request in prescribed form supplied by the company. The aforesaid form when duly filled and sent to the company is known as 'Dividend Mandate'. The shareholder fills in the form and puts his signature authorising the company to pay dividends direct to his banker. This form is also used for similar requests for payment of interest on debentures or other types of securities. The advantages of 'dividend mandate' are:

- (a) It reduces the amount of unclaimed dividends which the company has to carry forward from year to year.
- (b) It enables the use of one dividend warrant for the payment of dividends due to several shareholders having accounts with the same bank.

A specimen form of 'Dividend mandate' is given below:

Dividend Mandate (Specimen)

To
The ABC Co. Ltd.
.....
Mumbai

I/We hereby request and authorise you to pay all dividends from time to time falling due, and becoming payable on any shares now or hereafter to be registered in my/our name(s) in the books of the company, to Allahabad Bank, Anand Lok, New Delhi (Saving Bank A/c 5534) whose acknowledgement shall be a sufficient discharge to the company.

Dated this.....day of.....20.....

NB : In case shares are held in joint names, this form must be signed by all the registered holders.

Signature(s) of Shareholder(s)

Procedure for payment of final dividend

1. Arrange to hold meeting of the Board of directors to consider the amount of dividend to be recommended to the ensuing annual general meeting for declaration.
2. Notify to the recognised stock exchange with which the shares of the company are listed without delay the date of the aforesaid Board meeting.
3. Ensure that the required percentage of profits is transferred to the company's reserves [Rule 2 of the Companies (Transfer of Profits to Reserves) Rules, 1975].
4. Fix up the book closure date/record date for payment of dividend and give due notice to the stock exchange(s) where the shares are listed.
5. Forthwith inform the recognised stock exchange(s) with which the shares of the company are



listed after the holding of the Board meeting in which dividend is recommended or declared.

6. Include in the agenda of the annual general meeting, the business of declaration of dividend.
7. Pass an ordinary resolution in the annual general meeting declaring the dividend.
8. Fix and notify the recognised stock exchange with which the shares of the company are listed in advance of the date on and from which the dividend will be payable and issue simultaneously the dividend warrants which shall be encashable at par at all the branches of the company's bankers so as to reach the shareholders on or before the date fixed for payment of dividend.
9. Arrange to make payment within 30 days of declaration either in cash or by cheque/warrant sent through the post directed at the registered address of the shareholder entitled to the payment of the dividend. In the case of joint shareholders the dividend should be sent to the registered address of the joint shareholder who is first named on the Register of Members or to such person and to such address as the shareholder or the joint shareholders may in writing direct [Section 205A].
10. Hold a Board meeting to authorise opening of dividend account with provision for:
 - (a) Styling the dividend account as 'Unpaid Dividend Account' after 37 days from the date of declaration of dividend;
 - (b) Autographic signatures of authorised signatories of the company on the dividend warrants above certain amount;
 - (c) Execution of indemnity in connection with collection of paid warrants from the bank.
11. Arrange to transfer the total amount of dividend which remains unpaid or unclaimed within 7 days from expiry of 30 days from the date of its declaration to a special account to be opened by the company in this behalf.
12. Where instruments of transfer have been received by the company in relation to some shares and the transfer of such shares has not been registered when the dividend warrants were posted, ensure that amount of dividend in relation to such shares is also kept in the 'unpaid dividend account' unless the company is authorised by the registered holder of those shares in writing to pay the dividend to the transferees [Section 206A].
13. Regarding dividend on new shares issued during the year, ensure that:
 - (a) where the offer document provides for payment of dividend on the paid-up value, dividend is calculated only on the paid-up value of shares;
 - (b) dividend is calculated on the pro rata basis on the shares allotted during the year from the date of allotment.
14. Where duplicate dividend warrants are to be issued, obtain duplicate indemnity in lieu of dividend warrants lost/torn/defaced/mutilated.
15. Obtain permission of the RBI for payment of dividend, in foreign exchange. If dividend-balancing arrangement applies, no foreign exchange can be drawn for payment of dividend.

1.6.3 Unpaid and unclaimed dividends

Unpaid dividends - According to section 205A amended by the Companies (Amendment) Act, 2000 where a dividend has been declared by a company but has not been paid or claimed within 30 days from the date of the declaration to any shareholder entitled to the payment of the dividend, the company shall within 7 days from the date of expiry of the said period of 30 days transfer the total

amount of dividend which remains unpaid¹ or unclaimed within the said period of 30 days to a special account to be opened by the company in that behalf in any scheduled bank to be called "Unpaid Dividend Account of.... Company Limited/Company (Private) Limited". If default is made in transferring the unpaid or unclaimed dividend to the said account, the company shall pay interest from the date of default @12% per annum. Such interest will be paid to the members of the company in proportion to the amounts remaining unpaid to them.

Transfer of unpaid dividend to Investor Education and Protection Fund - Section 205A (5) provides that any money transferred to the unpaid dividend account of a company which remains unpaid or unclaimed for a period of seven years from the date of such transfer must be transferred by the company to the Fund set up by the Central Government under Section 205C.

The company shall be entitled to a receipt from the authority or committee under sub-section (4) of section 205C for any money transferred by it to the Fund and such a receipt shall be effectual discharge of the company in respect thereof [Sec. 205A(7)].

Payment of unpaid or unclaimed dividend [Section 205B]-No claims shall lie against the Fund or the company in respect of individual amounts which were unclaimed and unpaid for a period of seven years from the dates they first became due for payment and no payment shall be made in respect of such claims [Explanation to sub-section (2) of section 205C].

Penalty - If a company fails to comply with any of the above requirements, the company and every officer of the company who is in default shall be punishable with fine which may extend to ₹5000 for every day during which the failure continues.

Establishment of Investor Education and Protection Fund [IEPF] [Section 205C]

The Central Government shall establish a fund to be called the Investor Education and Protection Fund (hereafter in this section referred to as the "Fund") [Sec. 205C(1)].

There shall be credited to the Fund the following amounts, namely:—

- (a) amounts in the unpaid dividend accounts of companies;
- (b) the application moneys received by companies for allotment of any securities and due for refund;
- (c) matured deposits with companies;
- (d) matured debentures with companies;
- (e) the interest accrued on the amounts referred to in clauses (a) to (d);
- (f) grants and donations given to the Fund by the Central Government/State Governments, companies or any other institutions for the purposes of the Fund; and
- (g) the interest or other income received out of the investments made from the Fund. [Sec. 205C(2)].

However, no such amount referred to in clauses (a) to (d) shall form part of the Fund unless such amounts have remained unclaimed and unpaid for a period of seven years from the date they became due for payment. [Section 205C(2)].

No claims shall lie against the Fund or the company in respect of individual amounts which were unclaimed or unpaid for a period of seven years from the dates that they first became due for payment and no payment shall be made in respect of such claims. The Fund shall be utilised for promotion of investor awareness and protection of the interests of investors in accordance with such rules as may be prescribed. [Sec. 205C(3)]. Accordingly, the Investor Education and Protection Fund (Awareness and Protection of Investors) Rules, 2001 have been issued.

The Central Government shall, by notification in the Official Gazette, specify an authority or committee, with such members as the Central Government may appoint, to administer the Fund, and maintain



separate accounts and other relevant records in relation to the Fund in such form as may be prescribed in consultation with the Comptroller and Auditor-General of India. [Sec. 205C(4)]. The Committee for administering the Fund has since been constituted by Notification No. SO 1087(E), dated 11-11-1999.

It shall be competent for the authority or committee appointed under sub-section (4) to spend moneys out of the Fund for carrying out the objects for which the Fund has been established. [Sec. 205C(5)]. The Authority has also been empowered to provide financial assistance from the Fund to any organisation/entity/person in terms of Guidelines announced by appropriate authority.

Can dividends be paid out of Capital

Dividends (including interim dividend), as per section 205, may be paid out of the following three sources only:

- out of current profits,
- out of profits for any previous financial year or years, and
- out of moneys provided by the Central or State Government for the payment of dividend.

Accordingly, dividends are not allowed to be declared out of capital. If the memorandum or articles give power to the company to pay dividends out of capital, such a power shall be invalid- *Verner v. General & Commercial Investment Trust Ltd.* [1894] 2 Ch.239.

Consequences of payment of dividend out of capital

In case dividends have been paid out of capital, the following consequences follow:

1. Directors who knowingly paid dividends out of capital shall be held personally liable to make good the amount to the company - *Oxford Benefit Building & Investment Society, In re* [1886] 35 Ch. D. However, directors shall incur no liability where such payment was made on the faith of bona fide valuation of a company's assets which subsequently proved to be an over-estimate - *Stringer's case* [1869] 9 QBD 436.
2. The members who receive dividends know that they have been paid out of capital, the directors may have a right of indemnity against such members to the extent that they have respectively received dividends - *Moxham v. Grant* [1900] 1 QB 88 (CA).
3. Where an interim dividend has been paid out of capital owing to a bona fide mistake and the directors propose to recoup such dividend out of profits before distributing any further dividends, a member who has received such dividend cannot maintain an action against the directors - *Towers v. African Tug Co.* [1904] 1 Ch.558.
4. When dividends improperly paid out of capital have been made good out of subsequent profits, liability ceases to attach to the directors - *Boaler v. The Watchmaker's Alliance* [1903].

The only situation where a return on investment may be allowed out of capital is where interest is paid out of capital, on the shares of the company, with the previous approval of the Central Government under section 208. If interest is paid out of capital otherwise, it amounts to reduction of capital which is not allowed to be made except by following the procedure laid down in sections 100 to 105.

In the event of payment of dividend out of capital, except as aforesaid, not only the directors and officers of the company making such payment would commit an offence under the Act but shall also be liable to make good the amount so paid as dividend to the company. Where, however, the shareholders receive the dividend paid out of capital and they had the full knowledge that dividend was being paid out of capital they cannot keep the dividend with them and have to return the amount received to the company - *Towers v. African Tug Co.* [1904] 1 Ch. 558 (CA). Only when a misrepresentation was made to the shareholders by the directors that the dividends were being paid out of profits while they were actually paid out of capital, the shareholders would not be accountable and the directors alone would be accountable to the company.

Payment of dividend out of capital profits

The term 'capital profits' may be defined to mean those profits which arise otherwise than in the normal course of the business. Thus, capital profits would arise where a company sells part of its fixed assets at a price higher than the original cost of such assets or where it receives premium on issue of shares, etc. Such profits may be realised or take the form of book figures only created by such matters as revaluation. Whether such profits can be distributed as dividends or not has not been specifically dealt with in the Companies Act.

However, the position in this regard in our country has been the same as that in England, based, as it is, on the decision in the under mentioned two important cases:

- (1) *Lubbock v. British Bank of South America* [1892] 2 Ch. 198
- (2) *Foster v. The New Trinidad Lake Asphalt Co. Ltd.* [1901] 1 Ch. 208.

Following the decisions of these two cases, capital profits are not considered as available for distribution as dividend unless :

- (i) the Articles of Association permit such a distribution;
- (ii) the surplus is realised; and
- (iii) such surplus remains after a valuation of the whole of the assets and liabilities has been fairly taken.

1.7 BOARD OF DIRECTORS

1.7.1. Directors and Managerial Personnel

Meaning of a Director

Section 2(13) of the Companies Act, 1956 defines a 'director' as including "any person occupying the position of a director by whatever name called". Thus, it is not the name by which a person is called but the position he occupies and the functions and duties which he discharges that determine whether in fact he is a director or not. In *Re, Forest of Dean Coal Mining Co.* * it was stated that function is everything; name matters nothing. So long as a person is duly appointed by the company to control the company's business and authorised by the Articles to contract in the company's name and on its behalf, he functions as a director. A company is indeed a person, but a juridical person and the directors as a body endow the juridical person with human face that can act and react. Under the scheme of the Companies Act, the company itself and its directors or the Board of directors are primary agents of the company to transact its operations. The Companies Act specifies where the company itself is to act both as principal and the agent and where the Board of directors is to act on its behalf. In respect of the properties and assets of the company the directors or the Board of directors act as Trustees. Therefore, the directors have different attributes in relation to the company depending upon the facts of each case.

As stated earlier, directors apart from being trustees for the assets and properties of the company are also the agents of the company as it is the directors, collectively as Board, act on behalf of the company on all matters except those specifically reserved for the company to act. However, it may be noted that even though the directors for certain purposes can be considered as the agent of the company, yet in respect of such matters for which the directors (i.e., the Board) are empowered to take a decision, the company in any manner, including in the general meeting, cannot direct the directors to take a particular decision. For example, allotment of shares, transfer of shares, investments etc. If the body of the shareholders did not approve the decision, they are free to change the directors in the manner given in the Act. As stated elsewhere in the chapter a director apart from being the agent and trustee of the company, can also be treated as officer of the company, hence an employee for purposes specified in the Act.



Section 303(1) of the Companies Act (though for the limited purpose of maintenance of Register of directors, etc.) provides that any person with whose directions or instructions the Board of directors is accustomed to act is also deemed to be a director.

A manager or any other managerial personnel, is however, not a director - Andhra Pradesh High Court in *Deen Dayalu v. Sri B.P. Reddy* [1984] 2 Comp. LJ 396.

According to section 2(30) of the Act, the definition of an "officer" includes a director as well as any person under whose directions or instructions the Board or any one or more of the directors are accustomed to act.

Independent Director- Now-a-days the role of independent director is drawing wide attention specially in the context of public companies. This class of directors are actually elected directors who are not executive directors and who do not participate in day-to-day activities of the company. The Kumarmangalam Birla Committee has defined an independent director as an entity who does not have a "material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in judgment of the Board, may affect the independence of judgment."

Who may be appointed as a Director?

Section 253 of the Companies Act provides that no body corporate, association or firm can be appointed director of a company. Only an individual can be appointed as director.

However, no company shall appoint or re-appoint any individual or director of the company unless he has been allotted a Directors Identification Number (DIN) under section 266B [Proviso added to section 253 vide Companies (Amendment) Act, 2006].

In *Oriental Metal Pressing Works (P.) Ltd. v. B.K. Thakoor* [1961] 31 Comp. Cas. 143, the Supreme Court pointed out the reason as to why it is necessary that only an individual should be director of a company. It was held that the office of the director being to some extent an office of trust, there should be somebody readily available who can be held responsible for the failure to carry out the trust, and it might be difficult to fix that responsibility if the director was a corporation or an association of persons.

Qualifications for Directors

The Companies Act has not prescribed any academic or professional qualifications for directors. Also, the Act imposes no share qualification on the directors. So, unless the company's Articles contain a provision to that effect, a director need not be a shareholder unless he wishes to be one voluntarily. But the Articles usually provide for a minimum share qualification. As per Reg. 66 of Table A, a director must hold at least one share in a company. Where a share qualification is fixed by the Articles of a public company or a private company which is a subsidiary of a public company, section 270 provides that:

- (i) each director must take his qualification shares within 2 months after his appointment;
- (ii) the nominal value of the qualification shares must not exceed ₹5,000 or the nominal value of one share where it exceeds ₹5,000;
- (iii) share warrants will not count for purposes of share qualification.

In case of joint shareholdings, only one of the joint shareholders can be said to possess share qualification except where Articles provide otherwise - [*Grundy v. Briggs* [1910]].

If a director fails to obtain his qualification shares within two months, he vacates office automatically on the expiry of two months after the date of his appointment, and if he acts as a director after the expiry of said two months without taking qualification shares, he shall be liable to a cumulative (₹500 + ₹5,000) fine up to ₹5,500 for every day until he "stops acting as such (section 272, read with section 283).

However, the Articles of a company cannot compel a person to hold qualification shares before he is elected as a director nor can they require him to obtain qualification shares within a shorter period than two months after his appointment; and if any provision to this effect is made in the Articles, it shall

be void.

The effect of this provision is that, if the company is wound up during this period of two months, the director cannot be placed in the list of contributories, inasmuch as there is no express or implied contract under which he would be bound to take the qualification shares, since his name cannot be put on the Register of Members unless he has applied for shares and these are allotted to him - *Zamir Ahmed Raz v. D.R. Banaji* [1951] 27 Comp. Cas. 634.

The fact that the shares have been pledged or mortgaged will not affect the qualification unless Articles provide otherwise.

Qualification shares vis-a-vis private company -Provisions of sections 270 and 272 do not apply to a private company unless it is subsidiary of a public company (Section 273). Thus, a pure private company may or may not provide in its articles any requirement of share qualification.

Thus, a provision in the articles of a private company requiring its directors to obtain qualification shares is not repugnant to the provisions of section 273. [*Mrs. Aruna Suresh Mehra v. Jifcon Tools (P.) Ltd.* [1998] 18 SCL 79 (CLB - New Delhi)].

Disqualifications of a Director

Section 274 of the Companies Act, 1956 provides that the following persons shall not be capable of being appointed as directors of any company:

- (a) a person found by a competent court to be of unsound mind and such finding remaining in force,
- (b) an undischarged insolvent;
- (c) a person who has applied to be adjudged an insolvent;
- (d) a person who has been convicted by a Court of an offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months, and a period of five years has not elapsed from the date of the expiry of the sentence;
- (e) a person who has not paid any call in respect of shares of the company held by him, whether alone or jointly with others and six months have elapsed from the last date fixed for the payment of the call; and
- (f) a person who has been disqualified by a Court/Tribunal in pursuance of section 203. Section 203 empowers the Court/Tribunal to restrain fraudulent persons from managing companies, unless the leave of the Court/ Tribunal has been obtained for his appointment;
- (g) a person who is already a director of a public company which,—
 - (A) has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April, 1999;
 - or
 - (B) has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more.

However, a director disqualified under section 274(1)(g) shall not be eligible to be appointed as a director of any other public company for a period of five years from the date on which such public company, in which he is a director, failed to file annual accounts and annual returns under sub-clause (A) or has failed to repay its deposit or interest or redeem its debentures on due date or pay dividend referred to in clause (B).

In view of language mentioned in clause (g) incorporated in section 274(1) on 13-12-2000, if on date of commencement of amended section 274(1) any person has been director in a defaulting company, he will be affected by section 274(1)(g) - *Nebandu Dutta v. Arindam Mukherjee* [2004] 55 SCL 146



(Cal.)

The Department of Company Affairs has clarified that special directors appointed under section 16(4) of the SICA, 1985 by the BIFR shall not be disqualified for appointment as directors in view of new section 274(1)(g) of the Companies Act, 1956. -Press Release, dated 1-6-2001.

Again, the Department of Company Affairs (Circular No. 8/2002, dated 22-3-2002) has clarified that:

- (i) nominee directors appointed by the public financial institutions and companies established under the Acts of Parliament having non obstante provisions over the Companies Act, 1956 like IDBI, LIC, UTI, IIBI, etc, in their respective statutes shall not be liable to be disqualified for appointment as directors by virtue of section 274(1)(g);
- (ii) nominee directors appointed on the Boards of assisted concerns or other public companies by (a) Public Financial Institutions within the meaning of section 4A of the Companies Act, 1956; (b) Central or State Government; and (c) Banking Companies are also exempt from the provisions of section 274(1)(g) of the Companies Act, 1956."

The Central Government vide powers conferred by clause (b) of section 642(1) has made certain rules to carry out the purpose of section 274(1)(g). These Rules, inter alia, provide as follows:

1. Whenever a company fails to file the annual accounts and annual returns, as described in sub-clause (A) of clause (g) of sub-section (1) of section 274, persons who are directors on the last due date for filing the annual returns for any continuous three financial years commencing on and after the first day of April, 1999, shall be disqualified.
2. If a company has failed to repay any deposit, irrespective of the enactment, rules or regulations under which the deposits have been accepted by the companies, or interest thereon, or redeem its debentures, or pay any dividend declared on the respective due dates, and if such failure continues for one year, as described in sub-clause (B) of clause (g) of sub-section (1) of section 274, then the directors of that company shall stand disqualified immediately on expiry of that one year from the respective due dates:

Provided that all the directors who have been directors in the relevant year, from the due date to the expiry of one year after the due date, will be disqualified:

Provided further that disqualification on account of the reasons cited under this Rule shall also apply to the re-appointment as a director.

3. Duty of Statutory Auditor to report on disqualification

- (a) It shall be the duty of statutory auditor of the appointing company as well as disqualifying company, as required under section 227(3)(f) to report to the members of the company whether any director is disqualified from being appointed as director under clause (g) of sub-section (1) of section 274 and to furnish a certificate each year as to whether on the basis of his examination of the books and records of the company, any director of the company is disqualified for appointment as a director or not.

Auditor cannot submit a report about disqualification of directors under section 274(1)(g) on the basis of statement supplied by company alone; he has to examine and even he has to make an independent enquiry about collected materials from other sources to submit such report – Pawan Jain v. Hindustan Club Ltd. [2005] 62 SCL 610 (Cal.).

- (b) It shall be the duty of statutory auditors of the "disqualifying company" as required in section 227(3)(f) to report to the members of the company whether any director in the company has been disqualified during the year from being reappointed as director, or being appointed as director in another company under clause (g) of sub-section (1) of section 274.
4. Duty of company to intimate disqualification - Whenever a company fails to file the annual accounts and returns, or fails to repay any deposit, interest, dividend, or fails to redeem its debentures, as

described in clauses (A) and (B) of clause (g) of sub-section (1) of section 274, the company shall immediately file a return in duplicate in Form 'DD-B', prescribed under these rules for this purpose, to the Registrar of Companies, furnishing therein the names and addresses of all the Directors of the company during the relevant financial years:

Provided that names of such directors who have been exempted from application of section 274(1)(g) by the Central Government, from time to time, shall be excluded:

Provided further that no unusual abbreviations or short forms shall be used in filing up Form 'DD-B', which shall give such details as may be necessary to distinguish and identify each director without any ambiguity.

5. Failure to intimate disqualification shall render director as officer in default—When a company fails to file Form 'DD-B' as above within 30 days of the failure that would attract disqualification under section 274(1)(g), officers of the company listed in section 5 of the Companies Act, 1956 shall be officers in default.
6. Registrar to Register—
 - (a) Upon receipt of Form 'DD-B' in duplicate under rule 5, the Registrar of Companies shall immediately register the document and place one copy of it in the document file for public inspection.
 - (b) The Registrar of Companies shall forward the other copy to the Central Government.
7. Names of the disqualified directors on the website etc.—
 - (a) The Central Government shall place on the website of the Department of Company Affairs the names and addresses and such other details including names and details of the companies concerned, as maybe necessary, in respect of all the disqualified directors.
 - (b) The Central Government may also publicize the names of disqualified directors in such manner as it may consider appropriate.
 - (c) The Central Government shall take such steps as may be required to update its website to ensure that name of the person, in whose respect disqualification period has expired after 5 years, is deleted from the website.

In view of non-filing of declaration prescribed in statutory form [vide section 274(1)(g)] by any of directors seeking appointment and reappointment, said director is not automatically disqualified; before a person is declared to be disqualified by auditor or any other person, a view has to be formed whether grounds mentioned in section 274 have been proved without any doubt—*Pawan Jain v. Hindustan Club Ltd.* [2005] 62 SCL 610 (Cal).

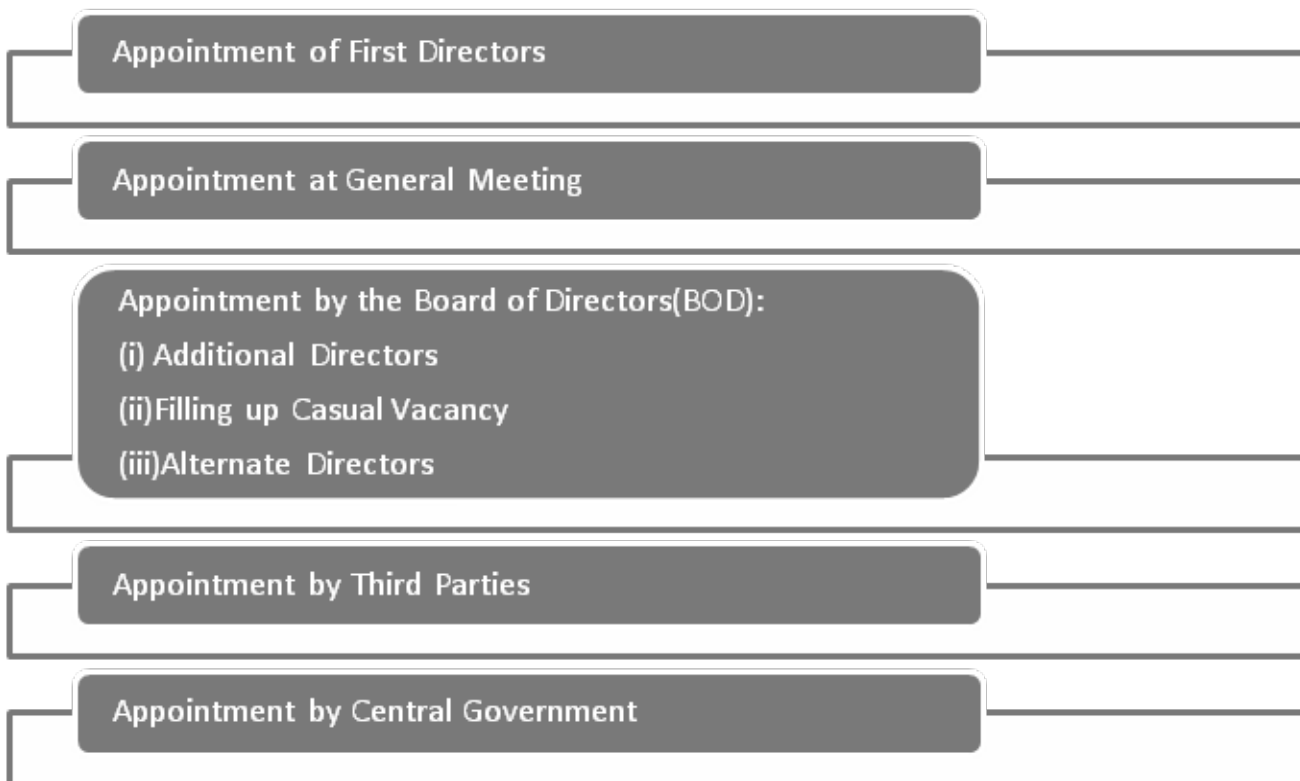
8. Duty of every Director- Every director in a public company registered under the Companies Act, 1956 shall file Form 'DD-A', prescribed under these Rules, before he is appointed or reappointed.
9. Punishment for contravention of the rules - If a company or any other person contravenes any provision of these rules for which no punishment is provided in the Companies Act, 1956, the company and every officer of the company who is in default or such other person shall be punishable with fine which may extend to five thousand rupees and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first, during which the contravention continues.

The disqualifications at (d) and (e) above may be removed by the Central Government by a notification in the Official Gazette [Sec. 274(2)]. On the other hand, a private company which is not a subsidiary of a public company may add to the above list of disqualifications [Sec. 274(3)]. By necessary implication, public companies are prohibited from including additional disqualification(s) for their directors in their Articles- *Cricket Club of India Ltd. v. Madhav L. Apte* [1975] 45 Comp. Cas. 574 (Bom.).



Appointment of Directors

The discussion on appointment of a director may be dealt with under the following heads:



Appointment of first directors - The first directors are usually appointed by name in the articles or in the manner provided therein. Where the articles do not provide for the appointment of first directors, the subscribers to the memorandum, who are individuals, shall be deemed to be the first directors of the company subject to the regulations of the company's articles. The first directors can hold office until the directors are duly appointed in accordance with the provisions of section 255 (Section 254).

As section 254 says that the subscribers will be deemed to be directors only subject to the regulations in the articles, if the articles provide for any share qualification, should only those subscribers who possess the necessary share qualification be deemed to be directors.

Where all subscribers to the memorandum are bodies corporate - If all the subscribers to the Memorandum happen to be bodies corporate none of the subscribers can be deemed to be directors; and the company will have no directors until the first directors are appointed under section 255, in the absence of other provisions in the articles. Presumably, the articles at the time of registration will contain the names of the first directors until directors are appointed at the first general meeting - A. Ramaiya—Guide to the Companies Act, 12th Edition, Page 1214.

It may, however, be noted that in case of a public company, a list of persons who are to be the first directors of a company along with their consent in writing must be delivered to the Registrar of Companies.

Thus, where the articles of the company name the first directors, the provisions of section 254 deeming the subscribers as directors would not apply. Where the articles, as in Regulation 64 of Table A, simply state that the number of directors and names of the first directors shall be determined in writing by the subscribers of the memorandum or a majority of them, the subscribers of the Memorandum shall continue to be deemed to be directors until the subscribers or a majority of them determine as to who

shall be the first directors.

Where, for any reason, for example, death, the persons named in the list of first directors do not assume office, it will be necessary for the subscribers of the Memorandum (who will then be the only members) to convene a meeting for the appointment of directors. To the extent to which the articles do not make any other provisions in that behalf, subscribers who would be entitled to requisition a meeting may call the meeting. Notice of the meeting must be served on every subscriber in the manner in which notices are required to be served by the Act.

A meeting is not necessary if all the subscribers concur in the appointment - *Re Great Northern Salt & Chemical Works*, ex p Kennedy [1890] 44 Ch. D 472.

Appointment of directors at general meeting - According to section 255, the directors must be appointed by the company in general meeting. In the case of a public company or of a private company which is a subsidiary of a public company, unless the articles provide for the retirement of all directors at every annual general meeting, at least two-third of the total number of directors must be persons whose period of office is liable to determination by rotation. In other words, only one-third of the total number of directors can be non-rotational directors.

Appointment of directors in case of a private company which is not a subsidiary of a public company - In case of a private company, which is not a subsidiary of a public company, if the articles are silent as to the appointment of directors, or do not specifically provide for appointment of directors otherwise than in a general meeting, then the directors are to be appointed in general meeting by the shareholders [Section 255(2)] as interpreted by the Calcutta High Court in the case of *Swapan Das Gupta v. Navin Chand Suchanti* [1988] 3 Comp. LJ 76 (Cal).

Section 256 provides that one-third or nearest to one-third of the directors subject to retirement by rotation must retire at an annual, general meeting. It follows that all such directors must retire in the course of three years, one-third of them retiring in each year. The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment. As between persons appointed on the same day, retirement is to be determined by mutual consent and in case of default, by lots [Section 256(2)].

If the directors do not hold a general meeting in time, can they continue till the meeting is held?-The Delhi High Court in *B.R. Kim dm v. Motion Pictures Association* [1976] 46 Comp. Cas. 339 held that directors cannot prolong their tenure by not holding a meeting in time. The directors due to retire by rotation must vacate office at the latest on the last day on which an annual general meeting ought to have been held. Retiring directors are, however, eligible for re-election.

Deemed re-appointment of a retiring director [Section 256] - The vacancy caused by the retirement of a director by rotation should be filled up at the same meeting or at an adjourned meeting. If it is not so done, the retiring director shall be deemed to have been appointed at such adjourned meeting except in the following cases:

1. at any previous meeting, a resolution for his re-appointment was put to vote, but was lost; or
2. the retiring director has, in writing, expressed his unwillingness to continue; or
3. he is not qualified or is disqualified for appointment; or
4. a special or ordinary resolution is necessary for his appointment or re-appointment by virtue of any provisions of the Companies Act; or
5. it is resolved to fill two or more vacancies by a single resolution [Proviso to section 263(2)].

Rotational and non-rotational directors vis-a-vis private company-In reply to a query: "Whether under the law it is compulsory for the private companies to have rotational directors?", the Department of Company Affairs expressed the following views:

In the case of a private company which is not a subsidiary of a public company, it is not compulsory



under the law that they must have rotational directors unless the Articles of Association of the company so require.

It is, therefore, possible for an independent private company to provide in its Articles that none of its directors is liable to retirement by rotation. Thus, where a person was a director of two private companies and he was not required to retire by rotation by the Articles of those companies and after the two companies were amalgamated, the Articles of the amalgamated company, also a private company, did not provide for retirement of directors by rotation, it was held that managing director of the amalgamated company was not liable to retire. The managing director will continue in office for an indefinite period. But if the company becomes a public company, then on the expiry of the term of 5 years, the managing director will retire and at the next concluded AGM he will retire as a director—*Swapan Dasgupta v. Navin Chand Suchanti* [1988] 64 Comp. Cas. 562 (Cal.).

Appointment of a director other than a retiring director [Section 257]—Section 257 provides for the procedure of appointment of a person other than retiring director in a public company or a private company which is a subsidiary of a public company. If any person, other than the retiring director wishes to stand for directorship or any member proposes a person for directorship, he must signify his intention to do so by giving 14 days' notice to the company before the general meeting and the company must inform the members not later than seven days before the general meeting either by individual notices or by advertisement of this fact in at least two newspapers circulating in the place where its registered office is located, of which one must be in English and the other in the regional language of that place. Also, the candidate or the member who intends to propose him as director has to deposit a sum of ₹500 which shall be refunded to such person or the member, as the case may be, if the candidate succeeds in being elected. In case such person is not elected as director, he or the member, as the case may be, will not be entitled to the refund of ₹500 and the amount deposited shall stand forfeited by the company.

Additional director, etc. seeking appointment as regular director - An additional director, or a director who has been appointed to a casual vacancy or an alternate director or a director nominated by any financial institution or any other similar body or by the Central Government under section 408, if he seeks appointment by the shareholders at a general meeting he must satisfy the requirements of section 257, as any such director is not a 'director retiring by rotation'. The expression 'director retiring by rotation' refers only to a director appointed by a company in general meeting and retiring.

The *Department of Company Affairs*, in this regard, has expressed the view that if a person who is appointed as an additional director wants to be elected as a director at the next annual general meeting, the provisions of section 257 will have to be complied with since he cannot be considered to be a director retiring by rotation at that meeting—Letter No. 8/3 (270)/63-PR dated 27-7-1963.

In *Smt. Namita Gupta v. Cachar Native Joint Stock Co. Ltd.* [1999] 21 SCL 394/98 Comp. Cas. 655 (CLB - N. Delhi), it was observed that normally there should be individual resolution relating to rejection of election of a retiring director and a separate resolution for election of a new director in that place, after following the procedure as per section 257.

Consent of a director to be filed with the Company and the Registrar - Section 264 requires every person proposed as a candidate for the office of the director to sign and file with the company his consent to act as a director, if appointed. Further, subsection (2) of section 264 requires a person appointed as a director to sign and file with the Registrar his consent in writing to act as such director. The consent with the Registrar must be filed within 30 days of his appointment. However, the consent with the Registrar shall not be required to be filed in the case of:

- (a) a director re-appointed after retirement by rotation or immediately on the expiry of his term of office; or
- (b) an additional or alternate director, or a person filling a casual vacancy in the office of a director under section 262, appointed as a director or re-appointed as an additional or alternate director,

immediately on the expiry of his term of office; or

(c) a person named as director of the company under its articles as first registered.

It may be noted that the provisions of section 264 are not applicable to a private company unless it is a subsidiary of a public company.

Consequences of not filing the consent-Non-filing of consent with the R.O.C. is at the most only an irregularity, and will not render invalid an appointment made without such consent having been filed - *Lalji Bhai Kapadia v. Laljibhai Desai* [1973] 43 Comp. Cas. 17.

Likewise, the Deptt. of Company Affairs has opined that non-filing of consent with the Registrar shall not result in the vacation of office as a director. The only consequence shall be that penalty under section 629A would be attracted. Such consent may be filed after 30 days but with payment of penal fee.

Appointment by Board of directors - The Board of directors can exercise the power to appoint directors in the following three cases:

(i) Additional Directors (Section 260)

(ii) Filling up the Casual Vacancy (Section 262)

(iii) Alternate Directors (Section 313).

(i) Appointment of Additional Directors-If the Articles authorise, the Board may appoint additional directors. Such additional directors together with the directors constituting the Board should not exceed the maximum number fixed by the articles. Also, the additional directors are entitled to hold office only up to the date of the next annual general meeting of the company (Section 260).

It may thus be noted that without a power given by the Articles, the Board cannot appoint additional directors. The section applies to all companies, public as well as private - *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holdings Ltd.* AIR 1981 SC 1298.

Powers of Additional Directors- Additional directors will enjoy the same powers and rights as other directors. Through this route, the Board of directors can therefore appoint competent persons on the Board who may find it difficult to come through election.

Is a resolution passed at Board meeting necessary for appointment of Additional Directors ?- Unlike in case of filling a casual vacancy which can be done only in a regular meeting of the Board (Section 262), the appointment of additional directors may be made either at a meeting of the Board or by passing a resolution by circulation as provided in section 289.

Tenure of Additional Director - As noted above, an additional director is entitled to hold office only up to the date of the next annual general meeting of the company. But, in case annual general meeting is not held on time, can the stay of the additional director be extended thereby? In *Krishna Prasad Pilani v. Colaba Land and Mills Company* [1959] 29 Comp. Cas. 273, it was held that a director appointed as an additional director vacates his office, at the latest, on the last day on which the annual meeting could have been called as required by section 166, and cannot continue in office thereafter on the ground that the meeting was not or could not be called within the time prescribed by that section. The expression "up to the date of the annual general meeting" means "upto the date when the next Annual General Meeting ought to be held at the latest".

The provision for an additional director is one which is meant to enable the companies to have the benefit of the services of a person, who otherwise is suitable for serving on the board, and whose presence in the board is desirable in the interests of the company, till the time the next AGM is held. That provision is not meant to enable the company to keep on its board a person as additional director for an indefinite period of time by not holding the AGM. Section 260, therefore, must necessarily be read with section 166 which stipulates that the AGM be held every year and not more than fifteen months shall elapse between the date of one AGM and the next - *P. Matarajan v. Central Government*



[2004] 51 SCL 76 (Mad.).

In *Ador-Samia Ltd. v. Indocan Engg. Systems Ltd.* [1999] 35 CLA 224 (CLB - N. Delhi), it was held that for application of section 260, time limit fixed under section 166 alone is relevant and not that under section 210.

Can an Additional Director be appointed as a Managing/Whole time Director - A managing director or whole time director, unless the articles of a company provide otherwise, is to be appointed by the Board of directors. However, since any director can be appointed as a managing or whole time director and there being nothing in the Companies Act suggesting that an additional director cannot be appointed as the managing/whole time director, there should be no objection to the appointment of an additional director as a managing or whole time director. But the tenure of an additional director being limited to the holding of the Annual General Meeting if the company at the Annual General Meeting does not re-appoint him as a director, he will automatically vacate his office as managing or whole time director also. It is because no person who is not a director can function as a managing or whole time director.

The aforesaid view has also been endorsed by the *Department of Company Affairs* which has expressed its opinion as follows:

"An additional director can be appointed by the Board of Directors of a company under section 260 of the Act. Such a person continues to be the additional director till the commencement of the next Annual General Meeting. As soon as the AGM opens, he ceases to be the additional director of the company. If such a person while he was the additional director of a company had been appointed as the managing director, the latter appointment also ceases simultaneously with his ceasing of directorship at the commencement of the AGM. However, if such a person is re-elected as a full-fledged director at the AGM and thereby he continues as a director of the company, he shall continue as a managing director also for the period for which he is so elected by the AGM. (Extracted from the Department of Company Affairs Letter No. 8/212(60), dated 17-3-1977, addressed to the Institute of Chartered Secretaries and Administrative India Association, Calcutta)."

Qualification shares vis-a-vis Additional Director - A person who is appointed as a director must not suffer from any disqualification. This rule equally applies to the requirement of share qualification where the articles so provide. Thus, if the articles require a person to acquire certain shares by way of qualification to become a director of the company, a person who does not possess or undertakes to possess within two months the prescribed qualification shares may not be entitled to be appointed as an additional director.

Can General body appoint additional directors?- In *Ananthalakshmi v. Indian Trade & Investments Ltd.* [1952] 22 Comp. Cas. 324, it was held that general body can also appoint additional directors except where Articles specifically provide otherwise.

(ii) Filling up casual vacancies - Casual vacancy means a vacancy in the office of a director appointed by the shareholders in a general meeting and caused by the death, resignation, insolvency or disqualification. The expression does not include vacancy caused by efflux of time or retirement by rotation. Section 262 empowers the Board to fill casual vacancies in the case of a public company or a private company which is a subsidiary of a public company. Thus, if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, subject to any regulations in the articles of the company, be filled by the Board of Directors at a meeting of the Board.

Tenure- It has to be noted that as per sub-section (2) of section 262, if the director fills up a casual vacancy, the person appointed will hold office not until the next Annual General Meeting only but for the entire period for which the person in whose place he was appointed would have held office. Thus, if Ram had been elected a director and died a month later, Bharat appointed in his place would continue for the whole period for which Ram, if he had not died, would have continued. But though

Bharat would continue for the whole of the unexpired term for which Ram had been appointed; on the expiry of that term, Bharat will not be eligible for re-appointment as 'a director retiring by rotation'.

Department's clarification - The following query was addressed to the Department: "(a) Whether a person appointed as a director to fill up a casual vacancy would continue in office until the date when retirement of the original director in whose place the former is appointed will fall due in the usual course, irrespective of the date of the next Annual General Meeting following the date of filling up of the casual vacancy.

(b) If the answer to item (a) above is in the affirmative, whether a person acting against the casual vacancy may be re-appointed by the General Meeting at the time when the director in whose place he was appointed will have retired, without the formalities prescribed under section 257 being observed."

The Department gave the following reply: "The Department's reply to the query raised in (a) above is in the affirmative while the reply to that raised in (b) above is in the negative, since the director appointed to a casual vacancy is not himself director within the meaning of section 257(1)" [Company News and Notes, dated July 1, 1963].

Filling of casual vacancy by a private company- Section 262 does not apply to a private company which is not a subsidiary of a public company. Such a company will fill-casual vacancies as provided by its own articles and/or section 255(2), that is, in a General Meeting. It need not follow the provisions of section 262.

Vacancy created by resignation, etc. of a director appointed to fill casual vacancy-The following query was addressed to the Department:

"X, a director of a company, was appointed at the Annual General Meeting. Due to some reason, X resigned from the Board and casual vacancy thus created was filled by the appointment of Y at a meeting of the Board of Directors. Necessary return concerning this change was filed with the Registrar. Later on, Y resigned and the directors again invited X to fill the vacancy created by the resignation of Y. The question is: Is the action of the Board in appointing X, in the second instance, quite in accord with the provisions of section 262(1) and particularly considering the fact that the appointment of X consequent upon the resignation of Y, for the purpose of filling the casual vacancy at a Board meeting does not, in effect, satisfy the statutory requirement which states "if the office of any director appointed by the company in general meeting is vacated?"

The Department gave the following reply:

"The Department's view on the point raised is that the appointment of X, by the Board, in the second instance, in the vacancy caused in the Board by the resignation of Y cannot, strictly speaking, be deemed to be an appointment to a casual vacancy in the office of director appointed by the company in general meeting, within the meaning of section 262(1) inasmuch as the appointment of Y himself was not originally made by the company in general meeting. However, in the interest of the smooth working of the company, if the casual vacancy is in an office which was filled by election at a general meeting, the Department would have no objection to the Board of Directors of the company filling that casual vacancy as many times as may be necessary." [Company News and Notes dated July, 1963].

However, A.M. Chakraborti does not agree with the aforesaid view of the Department. In his view, if a casual vacancy arises in the office of a director appointed in the casual vacancy under section 262, there is no casual vacancy within the meaning of section 262 and cannot be filled up by the Board of Directors. In such an eventuality, he opines, the Board may appoint an additional director. The term of office of such an appointee shall then be governed by section 260 and not by section 262.

Director appointed in general meeting not assuming office -No casual vacancy arises if a director appointed by the company in general meeting does not assume office (e.g., resigns or dies before



assuming office). There is no question of someone vacating any office if he had never assumed that office. The words "director appointed by the company in general meeting" used in section 262(1) must be read with the words following, i.e., "is vacated before his term of office will expire" – M. K. Srinivasan v. W. S. Subrahmanya Ayyar [1932] 2 Comp. Cas. 147.

Procedure for filling casual vacancy

1. Ascertain the provisions with regard to appointment of a director in a casual vacancy as contained in the Articles. Ensure that the procedure laid down is followed.
2. See that the written consent of the person proposed to be appointed is filed with the company.
3. Take steps to call a meeting of the Board of directors to appoint the director to hold office for the remaining period of the vacating director's term.
4. Intimate the appointee of his appointment as director.
5. See that the person so appointed files with the Registrar his consent to act as director within 30 days.
6. File, with the Registrar, return as per section 303 notifying the change in directorship within 30 days.
7. See that necessary entries are made in the Register of directors and Register of directors' shareholdings.

(iii) Alternate director (Section 313) - The Board of directors of a company may, if so authorised by its articles or by a resolution passed by the company in general meeting, appoint an alternate director to act for a director during his absence for a period of not less than three months from the State in which meetings of the Board are ordinarily held. However, the question of appointment of alternate director must be considered fairly in the interest of the company and its shareholders - D. Ross Porter v. Pioneer Seed Co. Ltd. [1989] 66 Comp. Cas". 363 (Delhi).

The alternate director merely fills a temporary vacancy in the office of a director which already exists and no new office of director is created by his appointment. Many provisions of this Act do not apply to the alternate director. For instance, appointment of an alternate director is not considered as an increase in the strength of the Board of directors. Likewise, alternate directorship held by a person cannot be counted towards maximum number of directorships which a person can hold. An alternate director is not required to hold any qualification shares." However, the alternate director is subject to the same liability and supposed to perform the same duties as any other director. This follows even from the very definition of 'director' in clause (13) of section 2, which includes any person occupying the position of director by whatever name called. The alternate director occupies the position of a director and although he is called alternate director, he is nevertheless a director.

It is the prerogative of the Board of directors to appoint an alternate director. The articles of the company or a resolution passed by the shareholders must give an enabling power to the Board to appoint an alternate director. Neither the shareholders of the company nor any other person can exercise the power to appoint alternate director.

An alternate director is neither an agent of the original director nor his proxy. The original director cannot nominate alternate director to the directorship held by him. He may nevertheless make his recommendation. Similarly, an alternate director is not obliged to act as per instructions of the original Director.

Consent: An alternate director appointed as such for the first time shall be required to file his consent with the Registrar. However, on his regular appointment as a director in continuation, it would not be necessary to file the consent [Sec. 264(2)(b)].

When does an alternate director vacate his office - An alternate director shall not hold office as such for a period longer than that 'permissible' to the original director in whose place he has been appointed

and shall vacate office if and when the original director returns to the State in which meetings of the Board are ordinarily held.

The Department of Company Affairs has clarified that the alternate director vacates his office whether or not the original director attends the Board meeting on his return to the State - Letter No. 6/16(313)/68-PR, dated 5-2-1968.

Where the original director is a non-retiring director, an alternate director appointed in his place can continue indefinitely subject only to the condition that he shall vacate the office as and when the original director returns to the State in which the meetings of the Board are ordinarily held.

The provisions contained in various sub-sections of section 313 leave quite a few matters unexplained. Few lack of clarities have been mentioned earlier in this paragraph. The further issues that need attention are as under:

- (i) should the original director be considered an interested director in passing the resolution appointing the alternate directors? Answer is possibly no as the alternate director is independently appointed by the Board.
- (ii) Whether use of the word "returns" in sub-section (2) of section 313 dealing with vacation of office by the alternate director is correct as in large number of cases, the original directors are foreigners and the office of the alternate director was basically created to meet the eventuality of foreign directors not being in a position to regularly attend Board meetings of the company. There is no question of 'returning' by such original directors to the State in which Board meetings are ordinarily held.
- (iii) There could be companies which may not hold Board meetings regularly in one State i.e. either the State of their registration or the State where the head office is located. Then there may not be a State in which Board meetings are ordinarily held. Then how the absence of the original director from the State in which Board meetings are ordinarily held to be seen? A possible view, in such a situation, would be to reckon the State of registration of the company concerned.
- (iv) Why not the resolutions passed by circulation be kept apart for original directors? In other words, the alternate directors shall attend the meetings and act therein as directors but circular resolutions are to be considered by the original ones. There may be a valid argument against this situation. The original director, not being in regular touch with the affairs of the company may not be able to do justice to the matter(s) in the circular resolution.
- (v) Can an alternate director be alternate to more than one director? Possible answer is no. Similarly can more than one alternate director be appointed for one original director? Here also, the answer seems to be no, as section 313 allows 'an alternate director' to be appointed for a director.
- (vi) In view of MCA's General Circular No. 28/2011, dated 20-5-2011 allowing video conferencing for conducting Board/Committee Meetings, it is now a matter of consideration whether at all the 'Alternate Director System' in the Act remains relevant.

Appointment of directors by proportional representation [Section 265]

Ordinarily, directors are appointed by simple majority vote on the resolutions moved for their appointment. As a result majority shareholders controlling 51 per cent or more votes may elect all directors and a substantial minority, as high as 49 per cent, may find no representation on the Board. In order to enable the minority shareholders to have a proportionate representation on the Board, section 265 of the Companies Act gives an option to companies to appoint directors through a system of proportional representation. The section provides that a company may provide in its Articles for the appointment of not less than 2/3rds of the total directors according to the principle of proportional representation by single transferable vote or some system of cumulative voting or otherwise. Such appointment shall be made once in every three years (Section 265).

Single transferable vote - Under the system of single transferable vote, a quota of votes is fixed. A person



gets elected if he gets the required number of votes fixed as quota. Quota is fixed in the following manner:

Suppose in an election 600 votes are cast and there are 5 seats. The quota shall be obtained by dividing the total number of votes cast by the total number of seats plus one and adding one to the result. Thus, the quota in this case will be 101 votes, calculated as follows:

$$\frac{600}{5+1} + 1 = 101 \text{ votes}$$

Now, let us see how this system works. Suppose there are seven candidates, viz., A, B, C, D, E, F & G. The voters shall cast their votes by giving preference as preference 1, say, to A, preference 2 to B, preference 3 to C, and so on. At the first instance first preference votes are counted. All those candidates who get 101 or more first preference votes get elected.

Let us suppose, on counting of first preferences, the following tally emerges:

A gets	190 votes
B gets	90 votes
C gets	85 votes
D gets	75 votes
E gets	60 votes
F gets	58 votes
G gets	42 votes
Total votes polled	600 votes

Since A gets more than the quota, he shall be declared elected. We find that A has surplus 89 first preferences. His papers are scrutinised and the second preference found in them is counted. The second preferences in A's papers are noted as follows:

D	30
E	10
F	15
G	120
Total	175

Accordingly, surplus of 1st preferences of A, i.e., 89 votes shall be transferred to D, E, F and G in the ratio of their second preferences, viz., 30:10:15:120. It shall come to:

$D = \frac{30 \times 89}{175}$	= 15
$E = \frac{10 \times 89}{175}$	= 5
$F = \frac{15 \times 89}{175}$	= 8
$G = \frac{120 \times 89}{175}$	= 61

Now the tally is:

A = 190

B = 90

$$C = 85$$

$$D = 75 + 15 = 90$$

$$E = 60 + 5 = 65$$

$$F = 58 + 8 = 66$$

$$G = 42 + 61 = 103$$

G gets the quota and is therefore elected. Now, since there are no surplus votes in any account; the elimination round starts. E, who has got the lowest adjusted number of first preference votes is eliminated. His 60 papers are scrutinised to note the second preferences therein and they are:

In favour of B - 11

In favour of C - 5

In favour of D - 15

In favour of F - 25

After transferring second preference in E's papers, the tally is :

A-190

$$B-90+11 = 101$$

$$C - 85 + 5 = 90$$

$$D-90+15=105$$

E - 65

$$F-66+ 25 = 91$$

G-103

B and D get elected having obtained quota or more votes. Now, C has the next lowest and is therefore eliminated. His ballot papers shall now be scrutinised. It is found that there are 15 second preference in favour of F. These will be added to F's tally of 91 votes who then stands elected. Thus, A, B, D, F and G get elected.

Cumulative voting - As per the cumulative voting system, the total number of votes cast would be equal to the total number of shares multiplied by the number of directors to be elected. Again, each share carries that many votes as are the vacancies. Thus, if there are 1000 shares and ten directors are to be elected, the total number of votes cast would be equal to 10,000. A candidate getting 1000 votes should be declared elected. Now assuming that the minority holds 10 per cent of shares, i.e., 100 shares, the total votes which the minority can therefore cast in favour of one or more candidate would be equal to $100 \times 10 = 1000$. In case, the minority is bent upon having at least one of its representatives on the Board, it can do so by casting all the votes in favour of that single candidate and in that event its representative would get elected.

Appointment of directors by the Central Government [Section 408]

The Central Government has been empowered to appoint directors on an order passed by the Company Law Board. The Company Law Board may so order either on a reference by the Central Government or on the application of not less than 100 members of the company or of members holding not less than 1/10th of the total voting power. Such appointments shall be so ordered by the Company Law Board where it finds that the affairs of the company have been conducted in a manner oppressive to any member of the company or in a manner prejudicial to the interests of the company or to public interest. Such a director may be appointed for any term but not exceeding three years.

In lieu of passing an order as aforesaid, the Company Law Board may direct the company to amend



its Articles so as to provide for election of directors by the system of proportional representation. It may also direct that until new directors are appointed in pursuance of the order aforesaid, such number of persons as it may specify as being necessary to effectively safeguard the interests of the company or its shareholders or the public interest shall hold office as additional directors of the company [Section 408(2)].

A person appointed by the Central Government in pursuance of the above provisions shall not be:

- (a) considered for the purpose of reckoning 2/3rd or any other proportion of the total number of directors of the company [Section 408(3)],
- (b) required to hold qualification shares [Section 408(4)], and
- (c) required to retire by rotation [Section 408(4)].

The Central Government may remove any such director from his office at any time and appoint another person to hold office in his place [Section 408(4)].

The provisions of this section are applicable to both public and private companies.

Once the Central Government has exercised its power to appoint director(s) under section 408, it is concurrently empowered to issue any direction to the company as may be necessary/appropriate. The directions may include directions to suitably alter the Articles of Association or remove the auditor and to make fresh appointment of another auditor in his place.

Appointment of Directors by third parties (Nominee Directors)

There may be occasions when directors represent certain third parties in the Board. This usually happens when the Government, foreign collaborators, holding companies, financial institutions or other lenders, etc., nominate a director to represent their interest on the Board. The phenomenon of nominee directors has become an important feature of the modern Indian corporate scene. It is primarily because of the role of the various lending institutions like banks, mutual funds, public financial institutions, State financial corporations, etc. These lending institutions, in the modern corporate world have assumed a pivotal role in financing the various projects of the companies. Because of their heavy commitments, such providers of money naturally desire to safeguard their interests. Besides, they will also like to ensure that the money is invested in the stipulated purposes only. The right to nominate the directors on the Boards of financed companies is usually contained in the contract itself. However, the special legislations governing certain public financial institutions and State financial corporations envisage the appointment of certain director on the Boards of borrowing companies and such a provision has an overriding applicability in spite of the normal regulatory provisions of the Companies Act, the memorandum of Association and the Articles of Association.

Except where a statute provides for nomination of directors on the Board of a company, nominee directors can be appointed only if a provision to that effect exists in the Memorandum of Association or Articles of Association of the company. It is because section 255 of the Companies Act, 1956 provides that unless the Articles provide for the retirement of all directors at every annual general meeting, not less than 2/3rds of the total number of directors of a public company or a private company which is a subsidiary of a public company shall be liable to retire by rotation. Sub-section (2) of section 255 provides that the remaining directors shall, in default of and subject to any regulation in the Articles of the company, also be appointed by the company in general meeting. Therefore, it would be necessary for the company to specifically provide in its Articles, or amend its Articles to provide, for appointment of a non-rotational director by the assisting financial institution(s) except those created by special Acts and having the overriding provision in this regard. Therefore, if the Articles do not contain a provision in this regard, they shall have to be first amended and only then the appointment can be made. It may be mentioned that in the case of statutes governing certain statutory financial institutions like the LIC, UTI, SFCs and IDBI empower them to appoint nominee directors. Therefore, in their cases, the above procedure need not be followed as these special statutes override the provisions of the Companies Act and the Articles of Association.

It should be ensured that the total number of non-rotational directors does not exceed 1/3rd of the total strength of the Board.

Liability of nominee directors – Nominee directors are in the same position and they owe same duties to the company as any other director.

However, by virtue of special provisions in the respective Acts governing different financial institutions, the directors nominated by the financial institutions have been given immunity from action for any liability as a director in the company and administrative instructions have also been issued to the Department of Company Affairs not to launch any prosecution against such directors.

Responsibilities of nominee directors – Department of Company Affairs, vide its Circular No. 8/2002, dated 22-3-2002, has cast the following responsibilities on the nominee directors of Public Financial Institutions / Banks / Government:

- (i) The Nominee Directors are expected to work assiduously towards observance of good corporate governance practices in the company with due regard to the legitimate interests of the various stakeholders. The various provisions relating to good corporate governance have been introduced in the Companies Act/Rules/Regulations and clause 49 of the Listing Agreement introduced by the SEBI. The Nominee Directors are expected to study these provisions of corporate governance and have them implemented.
- (ii) Ensure that the operations of the company are conducted in consonance with public policy.
- (iii) Ensure strict compliance in letter and spirit of all the statutory provisions in particular the provisions of the Companies Act and the regulations, clarifications etc. issued thereunder. It is the duty of the nominee directors to fully acquaint themselves in the relevant provisions of the Company Law and ensure that measures are instituted to monitor and certify that these statutory provisions are being observed.
- (iv) The Nominee Directors should see that important committees of the Board of Directors are constituted and are functioning effectively such as Audit Committee, Nominations Committee, Remuneration Committee etc. The Nominee Directors are expected to seek membership of these important committees and through their active participation in such committees ensure that the objectives of setting up these committees are being achieved.
- (v) The Nominee Directors are expected to regularly attend and actively participate in the proceedings of the Boards and in committee on which they are included. Their frequent absence for insufficient reasons from the meetings of the Board of Directors/Committees would negate the purpose for which the Nominee Directors have been nominated by the Institutions and they would not be able to perform the various responsibilities listed out in this paragraph.
- (vi) Duly safeguard the interest of the Government/Banks/Financial Institutions which they represent. Ensure proper utilization of financial assistance by the assisted company and prevent any misuse/diversion of funds by the promoters/management of the companies.
- (vii) Provide adequate feedback to the nominating Institutions/Banks/Companies on the affairs and operations of the assisted concerns.
- (viii) The Financial Institutions are expected to closely monitor the participation by the Nominee Directors on the Boards/Committees as above and to ensure that they are discharging their responsibilities as listed out above. In case any Nominee Director is failing to discharge his/her responsibilities the Institutions are expected to take steps to replace him/her. The Institutions are also expected to send a six monthly report to the Department of Company Affairs (ROC) bringing out the steps taken by them to ensure that their Nominee Directors are discharging their responsibilities. The Financial Institutions should also in a separate section of their Annual Report clearly bring out the measures instituted by them to ensure that the system of Nominee Directors is functioning effectively.

The above amply show that the responsibility on a nominee director is far wider than to look after the interests of the nominating body. His basic responsibility is to the company on whose Board he is



serving. He can ill afford to ignore his fiduciary responsibility to all stakeholders of the company and the company itself.

Remuneration and sitting fee for Nominee Director- As the Act treats all the directors alike, there is no doubt that nominee directors are equally entitled to remuneration and sitting fee for Board and Committee Meetings. But the question is whether the remuneration and the fee earned is personal to such director or through the director the amounts are payable to the nominating body/authority. The Act does not deal with the issue of nominee director; it is a matter either in the Articles of the company or in the statute governing the body/authority making the nomination. But as all directors in the company are recognized by the Act as individual persons, presumably there will not occur irregularity if nominee directors receive these payments in their personal capacity in the absence of a provision in the Articles or in any relevant statute. On the other hand nominee directors are there in the company not by virtue of their personal standing but only because their employing body/authority has nominated them and as such, such directors have no right to appropriate the money. Till a court decision comes in this regard, the issue will remain open. Safer course for the company will be to obtain a written instruction from the nominating body/ authority in this regard.

Appointment of special directors under Sick Industrial Companies (Special Provisions) Act (SICA), 1985

Under section 16(4) of SICA, 1985 as amended in 1994, it is provided that where the Board of Industrial and Financial Reconstruction (BIFR) constituted under the Act (SICA) deems it necessary that an enquiry should be made into an industrial company the BIFR shall appoint one or more persons as special directors 'for safeguarding financial and other interests of the company or in public interest'. It is further stated in sub-section (4A) that the BIFR may issue such directions to a special director as it may deem necessary or expedient for proper discharge of his duties. Again, sub-section (5) provides that the provisions relating to share qualification, age limit, number of directorships, removal from office, etc. shall not apply to any director appointed by the BIFR. The Department of Company Affairs has clarified that special directors appointed under section 16(4) of the SICA, 1985 by the BIFR shall not be disqualified for appointment as directors in view of new section 274(1)(g) of the Companies Act, 1956. - Press Release, dated 1-6-2001. The Act, however, contains no provision as to powers exercisable by the special directors.

The difference between a special director appointed under SICA, 1985, and a director appointed as nominee of a financial institution, etc., is that the special director is appointed to safeguard the interests of the company or public interest while the nominee director safeguards the interests of the nominating institution/person along with that of the company.

Minimum and maximum number of directors

Provisions in this regard are as follows:

Minimum number of directors - Section 252 provides that every public company (other than a public company which has become such by virtue of section 43A) must have at least 3 directors and every private company (including a deemed public company) must have at least 2 directors. However, a public company having—

(a) a paid-up capital of five crore rupees or more;

(b) one thousand or more small shareholders;

may have a director elected by such small shareholders in the manner as may be prescribed.

The expression 'small shareholders' means a shareholder (including a preference shareholder) holding shares of nominal value of twenty thousand rupees or less in a public company to which this section applies.

The Department of Company Affairs, in this regard, has prescribed the Companies (Appointment of

the Small Shareholders' Director) Rules, 2001. These rules, inter alia, provide for the following:

- (i) Small shareholders intending to propose a person as their representative on the board of the company would be required to give 14 days notice prior to shareholders meeting.
- (ii) The proposed name would have to be endorsed by signatures of at least 100 small shareholders who together represent at least a tenth of the total small shareholders in a company.
- (iii) The nominee would necessarily have to be a small shareholder of the company.
- (iv) The proposed nominee shall give, in writing, his consent to represent small shareholders.
- (v) Listed public companies shall elect the small shareholders nominee through a postal ballot while unlisted company shall appoint such nominee if majority of the small shareholders recommend his candidature at their meeting.

The rules also empower the company to act suo motu to elect a small shareholders' director from amongst shareholders.

- (vi) A nominee of the small shareholders would not be eligible for appointment as whole time director or managing director of the company.
- (vii) The tenure of such director shall be a maximum of three years and he need not retire by rotation. The person can be elected for another period of three years on expiry of his tenure.
- (viii) A person shall not hold office as small shareholders' director in more than two companies.
- (ix) Disqualifications - Rule 5 provides that a person shall not be capable of being appointed as small shareholders' director of a company if—
 - (a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
 - (b) he is an undischarged insolvent;
 - (c) he has applied to be adjudicated as an insolvent and his application is pending;
 - (d) he has been convicted by a Court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months, and a period of five years has not elapsed from the date of expiry of the sentence;
 - (e) he has not paid any call in respect of shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last date fixed for the payment of the call; or
 - (f) an order disqualifying him for appointment as director has been passed by a Court in pursuance of section 203 and is in force, unless the leave of the Court has been obtained for his appointment in pursuance of that section.

The above grounds are similar to those provided under section 274 of the Act for disqualification of directors except the ground contained in clause (g) of sub-section (1) of section 274. Omission of this ground in above rule appears to be a drafting lapse and, therefore, needs correction.

- (x) Vacation of office - Rule 6 provides that a person appointed as small shareholders' director shall have to vacate the office if—
 - (a) such person so elected as director of small shareholders, ceases to be a small shareholder, on and from such date on which he ceased to be a small shareholder;
 - (b) he has been rendered disqualified by virtue of sub-rule (1) of rule
 - (c) he fails to pay any call in respect of shares of the company held by him, whether alone or jointly with others, within six months from the last date fixed for the payment of the call;



- (d) he absents himself from three consecutive meetings of the Board of directors, or from all meetings of the Board for a continuous period of three months, whichever is longer, without obtaining leave of absence from the Board;
- (e) he, or any firm of which he is a partner or any private company of which he is a director, accepts a loan, or any guarantee or security for a loan, from the company in contravention of section 295;
- (f) he acts in contravention of section 299;
- (g) he becomes disqualified by an order of Court under section 203; and
- (h) he is removed in pursuance of section 284.

Maximum number of directors - Regarding the maximum number of directors, there is nothing provided in the Act. Thus, there is no limit to the maximum number of directors. All members may also be appointed directors. The Articles of a company may, and usually do, fix the minimum and maximum number of directors of its Board. For instance, the Articles of a company may fix 6 as the minimum and 10 as the maximum number of directors for the Board.

For the purpose of maximum limit fixed by the Articles, directors appointed by the Central Government under section 408 of the Act or by the Company Law Board (now Tribunal*) under section 397 or 398 of the Act are not to be taken into account.

Similarly, nominee directors appointed by the public financial institutions are also not to be counted within the maximum limit fixed by the Articles.

Presumably, the special directors appointed pursuant to SICA also will not be counted to determine whether the number of directors has exceeded the maximum number in the Articles.

Again, since an alternate Director takes the place of original Director he is not counted for determining maximum or minimum number of Directors.

Increase or reduction in the number of directors

A company in general meeting may, by ordinary resolution, increase or reduce the number of its directors within the limits fixed in that behalf by its Articles (Section 258).

In certain cases, the increase in number of directors also requires the approval of the Central Government. Section 259 provides that if a public company, or a private company which is a subsidiary of a public company wishes to increase the number of its directors beyond the maximum fixed by its Articles as originally framed the increase even though decided upon by resolution of the company in general meeting will not have any effect unless approved by the Central Government, and shall become void, if and insofar as it is disapproved by the Central Government. But, if the increase in the number does not make the total number of directors more than twelve, no approval of the Central Government shall be necessary. It may be noted that the above provision is equally applicable in respect of a company in existence as on 21st day of July, 1951 insofar as such a company requiring to increase the number of directors exceeding the number provided in its Articles, then in force. Here also an increase upto twelve in number will not be required to be approved by the Central Government.

Independent private companies and Government companies exempted - It may be noted that the restrictive provisions of section 259 do not apply to:

- (i) a private company which is not a subsidiary of a public company;
- (ii) a Government company (Notification GSR 235, dated 31-1-1978); and
- (iii) section 25 company (S.O. Number 1578, dated 1-7-1961).

Therefore, though technically all the members of the above said companies can be made the directors, it is usual to provide in the articles the maximum number to avoid confusion.

Number of Directorships

As per section 275 of the Companies Act, 1956, a person cannot hold office at the same time as a director in more than fifteen companies. However, section 278 provides that in computing this number of fifteen directorships, the directorships of,

- (i) private companies [other than subsidiaries or holding companies of public company(ies)],
- (ii) unlimited companies,
- (iii) associations not carrying on business for profit or which prohibit payment of a dividend, and
- (iv) alternate directorships (i.e., he is appointed to act as a director only during the absence or incapacity of some other director),

will be omitted.

In case any company ceases to fall in the categories under (i), (ii) or (iii) above, the directorships shall continue to remain excluded up to a period of three months from such cessation [Section 278(2)].

Foreign Companies-Directorships in foreign companies shall not be counted for the aforesaid ceiling of 15 companies under section 275 as they do not come within the definition of 'company' in the Act.

Vacation of office of a director [Section 283]

Section 283 provides for the office of a director becoming vacant on the happening of certain events. It provides that the office of a director shall become vacant if:

- (a) he fails to obtain within the time specified in sub-section (1) of section 270 (two months after the date of appointment as a director), or at any time thereafter ceases to hold, the share qualification, if any required of him by the Articles of the company;
- (b) he is found to be of unsound mind by a Court/Tribunal of competent jurisdiction;
- (c) he applies to be adjudicated an insolvent;
- (d) he is adjudged an insolvent;
- (e) he is convicted by a Court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months;
- (f) he fails to pay any calls in respect of shares of the company held by him, whether alone or jointly with others, within six months from the last date fixed for the payment of the call unless the Central Government has, by notification in the Official Gazette, removed the disqualification incurred by such failure;
- (g) he absents himself from three consecutive meetings of the Board of directors or, from all meetings of the Board for a continuous period of three months, whichever is longer, without obtaining leave of absence from the Board;

Thus, where a director absented himself from the Board meeting held on 12-1-2005, 4-2-2005 and 5-3-2005, his disqualification as envisaged in section 283(1)(g) would not arise without completion of a continuous period of three months from the date of the first meeting [D. Srinivasan v. H.S. Vishwanath [2007] 75 SCL 59 (CLB-Chennai)].

Further, where there was no proof that notices of board meetings were served on directors, directors could not be removed on the ground that they abstained from attending meetings''' [Vijay Krishan Jaidka v. Jaidka Motor Co. Ltd. [1996] 10 SCL 244 (CLB)].

Again, where the director had been deliberately kept out of the affairs of the company and eventually was not allowed to continue in office as director of the company and there was no definite evidence as to the service of notices of Board meetings, he could not be removed from his position of a director by reason of non-attendance of three Board meetings [Bagri Cereals (P.) Ltd., In re[1997]5Comp.LJ. 145 (Cal.)].



- (h) he (whether by himself or by any person for his benefit or on his account), or any firm in which he is a partner or any private company of which he is a director, accepts a loan, or any guarantee or security for a loan from the company in contravention of section 295;
- (i) he acts in contravention of section 299 [Disclosure of interest by the directors];
- (j) he becomes disqualified by an order of Court under section 203;
- (k) he is removed in pursuance of section 284;
- (l) having been appointed a director by virtue of his holding any office or other employment in the company, he ceases to hold such office or other employment in the company; or
- (m) where a director or any other officer of a company has been convicted of an offence under section 209A, he shall, on and from the date on which he is so convicted, be deemed to have vacated his office as such and on such vacation of office, shall be disqualified for holding such office in any company, for a period of five years from such date [Section 209A(9)].

A private company which is not a subsidiary of a public company may, by its articles, provide that the office of director shall be vacated on any grounds in addition to those specified above, for example, when a director's activities appear prejudicial to the bona fide interest of the company, the remaining members of the Board may require such director to vacate his position/resign, by writing a letter to him, signed by all of them. Articles of a private company simpliciter may contain a clause to this effect.

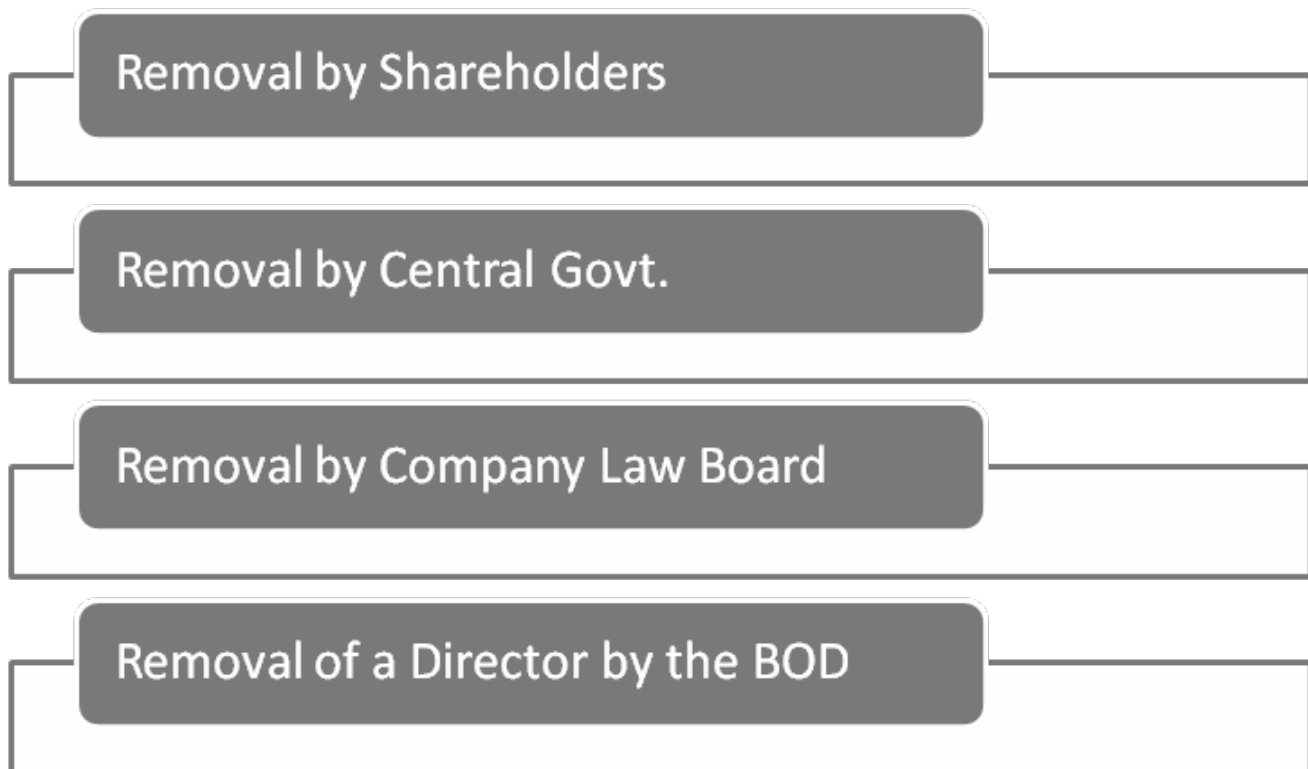
However, sub-section (2) of section 283 provides that the disqualification referred in clauses (d), (e) and (f) above shall not take effect:

- (a) for thirty days from the date of the adjudication, sentence or order;
- (b) where any appeal or petition is preferred within the thirty days aforesaid against the adjudication, sentence or conviction resulting in the sentence, or order until the expiry of seven days from the date on which such appeal or petition is disposed of; or
- (c) where within seven days aforesaid, any further appeal or petition is preferred in respect of the adjudication, sentence, conviction, or order, and the appeal or petition, if allowed, would result in the removal of the disqualification, until such further appeal or petition is disposed of [section 283(2)].

Penalty - If a person functions as a director after his office has become vacant on account of any of the disqualifications specified in (a) to (l) above, he shall be punishable with fine upto ₹5,000 for every day during the period he so functions [section 283(2A)]. It appears reasonable to view that the company itself and the co-directors should as well be made liable for the illegal continuance. Unfortunately, the law is silent on this aspect.

Removal of a director

The discussion on removal of a director may be grouped under the following three heads:



- 1. Removal by shareholders** - Section 284 recognises the inherent right of shareholders to remove the directors appointed by them. It is not even necessary that there should be proof of mismanagement, breach of trust, misfeasance or other misconduct on the part of the directors. Where the shareholders feel the policies pursued by the directors or any of them are not to their liking, they have the option to remove the directors by passing an ordinary resolution in the same way as they have the right to appoint directors by passing an ordinary resolution.

Section 284 provides that a company may, by ordinary resolution passed in general meeting after due receipt of a special notice, remove a director before the expiry of his term of office.

In *Queen Kuries & Loans (P.) Ltd. v. Sheena Jose* [1993] 76 Comp. Cas. 821 (Ker.), it was held that the notice must disclose the grounds on which the director is proposed to be removed. The disclosure of the ground for removal is a matter of substance and not of form because the directors concerned are entitled to make a representation in writing against their removal at the meeting. The company is bound to send a copy of the representation to every member of the company to whom the notice of the meeting has been sent. It is only after these steps are taken that the resolution can be passed. So, where a special notice of the resolution was not given, it amounted to a serious lapse depriving the directors of their statutory right to make a representation. The resolution removing the director was therefore held to be invalid.

Note that the grounds for removal of the directors are required to be stated in the explanatory statement accompanying the notice of the meeting. Thus, where requisitionists themselves call and hold the meeting (on directors' failure to do so), the notice of the meeting must be accompanied by the said explanatory statement. But, where meeting is called and held by the directors, though on requisition, the responsibility of stating the grounds shall be that of the directors. The problem may, however, arise in view of the Supreme Court decision in *L/C v. Escorts* AIR 1986 SC where the apex court laid down that the requisitionists could not be compelled to state the grounds for removal of directors and calling of the meeting refused on this count. Directors may, therefore, be not aware of the grounds. It will appear that in such cases, the explanatory statement should carry the statement of the fact that the



requisitionists have failed or refused to state the grounds. In the meeting, requisitionists will, however, be bound to disclose the reasons.

On receipt of the special notice for removal of a director, the company must forthwith send a copy thereof to the director concerned to enable him to make a representation. If he makes a representation in writing and requests the company to notify it to the members, the company must, unless it is received by it too late for it to send to the members, state the fact of the representation to every member of the company to whom notice of the meeting is sent. If the representation is not sent as aforesaid, the company must at the instance of the director read it out at the meeting. The director is also entitled to be heard on the resolution at the meeting.

Any omission to serve a special notice on the directors sought to be removed constitutes denial of their statutory right of reply and in the absence of such notice to the directors, any resolution for their removal would be vitiated by such omission - *S. Varadarajan v. Udhayem Leasings & Investments (P.) Ltd* [2005] 62 SCL 315 (CLB - Chennai).

The following directors, however, cannot be removed by the shareholders in general meeting:

- (i) a director appointed by the Central Government under section 408;
- (ii) a director of a private company holding office for life on April 1, 1952;
- (iii) a director elected by the principle of proportional representation under section 265;
- (iv) directors appointed by Central Government under Industries (Development & Regulation) Act, 1951;
- (v) special directors appointed under Sick Industrial Companies (Special Provisions) Act, 1985;
- (vi) directors appointed by financial institutions under statutory powers;
- (vii) nominee directors;
- (viii) directors appointed by Company Law Board (now Tribunal) under section 402.

Filling vacancy caused by removal of a director - The vacancy caused by the removal of a director may be filled at the same meeting, and if so filled, person appointed thereto will only hold office for the residual period of the removed director [section 284(5)]. However, a special notice of the intended appointment must have been given. The special notice may or may not be simultaneous or from the same shareholder as regards removal and appointment as a result of removal.

If vacancy is not filled by the company in general meeting, the Board of directors may fill it as if it were a casual vacancy in accordance with section 262 [section 284(6)]. However, the Board cannot appoint the removed director.

2. Removal by Central Government - Under section 388B, the Central Government has the power to make a reference to the Company Law Board (now Tribunal) against any managerial personnel. The power can be exercised where, in the opinion of the Central Government, there are circumstances suggesting:

- (a) that any person concerned in the conduct and management of the affairs of a company is or has been guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law, or breach of trust in connection therewith; or
- (b) that the business of the company is not or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practices; or
- (c) that the business of the company is or has been conducted or managed by such person in a manner which is likely to cause or has in fact caused, serious injury or damage to the interest of trade, industry or business to which such company pertains; or

- (d) that the business of the company is or has been conducted and managed by such person with an intent to defraud its creditors, members, or any other person or otherwise for a fraudulent or unlawful purpose in a manner prejudicial to public interest.

The reference may be made by stating a case against the person aforesaid with a request that the Company Law Board (now Tribunal) may inquire into the case, record finding as to whether or not such person is fit and proper person to hold the office of director or any other office connected with the conduct and management of any company.

Under section 388C, the Company Law Board (now Tribunal) has the powers to pass an interim order suo-motu or on the application of the Central Government, in the interest of members or creditors or in the public interest. The interim order may direct the concerned managerial personnel not to discharge any of the function of the office until further order. The Company Law Board (now Tribunal) may further order the appointment of a suitable person to perform the duties of the personnel concerned and specify the terms and conditions thereof.

At the conclusion of the hearing of the case, the Company Law Board (now Tribunal) shall record its findings, stating therein specifically as to whether or not the director is a fit and proper person to hold the office of director or any other office connected with the conduct and management of any company (Section 388D).

On the basis of the aforesaid findings, the Central Government may, by order, notwithstanding any other provision contained in the Act, remove the delinquent respondent (director) from his office (Section 388E).

After the delinquent person has been, by order, removed, he shall not hold any managerial office of any company for a period of five years from the date of the order of removal, nor will he be paid any compensation for loss of office as a result of removal. The time limit may, however, be relaxed by the Central Government with the previous concurrence of the Company Law Board (now Tribunal).

However, in *Union of India v. Satyam Computer Services Ltd.* [2009] 89 SCL 393, the CLB, on a reference by the Central Government and taking facts into account ordered removal of the then Board of Directors and allowed the Central Government to constitute a Board comprising not more than ten members.

3. Removal by Company Law Board (now Tribunal) [Section 402(d)] - Where an application has been made to the Company Law Board (now Tribunal) under section 397 or 398 against oppression and mismanagement of a company's affairs, the Company Law Board (now Tribunal) may order for the termination or setting aside of an agreement which the company might have made with any of its directors. Such a director shall not be entitled to serve as a manager, managing director or director of the company without leave of the Company Law Board (now Tribunal) for a period of five years from the date of Company Law Board's (now Tribunal) order terminating or setting aside his contract with the company [section 407(6)]. He shall also not be entitled to claim any compensation from the company for the loss of office [Section 407(a)].

4. Removal by the Board of Directors - It may be interesting to debate as to whether a director can be removed by the Board of Directors if such a power is conferred upon it by the Articles of Association.

Section 283 of the Companies Act, 1956 provides for vacation of office of a director of any company on the happening of certain contingencies, and that according to its sub-section (3), no public company or a private company which is a subsidiary of a public company can provide for any additional grounds for the vacation of office of a director. This means that a private company which is not a subsidiary of a public company may, by its articles, provide that the office of director shall be vacated on any grounds in addition to those specified in section 283. It is sometimes provided in the articles of a private company that the office of director shall become vacant if he be requested in writing by all his co-directors to resign. It is doubtful whether it is lawful for a public company or a private company which is a subsidiary of a public company to include such a provision in its articles in view of the provisions



contained in section 283(3). However, there is no bar to a private company which is not a subsidiary of a public company for including such a provision in its articles.

Resignation by a Director

There is nothing in the Companies Act as to whether, and by what procedure, a director can resign. The Act, however, indirectly recognises the right of resignation through the provisions in section 318, one of which is that no director is entitled to a compensation if he resigns his office.

Articles of association usually provide for resignation by a director by giving written notice to the company. Even though there is no such provision in the articles, a director may resign unless the articles forbid him to do so. In *S.S. Lakshmana Pillai v. Registrar of Companies* [1977] 47 Comp. Cas. 652 (Mad.), the Madras High Court held that if there is a provision in the articles, resignation will take effect in accordance with such provision and, if there is no provision, resignation will take effect in accordance with its terms. Notice may be written or oral.

In the aforesaid case, the Madras High Court also held that the resignation shall be effective even when no other director was in office. In this case, of the two directors of a company, one died and the other wanted to resign.

The Court, however, observed that a director could not evade his obligations by severing his connection with the company. But, where a director has tendered his resignation and Board of directors has accepted it and has acted on it, such a director cannot be held liable for liability incurred by said company after date of acceptance of his resignation except the liability which has been incurred by him for purchase of shares of said company and nothing more - *Saumil Dilip Mehta v. State of Maharashtra* [2002] 39 SCL 102 (Bom.).

Resignation to be valid must be addressed to the company. Letter of resignation addressed to a third party shall have no effect - *Registrar of Companies v. Orissa Paper Products Ltd* [1988] 63 Comp. Cas. 460 (Ori.). In *Saumil Dilip Mehta v. State of Maharashtra* [2002] 39 SCL 102 (Bom.), it was held that a director can resign just by sending in writing a letter informing either chairman or secretary of company, his intention to resign from post of director of said company. He can tender his resignation unilaterally and without filling in Form No. 32 and without sending a notice to Registrar of Companies.

Once a resignation letter is submitted to the board, the date on which the intention to relinquish post is communicated to board would be the date from which the director ceases to be a director of the company - *Mother Care (India) Ltd. v. Prof. Ramaswamy P. Aiyar* [2004] 51 SCL 243 (Kar.).

Where a director has contracted to serve the company for a fixed period, he may resign subject to payment of damages, if any, suffered by the company as a consequence of premature termination of his service agreement.

Once a director has given a notice of resignation, he cannot withdraw it except with the consent of the company properly considered by the directors. But, where articles contain a provision that a director may resign only if the Board consents, the resignation shall not be effective until the Board's consent is given and the resignation may be withdrawn in the meantime - *Glossop v. Glossop* [1907] 2 Ch. 370.

A verbal resignation accepted at a meeting is sufficient, even if the articles provide for resignation in writing - *Latchford Premier Cinema v. Ennion* [1931] 2 Ch. 409.

A managing or whole time director cannot resign merely by giving a notice. In his case, a formal acceptance of the resignation by the company is essential. This is because of the fact that such a director, besides being an ordinary director, is also in the whole or substantially the whole time employment of the company. He has to be relieved of all the duties and responsibilities attaching to his office. The notice by a director holding office both of a whole time and ordinary director, for resignation shall apply to both the offices - *Mosely v. Koffyfontein Mines Ltd.* [1911] 1 Ch. 73.

Validity of the acts of a director where his appointment is invalid [Section 290]

Section 290 provides that the acts done by a director shall be valid even if his appointment is discovered to be invalid because of any defect or disqualification or where his appointment had terminated by virtue of any provision contained in the Companies Act or in the articles.

Exceptions

However, the aforesaid position shall not prevail in the following cases:

- (i) Where appointment is illegal or no appointment at all.
- (ii) Where the director continues in his office knowingly that his term has expired.
- (iii) Where the director knew from the beginning that his appointment was defective.
- (iv) In case of acts done after his appointment has been shown to him to be invalid,
- (v) Acts of a managing director, manager or secretary.
- (vi) Acts ultra-vires the company
- (vii) Where requirement as to minimum number of directors not satisfied '[Sly, Spink and Co. (supra)]'.
- (viii) Where the third party was aware of the irregularity, such party shall not be entitled to enforce against the company.

Managing Director

Meaning- Section 2(26) defines 'managing director' as a director who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its Board of directors, or by virtue of its Memorandum or Articles of Association, is entrusted with substantial powers of management which would not otherwise be exercisable by him. The expression includes a director occupying the position of a managing director, by whatever name called.

The definition makes it clear that the managing director's powers of managing the affairs of the company must be substantial. The power to do administrative acts of routine nature such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to sign any certificate of share shall not be deemed to be included within substantial powers of management.

The managing director exercises his powers subject to the superintendence, control and direction of the Board of directors.

The managing director is thus a-director who carries on the day to day business of the-company. He is the executive head of the company and, subject to the control of the Board of directors of the company, controls the company's affairs.

The managing director has necessarily to be a director. He, like any other director, has no powers of management except when acting as one of the members of the Board and to the extent those powers are delegated to him by the Board.

A director entrusted with managerial functions will be a managing director even though he may be called as 'technical director' or 'technical advisor' (Fourth Annual Report - year ended 31st March, 1960).

Appointment of Managing Director- In terms of section 2(26), a managing director may be appointed in any of the four ways, namely:

- (a) by virtue of an agreement with the company,
- (b) by virtue of a resolution passed by the company in general meeting,
- (c) by virtue of a resolution passed by the Board of directors, and
- (d) by virtue of the Memorandum/Articles of Association.



Section 269(1) of the Companies Act, 1956, as amended by the Act of 1988, makes it obligatory for a public company or a private company which is a subsidiary of a public company having a paid up share capital of such sum as may be prescribed (presently, Rupees five crores) to appoint (or re-appoint) a managing or whole time director (includes a director in whole time employment of the company) or a manager. Further, sub-section (2) of section 269 provides for the approval of the Central Government to be obtained in certain cases. This approval is to be taken in e-Form 25A.

The sub-section reads as follows:

“On and from the commencement of the Companies (Amendment) Act, 1988, no appointment of a person as a managing or whole time director or a manager in a public company or a private company which is a subsidiary of a public company shall be made except with the approval of the Central Government unless such appointment is made in accordance with the conditions specified in Parts I and II of Schedule XIII (The said Parts being subject to the provisions of Part III of that Schedule) and a return in the prescribed form is filed within 90 days from the date of such appointment.” The return is to be made in e-Form 25C.

Approval of the Government- Prior to the Amendment Act, 1988, no appointment of a managerial personnel could be made without the approval of the Central Government. The amended sub-section (2) of section 269 enables a company to appoint a managerial personnel even without the approval of the Central Government on fulfillment of the conditions laid down in Schedule XIII. However, in all other cases, the appointment made by the company must be approved by the Central Government. As per Schedule XIII, for appointment of a managing, whole time director or a manager, approval of the Central Government would not be required if the following conditions are satisfied:

- (a) He had not been sentenced to imprisonment for any period or to fine exceeding Rupees one thousand for conviction of an offence under any of the specified fifteen Acts mentioned in Schedule XIII;
- (b) He had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974;
- (c) He has completed the age of twenty-five years and has not attained the age of seventy years or the age of retirement, if any, specified by the company, whichever is earlier. With the amendment of Sch. XIII w.e.f. 12-9-1996, a company will now have the freedom to appoint a managerial person who has not completed the age of 25 years but has attained the age of majority or has attained the age of 70 years without the approval of the Central Government provided his appointment is approved by special resolution passed by the company in a general meeting;
- (d) He is a managerial person in more than one company and he draws remuneration from one or more companies subject to the ceiling provided in Section III of Part II (viz., higher maximum limit admissible from any one of the companies of which he is a managerial person).
- (e) He is resident in India;

In case any of the above conditions of Schedule XIII are not complied with, an application must be made to the Central Government within ninety days of the appointment [Section 269(3)].

The Central Government shall not accord its approval to an application made under section 269(3), if it is satisfied that :-

- (a) the managing or whole time director or the manager appointed is, in its opinion not a fit and proper person to be appointed as such or such appointment is not in the public interest; or
- (b) the terms and conditions of the appointment of managing or whole time director or the manager are not fair and reasonable. [Section 269(4)]

Further sub-section (5) of section 269 empowers the Central Government to accord approval for a period lesser than the period for which the appointment is proposed to be made.

In case the appointment is not approved by the Central Government, the appointee shall vacate the office immediately on communication of the decision of the Central Government to the company [Section 269(6)].

Number of companies of which one person may be appointed Managing Director- Section 316(1) states that a person, who is either the managing director or a manager of any other company (including a private company which is not a subsidiary of a public company), cannot be appointed a managing director of a public company or a private company which is a subsidiary of a public company. But, such an appointment can be made if the Board of directors of such a company approves of the appointment by a unanimous resolution passed, at its meeting, specific notice of which had been given to all the directors then in India [Proviso to section 316(2)].

It may be noted that the prohibition contained in sub-sections (1) and (2) of section 316 is directed against a public company or a private company which is the subsidiary of a public company and it is only such a company that has to ensure the passing of an unanimous resolution of the Board. Suppose that an individual who is already the managing director of a public company or a private company which is the subsidiary of a public company, is appointed as managing director or manager of a private company, neither sub-section (1) nor sub-section (2) can operate against such subsequent appointment by the private company. Consequently, the proviso to subsection (2) of section 316 does not come into play in such a case.

Further sub-section (3) of section 316 puts a ceiling on the number of companies a person can be the managing director or manager of. According to the sub-section a person cannot hold the office either of managing director or of manager in more than two companies of which each one or at least one is a public company or a private company which is a subsidiary of a public company. However, the restriction does not apply to managing directorship in private companies, not being subsidiaries of public companies. Thus, a person may be managing director of any number of private companies.

Sub-section (4) of section 316, however, permits any person to be appointed as a managing director of more than two companies if the Central Government is satisfied that it is necessary that the companies should for their proper working, function as a single unit and have a common managing director.

On perusal of the above provision, it is clear that a person cannot be appointed as a whole time director of more than one company even with the approval of the Central Government.

Wholly owned Government companies exempted : It may be noted that the provisions of section 316 do not apply to the wholly owned Government company. [G.S.R. 577(E), dated 16-7-1985].

Tenure of appointment - According to section 317, the term of office of a managing director cannot exceed five years at a time. However, he may be re-appointed or re-employed or his term of office may be extended but again the period shall not exceed five years on each occasion. Further, such reappointment or extension shall not be sanctioned earlier than two years from the date on which it is to come into force.

Exemption - The provisions of section 317, however, do not apply to a private company unless it is a subsidiary of a public company.

Wholly owned Government companies have also been exempted. [G.S.R. 577(E), dated "16-7-1985].

Disqualifications - Section 267 prohibits the appointment of certain persons as managing director. The section provides that no company shall appoint or employ, any person as its managing or whole time director who—

- (a) is an undischarged insolvent, or has at any time been adjudged an insolvent;
- (b) suspends, or has at any time suspended, payment to his creditors, or makes or has at any time made, a composition with them; or
- (c) is, or has at any time been convicted by a court of an offence involving moral turpitude.



Since a managing director has necessarily to be a director, a person who is disqualified to be appointed as a director under section 274 (already discussed) cannot be appointed as managing director/whole time director.

Further, a person who does not satisfy the conditions of Schedule XIII cannot be appointed as a managing director of a company without the approval of the Central Government.

Manager

Meaning- Section 2(24) defines 'manager' as: "Manager" means an individual who, subject to the superintendence, control and directions of the Board of directors, has the management of the whole or substantially the whole of the affairs of the company, and includes a director or any other person occupying the position of a manager, by whatever name called and whether under a contract of service or not.

Thus, an individual must be in charge of the whole or substantially the whole of the affairs of the company, in order to be called a manager in accordance with the Companies Act. A person who is one of the departmental manager or a branch manager is not deemed to be a manager in this sense.

Please note that only an individual can be appointed a manager of a company. According to section 384, no company can appoint or employ any firm, body corporate or association as its manager.

Disqualifications of a manager - Section 385 lays down the disqualifications of a manager. The section provides that no company shall appoint or continue the appointment or employment of any person as its manager, who—

- (a) is an undischarged insolvent; or
- (b) has at any time within the preceding five years been adjudged an insolvent; or
- (c) suspends or has suspended within the previous five years payment to his creditors; or
- (d) makes, or has at any time, within the preceding five years made a composition with his creditors, or
- (e) is, or has at any time within preceding five years been convicted of an offence involving moral turpitude.

The Central Government may, however, by notification in the Official Gazette, remove any of the aforesaid disqualifications incurred by any person either generally or in relation to any company or companies specified in the notification [Section 385(2)].

Number of companies a person can be appointed manager- Sub-section (1) of section 386 disallows the appointment or employment of any person as manager if he is either the manager or the managing director of any other company except as provided in sub-section (2) of section 386. As per sub-section (2) of section 386, a company may appoint or employ a person as its manager, if he is the manager or managing director of one, and not more than one, other company. However, such appointment or employment must be made or approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting, and of which meeting and of the resolution to be moved thereat, specific notice was given to all the directors then in India.

The Central Government has been further empowered under sub-section (4) of section 386 to permit, by order, any person to be appointed as a manager of more than two companies, if it is satisfied that it is necessary that the companies should, for their proper working, function as a single unit and have a common manager.

Prohibition of simultaneous appointment of different categories of managerial personnel [Section 197A]

Notwithstanding anything contained in the Companies Act or any other law or any agreement or instrument, no company can, after the commencement of the Companies (Amendment) Act, 1960, appoint or employ at the same time or continue the appointment or employment at the same time, of a person as a managing director as well as a manager.

It may be noted that section 197A prohibits the simultaneous appointment of a managing director and manager in a company. There is no legal prohibition against having whole time director and manager simultaneously or managing director and whole-time director simultaneously.

Effect of contravention of sec. 197A-In R. S. Mathur v. H. S. Mathur AIR 1968 All. 241 it has been held that this section prohibits only the company, and the persons appointed or whose employment is continued in contravention of the section are not punishable under section 629A. But the legal effect of such appointment is that it is not valid, the provision being mandatory.

Procedure for appointment of managing director/whole time director/manager

Following procedure is to be followed:

1. Where a person who is not a director of the company is proposed to be appointed as managing/ whole time director of the company, it is necessary that he be first appointed as the director of the company as per the procedure laid down under section 257 (discussed earlier under 'appointment of a director other than a retiring director'). He should also file his written consent with the company to act as a director as per section 264.
2. If the appointment of the managing director/whole time director/manager is in accordance with the conditions specified in Schedule XIII, the appointment would not require approval of the Central Government.
3. If the appointment does not fulfill the conditions of Schedule XIII, an application for approval of the Central Government will have to be made to the Central Government within ninety days from the date of appointment of whole time director/managing director/manager. The application to the Central Government for the purpose shall be made in Form No. 25A. The application must be accompanied by the following documents :
 - (i) certified copy of the memorandum and Articles of Association;
 - (ii) certified copies of the annual accounts together with directors and auditors' report for the last five financial years;
 - (iii) certified copies of the resolution of Board/share holder(s) including resolution under section 316(2) where applicable;
 - (iv) certified copy of scheme approved by the BIFR/Financial Institutions/ Bank, for the revival of the company, if any;
 - (v) certified copies of newspaper clipping of notices published under section 640B, in original.
4. Where the proposed incumbent is already holding the post of managing director or manager in any other company (including a private company), section 316/386, as the case may be, requires the approval of the Board of directors by passing a resolution at its meeting with the consent of all the directors present at the meeting. Specific notice of the meeting as per section 286 and the resolution to be moved thereat has to be given to all the directors in India.
5. The appointment and the terms and conditions of the proposed appointment are to be considered and approved by the Board. Where the appointment is made in the Board meeting, proper disclosure has to be made if any director is interested in the appointment (vide section 299 of the Act). In case approval of general meeting is required, the Board has also to decide about the place, date and time of the general meeting and will finalise the draft notice containing the necessary resolution and explanatory statement and authorise the company secretary to issue notice for the meeting.



6. Disclosure of director's interest in any contract for the appointment of a manager, if any; and abstract of the terms of the contract for the appointment of a manager of the company or variation of the contract clearly specifying the nature of the concern or interest of the director, if any, is required to be made to every member, under section 302 of the Act, within twenty-one days of entering into the contract by means of an abstract of the term. Where the notice of the general meeting is given to the members within twenty-one days, as aforesaid, no separate abstract is required to be given under section 302 and explanatory statement for the concerned resolution, accompanying the notice of the general meeting may be deemed to be notice under section 302 also, by making a statement to this effect in the explanatory statement.
7. On the appointed day the general meeting shall be held for passing necessary resolution (ordinary or special, depending upon the stipulation in the articles of association).
8. Three copies of the notice of the meeting and one copy of the proceedings of the meeting have also to be sent to the stock exchange, in case of listed companies (Standard Listing Agreement).
9. Where the resolution passed is a special resolution, a copy thereof with Form No. 23 shall be filed with the Registrar of Companies together with the filing fee within thirty days. Also a copy of the resolution of the Board or agreement executed by the company, relating to the appointment/re-appointment/ renewal of an appointment or variation of the terms of appointment of the managing director should be filed along with Form No. 23 with the Registrar of Companies [Section 192].
10. The remuneration payable to the appointee should be within the specified limits of Part II of Schedule XIII. Otherwise, approval of the Central Government shall have to be obtained.
11. A return in Form 25C of the Central Government's General Rules and Forms is required to be filed with the Registrar of Companies within ninety days of the appointment. This return should also contain a certificate signed by the auditor or the secretary or where there is no secretary, a secretary in whole time practice for the compliance with the requirements of Schedule XIII.

Distinction between Managing Director and Manager

On a perusal of the definitions of the terms "managing director" and "manager" under sub-sections (26) and (24) of section 2 respectively, along with other relevant sections of the Companies Act, the following points of distinction may be noted:

1. A 'managing director' is entrusted with substantial powers of management. A 'manager', on the other hand, has the management of the whole or substantially the whole of the affairs of a company.
2. A managing director is appointed either under an agreement or by a resolution of the Board or general meeting or under the provisions of the Memorandum or Articles. A manager, on the other hand, is usually appointed either under a contract of service or by the Board of directors though the Articles may also provide for his appointment.
3. A managing director must be director whereas a manager may or may not be a director.
4. A managing director, on his ceasing to be a director, shall automatically cease to be the managing director as well. A manager-director, however, can continue as a manager even though he ceases to be a director.
5. The grounds of disqualifications of a managing director as given in section 267 remain effective for whole life and cannot be waived by the Central Government. Most of the grounds of disqualification of a manager as given in section 385 are only for five years and these can also be waived by the Central Government.

Whole time Director

In many sections of the Companies Act, the term 'Whole time director' has been used side by side with that of the 'managing director'. Confusion is, therefore, likely to arise in respect of their respective

position and role.

While the term 'managing director' has been specifically defined under section 2(26), no such definition of a whole time director is available. Explanation to section 269, however, states that the expression 'whole time director' includes a director in the whole time employment of the company.

Regarding appointment/re-appointment and remuneration of a whole time director, same provisions as are applicable to a managing director, are applicable. Under section 269, every public company and a private company which is a subsidiary of a public company must have a managing director or a whole-time director if its paid-up share capital is ₹5 crores or more. Similarly sections 267 and 268 providing for disqualifications of managing directors and approval of Central Government for their appointment/re-appointment also make the provisions applicable to whole time directors. Also, the provisions of sections 309, 310 and 311 dealing with remuneration of directors and other managerial personnel are applicable to whole time directors.

Distinction between Managing Director and Whole-time Director - The following points of distinction between a managing director and a whole time director may be noted :

1. A managing director may be appointed in that capacity in two or more companies at the same time but a whole-time director, by virtue of his whole time employment cannot act as such in more than one company.
2. The tenure of a managing director of a public company or a private company which is the subsidiary of a public company cannot be more than five years at a time. There is no such restriction in the case of a whole-time director.
3. Section 314 has clearly distinguished a managing director from a whole time director by explicitly exempting managing director from the rigours of that section leaving out the whole-time director.
4. A managing director is a special appointee having all embracing power of management and ordinarily he is not involved in day-to-day routine management. A whole-time director is an executive director having functional responsibilities e.g. Finance director.

Non-executive directors - This term has not been defined in the Companies Act, 1956. However, ever since the businesses started taking the corporate form, the nonexecutive directors came to be part and parcel of corporate form of management. The distinguishing feature is the fact that they cannot perform any executive function in the company where they are directors. The concept of non-executive directors, with the growing awareness for corporate governance, has now come up in sharp focus, as they constitute an integral part of the Board of directors, which is vested with the power of management of the company. Usually non-executive directors are taken in the Board of Companies for their special skill, professional status or experience to guide the Board in taking objective decisions and monitoring performance in unbiased and independent manner. The non-executive directors are often assumed to be independent directors, especially in the context of corporate governance. As the law stands today, the non-executive directors are officers of the company and share the responsibilities of management's decisions.

1.7.2. Payment of remuneration to Directors and Managerial Personnel

Remuneration paid to a Director in a professional capacity - The proviso to subsection (1) of section 309 excludes the remuneration received by a director in any other capacity provided the services rendered to the company are of a professional nature and, in the opinion of the Central Government, the director concerned possesses the requisite qualification for practice of the profession. This only means that the director must hold a position by virtue of which he can render services in his professional capacity. Thus, while the director is a medical man or an engineer or a legal advisor or a company secretary having the membership of the Institute of Company Secretaries of India or is a professionally qualified accountant being a member either of the Institute of Chartered Accountants or the Institute



of Costs and Works Accountants, the remuneration received by him in such professional capacity will not be hit by the provisions of section 309 provided the Central Government is of the opinion as mentioned above.

A mere expression of opinion by the Central Government to say that the person concerned possesses the requisite qualification is enough. Once the Central Government is satisfied that the director possesses the requisite qualification and also renders the professional services, it is not permissible for that Government to put any restriction on the remuneration payable to him in respect of the professional services; the remuneration being excluded from managerial remuneration - *Stup Consultants Ltd. v. Union of India* [1987] 61 Comp. Cas. 784 (Delhi) and *~Sree Gajanana Motor Transport Co. Ltd. v. Union of India* [1992] 73 Comp. Cas. 348 (Kar.).

Again, the Expert Advisory Committee of the Institute of Chartered Accountants of India, in this regard, has expressed the following opinion:

Under the proviso to sub-section (1) of section 309, the Central Government's approval is required merely by way of confirmation of the director's professional qualifications and not in respect of specific remuneration paid to the director for his professional services. Such approval and confirmation by the Central Government may well be implied in the case of those professions - such as the legal profession and the accountancy profession - where the practice of the profession is not legally possible unless the person concerned is a member of a recognised institute or body. The Companies Act, however, does not indicate whether specific approval is required, or implied approval shall be sufficient. Therefore, the safer course would be to seek a specific confirmation approving the director's professional qualification.

Refund of excess remuneration - If any director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limits prescribed under section 309 or without the prior sanction of the Central Government, where it is required, he shall refund such sums to the company and until such sum is refunded, hold it in trust for the company [section 309(5A)].

Sub-section (5B) of section 309 further provides that the company shall not waive the recovery of any sum refundable to it under sub-section (5A) unless permitted by the Central Government.

Additional remuneration from subsidiary, when prohibited - Sub-section (6) of section 309 specifies that no director of a company who is in receipt of any commission from the company and who is either in the whole time employment of the company or a managing director shall be entitled to receive any commission or other remuneration from any subsidiary of such company.

The provisions of sub-section (6), which prohibit a director from receiving any commission or other remuneration from the subsidiary of the company of which he is the director, are subject to a number of conditions to be fulfilled. First, the director concerned must be in receipt of commission from the holding company. Secondly, he should not be an ordinary director but should be either a managing or whole time director. There is, therefore, no bar against an ordinary director receiving remuneration or commission both from the holding and subsidiary companies. The prohibition would also not apply to a manager if he is not a director. Where, however, the manager is a director and is in whole time employment, then the prohibition may be attracted. Again, there is no bar against receiving commission or other remuneration from the subsidiary so long as remuneration other than by way of commission is received from the holding company. A person who is an executive and not a director in the holding company may receive both commission and other remuneration from the subsidiary in the capacity of manager or whole time director of the subsidiary. Similarly, an executive working in the subsidiary company may draw remuneration from the subsidiary and also from the holding company by way of both commission and other remuneration by working as a director in the holding company. Further, a director of the holding company can draw perquisites and remuneration in any form other than in the form of commission while at the same time drawing commission and other remuneration from the subsidiary company.

Sitting fee (Section 310) - The fee payable to a director for each meeting of the Board of Directors or

a Committee thereof is called sitting fee. According to section 310, sitting fee shall not exceed such amount as may be prescribed by the Central Government. As per GSR 580 (E), dated 24-7-2003, the maximum sitting fee has been fixed at ₹20,000 for companies with a paid-up share capital and free reserves of rupees 10 crores or more or turnover of rupees 50 crores or more. [Now provided under Rule 10B of the Companies (Central Government) General Rules and Forms, 1956]. For other companies the sitting fee is 10,000 rupees. Companies will have discretion to pay such amount by way of sitting fee as may be considered appropriate within the aforesaid ceiling.

Increase in remuneration - Section 310 provides that any provision or an amendment thereof, either in the company's Memorandum or Articles or in an agreement entered into by the company or in any resolution of the shareholders or of the Board, which purports to increase or has the effect of increasing, whether directly or indirectly, the remuneration of any director, shall not have any effect (a) unless the increase is in accordance with the conditions specified in Schedule XIII, or (b) unless it is otherwise approved by the Central Government.

Thus, approval of the Central Government shall not be required if the fixation or the increase in remuneration is in accordance with the conditions specified in Schedule XIII. It may be noted that Schedule XIII does not specify any conditions for increase in remuneration. It simply specifies the limits within which salary, commission and other perquisites can be paid without Government approval.

Remuneration to Managing Director

A managing director may be remunerated either by way of a monthly payment or as a specified percentage of the net profits of the company or (partly by one way and partly by the other. However, such remuneration should not exceed five per cent of the net profits without the sanction of the Central Government. Where there are more than one managing director/whole-time director(s) the total remuneration payable to all of them must not exceed ten per cent of the net profits without sanction of the Central Government [Section 309].

Remuneration to Manager (Section 387) - The manager of a company may, subject to the provisions of section 198, receive remuneration either by way of a monthly payment, or by way of a specified percentage of the 'net profits' of the company calculated in the manner laid down in sections 349 and 350 or partly by one way and partly by the other. However, except with the approval of the Central Government, such remuneration shall not exceed in the aggregate five per cent of the net profits calculated as above.

Application of sections 269, 310, 311, 312 and 317 to managers: The provisions of certain sections relating to managing directors have been made applicable to managers also (Section 388). These provisions include:

- (a) Section 269 : appointment or re-appointment requires Central Government approval except in cases specified under Schedule XIII;
- (b) Sections 310-311: increase in remuneration requires the Central Government approval except where the increase covered under Schedule XIII;
- (c) Section 312 : prohibition on assignment of office by a director;
- (d) Section 317: term of appointment to be not more than five years at a time.

Provisions of sections 386 to 388 discussed above do not apply to a private company. The disqualifications for the position of manager as given in section 385, however, apply to all types of companies.

The provisions of section 388E apply to the Manager as well.

Exemption to Government Companies - Vide Notification No. GSR 235, dated 31-1-1978, the DCA had notified that restrictions with regard to managerial appointment and remuneration as contained in sections 198, 259, 265, 269, 309-311, 387 and 388 as well as Schedule XIII do not apply to Government companies.



1.7.3 Powers and Managerial Remuneration

Powers of the Board of Directors

Section 291 of the Companies Act, 1956 provides for General Powers of the Board of Directors. It provides:

Subject to the provisions of the Act, the Board of Directors of a company shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to exercise and do.

However, the Board cannot exercise any power or do any act or thing which is directed or required, whether by the Companies Act or any other Act or by the Memorandum or Articles of the company or otherwise, to be exercised or done by the company in general meeting.

In exercising the aforesaid powers or doing any of the aforesaid acts or things, the Board will be subject to the provisions contained in that behalf in the Companies Act or any other Act, or in the Memorandum or Articles of the company, or in any regulations not inconsistent therewith and duly made thereunder, including regulations made by the company in general meeting.

Thus, the Board may exercise all powers of the company and can do all such acts and things that the company can do except those which are specifically provided to be exercised or done by the company in a general meeting. But the exercise of such powers of the Board shall be in conformity with the provisions of the Companies Act or any other Act and Memorandum, Articles, and resolutions of the company passed in general meeting.

It is therefore clear that the powers of a company in respect of all matters are to be exercised by the Board of directors except where these are reserved for exercise by company in general meeting. In *Nibro Ltd. v. National Insurance Co. Ltd.*, [1991] 70 Comp. Cas. 388 (Delhi), the Delhi High Court observed as follows:

"It is well settled that under section 291 except where express provision is made that the powers of a company in respect of a particular matter are to be exercised by the company in general meeting; in all other cases the Board of directors is entitled to exercise all its powers."

Do shareholders have the right to intervene? - Shareholders, by amending the articles may restrict the powers of the Board. But such amendment cannot be made retrospectively and a meeting of shareholders cannot therefore invalidate any act validly done by the Board. In *Jagdish Prasad v. Pt. Paras Ram* [1942] 12 Comp. Cas. 21 (All), it was observed that it is a first and elementary principle of company law that, when powers are vested in a Board of directors by the Articles of association of a company, they cannot be interfered with by the shareholders as such. If the shareholders are dissatisfied with what the directors do, their remedy is to remove them in the manner provided by the Articles or the Act. But so long as a Board of directors exists and particular powers are vested in it by the Articles, the Board is entitled to exercise those powers without interference by the shareholders and it is irrelevant whether the shareholders approve of what the directors have done or not. Further, majority shareholders cannot impugn the decision of the Board to institute judicial proceedings [*Herbertsons Ltd. v. Kishore Rajaram Chabbaria* [1999] 97 Comp. Cas. 429 (CLB-New Delhi)].

Exceptions - In the following cases, however, the general meeting of shareholders is competent to intervene and act in respect of a matter delegated to the Board of directors:

1. **Directors acting mala fide** - Where the directors act for their own personal interests in complete disregard to the interests of the company (*Marshall's Valve Gear Co. v. Manning Wardle & Co. Ltd* [1909] 1 Ch. 267), or where the personal interest of the directors clashes with their duties towards the company, or when they try to avoid taking steps for the redressal of the wrong done to the company, the majority shareholders may act to redress the wrong.
2. **Directors themselves wrong doers** - Where the directors who are the only persons to conduct litigation in the name of the company, are themselves the wrong doers and have acted mala fide, the shareholders can take steps to redress the wrong - *Satya Charan Lalv. R.P. Bajoria* [1950]

SLR 394.

- 3. Incompetency of the Board** - When the Board has become incompetent to act, e.g., where all the directors constituting the Board are interested in a dealing or where none of the directors was validly appointed, the majority of shareholders may exercise powers in a general meeting of the company. - B.N. Vishwanathan v. Tiffins B.A. and P Ltd. AIR 1953 Mad. 510.
- 4. Deadlock in management** - When there is a deadlock in the management so that directors cannot exercise some of their powers, the majority shareholders may exercise the powers in a general meeting of the company. In Barron v. Potter [1914] 1 Ch. 895, the Articles of a company gave the Board of directors power to appoint additional directors. But owing to differences between the directors, no meeting could be held for the purpose. The Articles also did not confer any power on the shareholders to increase the number of directors. Held, the company retained the power to appoint additional directors in a general meeting.

Powers of the Individual Directors - Section 291 provides for general powers of the Board of directors. In other words, it is the collective wisdom of the directors which has been conferred the privilege of managing the affairs of the company. However, unless the Act or the articles otherwise provide, the decisions of the Board are required to be the majority decisions only. Individual directors do not have any general powers. They shall have only such powers as are vested in them by the Memorandum or Articles or otherwise by the Board of directors. Thus, unless a power to institute suit is specifically conferred on a particular director, he has no authority to institute a suit on behalf of the company - Nibro Ltd. v. National Insurance Co. Ltd. [1991] 70 Comp. Cas. 388 (Delhi).

The mode or manner of exercise of Board's powers - Section 292(1) of the Companies Act, 1956 provides that the Board of directors of a company shall exercise the following powers on behalf of the company and it shall do so only by means of resolution passed at meetings of the Board:

- (a) The power to make calls on shareholders in respect of money unpaid on their shares;
- (aa) The power to buy-back its shares under section 77A;
- (b) The power to issue debentures;
- (c) The power to borrow moneys otherwise than on debentures. However, a banking company can borrow from other banking companies or from the Reserve Bank of India, the State Bank of India or any other bank established by or under any Act [Explanation 1 to section 292(1)].
- (d) The power to invest funds of the company. This power shall however be subject to the provisions of sections 293 and 372A.
- (e) The power to make loans. Again this power is subject to the provisions contained in sections 295 and 372A.

The Board may, however, by a resolution passed at a meeting delegate to any committee of directors, managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, a principal officer of its branch, the powers specified in clauses (c), (d) and (e) above on such conditions as the Board may prescribe [first proviso to section 292(1)].

Board's power to delegate functions under (d) and (e) is restricted to making loans and investments only to/in non-corporate entities and wholly owned subsidiaries as inter-corporate loans, investments etc. are governed by the specific provisions of section 372A of the Act.

Further, sub-section (5) of section 292 provides that the company in general meeting may impose any restrictions and conditions on the exercise by the Board of any of the powers specified above.

Section 25 - companies exempted: In the case of a company to which a licence has been granted under section 25, matters referred to in clauses (c), (d) and (e) of subsection (1) may be decided by the Board by circulation instead of at a meeting [Notification No. SO 2767, dated 5-8-1964].



Besides the powers specified in section 292 there are certain other powers also which can be exercised only at the meeting of the Board:

1. The power of filling casual vacancies in the Board [Section 262].
2. Sanctioning of a contract in which a director is interested [Section 297].
3. The power to recommend the rate of dividend to be declared by the company at the Annual General Meeting, subject to the approval by the shareholders.
4. The power to make political contributions [Section 293.A].

In the following cases, not only that the powers be exercised at the Board's meeting but also that every director present and entitled to vote must consent thereto:

1. The power to appoint a person as managing director or manager who is holding either office in another company [sections 316 and 386].
2. The power to give loan to, or invest in any shares of, any other body corporate [section 372A].

Power of the directors to institute a suit on behalf of the company - In *Furruccio Sias v. Jai Manga Ram Mukhi* [1998] 93 Comp. Cas. 750 (Delhi), the Court observed that it is a necessary requirement that there be proper authority by resolution of the Board of directors, or there has to be a power of attorney authorising institution of the suit on behalf of the corporation, or there has to be power conferred by the articles of association of a corporation, in a particular officer, to institute suits on behalf of the corporation.

Where authority conferred by Articles of Association was on the managing director and the joint managing director to institute suits and plaintiff was a wholetime director, in terms of Power of Attorney which has been granted to him by the company, the suit filed by the plaintiff as representing the company was not maintainable. Power of Attorney could not provide otherwise to the provision contained in the Articles.

Powers of the Board to institute legal proceedings - In *Herbertsons Ltd. v. Kishore Rajaram Chhabria* [1999] 97 Comp. Cas. 429 (CLB - New Delhi), it was held that initiating legal proceedings is within the independent powers of the Board. Further, not only the Act but all other statutes dealing with incorporated companies, whether criminal or civil, always recognise the Board of directors as one responsible for conducting the affairs of a company. Therefore, as a general proposition, majority shareholders cannot impugn the decision of the Board to institute judicial proceedings.

Restrictions on powers of directors: Section 293 of the Companies Act, 1956 provides that the Board of directors of a public company or a private company which is a subsidiary of a public company cannot exercise the following powers without the consent of the shareholders in general meeting:

1. Sell, lease or otherwise dispose of the whole, substantially the whole, of the undertaking of the company, or where the company owns more than one undertaking, of the whole or substantially the whole, of any such undertaking.

Company Law Board (now Tribunal) in *Aasia Properties Development Ltd. v. Juhu Beach Resorts Ltd.* [2007] 74 SCL 153 (CLB - New Delhi) held that the provisions of section 293 are attracted only in cases of sale, lease or otherwise disposal of an undertaking. Thus, in a hotel industry where it is common to enter into a management contract with reputed international hotel chains, which use its expertise in manning and managing hotel for an agreed consideration as management fees, no sale or lease can be said to be involved so as to attract the provisions of section 293(1)(a).

Sale of shares with intent to transfer controlling interest cannot be equated to sale of any part of undertaking so as to attract section 293(1)(a). The sale of shares, whatever be their number, even if it amounts to a transfer of the controlling interest of a company, cannot be equated to the sale of any part of the 'undertaking' so as to come within the mischief of section 293(1)(a) - *Brooke Bond India Ltd. v. U.B. Ltd.* [1994] 79 Comp. Cas. 346 (Bom.) / *CDS Financial Services (Mauritius) Limited v.*

BPL Communications Limited [2004] 121 Comp. Cas. 374 (Bom.)

However, this restriction does not apply to the case of a company whose ordinary business is to sell or lease property [Sec. 293(2)(b)].

Again, the title of the buyer or lessee who buys or takes a lease of any undertaking in good faith and after exercising due care and caution shall not be affected [section 293(2)(a)].

2. Remit or give time for the repayment of any debt due by a director except in the case of renewal or of continuance of an advance made by a banking company to its directors in the ordinary "course of business.
3. Invest, otherwise than in trust securities, the amount of compensation received by the company in respect of compulsory acquisition of any property or fixed assets of the company.
4. Borrow monies exceeding the aggregate of the paid-up capital of the company and its free reserves. 'Borrowing' does not include temporary loans* obtained from the company's bankers in the ordinary course of business.

The resolution passed by the company in general meeting must specify the total amount upto which moneys may be borrowed by the Board of Directors.

A loan was taken by company under an agreement executed by general manager. Company pleaded that agreement was not bound on company as general manager was not authorised to borrow by a resolution passed at a meeting of the Board. The Court held that since the necessary books of minutes and resolutions were in company's possession and were not open to inspection by strangers, the burden of proving that the necessary resolution had not been passed was on the company. In case the company failed to produce those books, it would lead to inference that there was a resolution passed by the company authorising its general manager to borrow money and thus the company shall be held bound - Hoshiarpur Azad Transport Co. Ltd. v. Sutlej Land Finance (P.) Ltd. [2001] 29 SCL 363 (P&H).

It may be noted that the Companies Act does not expressly empower companies to borrow money. Therefore, most of the companies expressly provide for such borrowing powers in the Memorandum. In such cases, where Memorandum authorises the company to borrow, the Articles provide as to how and by whom these powers shall be exercised. It may also fix up the maximum amount which can be borrowed by the company. It may, however, be noted that a trading company has an inherent implied power to borrow even if the objects clause in the memorandum of association is silent on borrowal. But, in many instances it may be difficult to specify a company as clearly a trading company. As such, as a safety measure, it is usual for the companies to take the power to borrow through the memorandum of association.

5. Contribute in any year, to charitable and other funds not directly relating to the business of the company or the welfare of its employees any amount exceeding ₹50,000 or five per cent of its average net profits of the last three financial years, whichever is higher.

The resolution passed by the company in general meeting must specify the total amount which may be contributed to charitable and other funds in any financial year.

However, contributions to National Defence Fund, the Prime Minister's National Relief Fund or any other fund approved by the Central Government for the purpose are exempted from the above provisions. In respect of these funds, any amount may be contributed without obtaining the sanction of the company in general meeting [vide section 293B of the Act]. The amount contributed in these funds must be disclosed in the profit and loss account of the company for the year in which the contribution was made.

Private companies exempted: The restrictions on the powers of the Board of directors imposed by section 293 do not apply to a private company which is not a subsidiary of a public company.



Managerial Remuneration

Meaning of managerial remuneration - Managerial remuneration may take the form of monthly payments, say, salary, or a specified percentage of net profits or a commission and/or by way of a fee for each meeting of the Board (called sitting fee). Besides, as per Explanation to section 198(4), the expression 'remuneration' shall also include:

- (a) any expenditure incurred by the company in providing any rent-free accommodation, or any other benefit or amenity in respect of accommodation free of charge, to any of its directors or manager;
- (b) any expenditure incurred by the company in providing any other benefit or amenity free of charge or at a concessional rate to any of the persons aforesaid;
- (c) any expenditure incurred by the company in respect of any obligation or service, which, but for such expenditure by the company, would have been incurred by any of the persons aforesaid; and
- (d) any expenditure incurred by the company to effect any insurance on the life of, or to provide any pension, annuity or gratuity for any of the persons aforesaid or his spouse or child.

Manner of payment of managerial remuneration - Sub-section (3) and sub-section (4) of section 309 lay down the manner by which the remuneration may be paid to the managerial personnel. According to sub-section (3), a director who is either in the whole time employment of the company or a managing director may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by other.

Sub-section (4) provides that a director who is neither in the whole time employment of the company nor a managing director may be paid remuneration either:

- (a) by way of a monthly, quarterly or annual payment with the approval of the Central Government; or
- (b) by way of commission, if the company by special resolution authorises such payment.

However, special resolution passed, as aforesaid, shall not remain in force for more than 5 years but may be renewed from time to time by passing special resolution for further period of not more than 5 years at a time [sec. 309(7)].

No renewal can be effected earlier than one year from the date on which it is to come into force [Proviso to sec. 309(7)].

- (c) A director may receive remuneration by way of a fee for each meeting of the Board, or a committee thereof attended by him [section 309(2)]. This is known as sitting fee. Sitting fee is not taken into account for computing the overall managerial remuneration under section 198. Prior to commencement of the Companies (Amendment) Act, 1960, it was possible even to make the payment of sitting fee on a monthly basis. However, this has since been discontinued.

It has been clarified by the Government of India by Press Release 2005/06/142 dated 2-8-2005 that the appointment of foreign national as a director of an Indian company does not need approval of the RBI under FEMA, 1999. Further, non-whole time directors who are not resident in India shall be paid the sitting fee, travel expenses, commission and remuneration in Indian rupees.

Overall limits to managerial remuneration - Section 198 provides that the total managerial remuneration payable by a public company or a private company which is subsidiary of a public company to its director or manager in respect of any financial year must not exceed eleven per cent of the net profits of that financial year computed in the manner laid down in sections 349 and 350 of the Companies Act except that remuneration to director will not be deducted from gross profits of the company. In computing the aforesaid ceiling of eleven per cent, section 198(4) says that the fees payable to

directors for attending Board meetings shall not be included.

Section 309, another section dealing with managerial remuneration, provides that subject to the general provisions of section 198, the remuneration be determined by the Articles, or by a resolution or, if the articles so require, by a special resolution, passed by the company in general meeting. The remuneration so payable shall be inclusive of the remuneration payable for services rendered by a director in any other capacity except where:

- (a) the services are of a professional nature, and
- (b) in the opinion of the Central Government, the director possesses the requisite qualifications for the practice of the profession.

Ceiling on managerial remuneration - According to sub-section (4) of section 309, a director who is neither in the whole time employment of the company nor a managing director may be paid remuneration subject to the following:

- (i) **one per cent** of the net profits of the company, if the company has a managing or a whole time director or a manager;
- (ii) **three per cent** of the net profits of the company in any other case.

In case a company has more than one such director, then the remuneration payable to all shall not exceed the aforesaid limits.

However, the company in general meeting may, with the approval of the Central Government, authorise the payment of such remuneration at a rate exceeding one per cent or, as the case may be, three per cent of its net profits.

As already noted, a director who is neither a managing director nor a whole time director may be paid remuneration either:

- (a) by way of a monthly, quarterly or annual payment, if approval of the Central Government is obtained; or
- (b) by way of commission, if the company by special resolution authorises such payment. When payment is made by way of commission not exceeding 1% or 3% mentioned above, no approval of Central Government need be taken -Circular No. 4/2011 [F. No. 14/6/2011-CL VII] dated 4-3-2011 of the M.C.A.

A whole time director or a managing director may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other [section 309(3)]. However, except with the approval of the Central Government such remuneration shall not exceed **five per cent** of the net profits for one such director, and if there is more than one such director, **ten per cent** for all of them taken together. The Expert Advisory Committee of the Institute of Chartered Accountants of India has expressed the opinion that in the case of a company which has more than one such director, the limit applicable is a composite ceiling of ten per cent for all such directors taken together, without a further limit of five per cent in respect of each director individually. The net profits of the company for the aforesaid purpose shall be computed in the manner laid down in sections 349 and 350, except that the remuneration of the directors shall not be deducted from the gross profits [section 198(1)].

Limits of Managerial Remuneration —at a glance

Total Managerial Remuneration Payable	11% of the net profits of the company calculated in accordance with the provisions of sections 349 and 350.
More than One Managing Director or Whole Time Director	Not exceeding 10% of the net profits of the company.



Only One Managing Director or Whole Time Director	Not exceeding 5% of the net profits of the company.
One or more Director(s), but no Managing Director or Whole Time Director	Not exceeding 3% of the net profits of the company.
One or more Director(s) and also a Managing Director or Whole Time Director	Not exceeding 1% of the net profits of the company.

Private companies- The provisions relating to managerial remuneration, as aforesaid shall not apply to a private company unless it is a subsidiary of a public company [section 198(1) and section 309(9)]. A private company has to take care of the matters of remuneration through provisions in its articles. In the absence of any such authority in the articles, the directors of a private company are not entitled to draw any remuneration - Radhey Shyam v. Official Liquidator [1969] 39 Comp. Cas. 340 (Raj.).

Managerial Remuneration vis-a-vis Schedule XIII - The Companies (Amendment) Act, 1988 introduced Schedule XIII u/ss. 269 & 310 to replace the administrative guidelines in respect of managerial remuneration issued by the Central Government. Accordingly, it is now open to a public company or a private company which is subsidiary of a public company, to appoint its managerial personnel, i.e., managing or whole time director and/or manager and fix their remuneration so long as the same is in accordance with the conditions laid down in Schedule XIII without seeking the prior approval of the Central Government.

The salient features of Schedule XIII are as follows:

Remuneration payable by companies having profits - Subject to the provisions of sections 198, 309 and 387, a company having profits in a financial year may pay any remuneration, by way of salary, dearness allowance, perquisites, commission and other allowances, which shall not exceed 5 per cent of its net profits for one such managerial person, and if there is more than one such managerial person, 10 per cent for all of them together.

A person who is a managerial person in more than one company shall be able to draw remuneration from one or more of those companies provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person.

Remuneration payable by companies having no profits or inadequate profits - Where in any financial year during the currency of tenure of the managerial person, a company has no profits or its profits are inadequate, it may pay remuneration to a managerial person, by way of salary, dearness allowance, perquisites and any other allowance, not exceeding ceiling limit of ₹24,00,000 per annum or ₹2,00,000 per month calculated on the following scale:

Sl. No.	Where the effective capital of a company is -	Monthly remuneration payable shall not exceed
(i)	less than ₹1 crore	₹75,000
(ii)	₹1 crore or more but less than ₹5 crores	₹1,00,000
(iii)	₹5 crores or more but less than ₹25 crores	₹1,25,000
(iv)	₹25 crores or more but less than ₹50 crores	₹1,50,000
(v)	₹50 crores or more but less than ₹100 crores	₹1,75,000
(vi)	₹100 crores or more	₹2,00,000

However, to pay the remuneration to a managerial person as per the aforesaid ceiling limits, it has been made mandatory to seek approval by way of a resolution passed by the Remuneration Committee. Besides, the company should not have made any default in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in the preceding financial year before the date of appointment of such managerial person.

Vide its Notification dated 16-1-2002, the Central Government has allowed companies to pay remuneration to their managerial personnel up to double the amount of the aforesaid ceiling by observing the required procedure as stated above and passing a special resolution at the general meeting, the notice of which must be accompanied by a statement containing the specified particulars. The remuneration fixed by way of special resolution, as aforesaid shall be valid for a period not exceeding three years.

Thus, companies with an effective capital of ₹100 crores or more can now pay, upto ₹4,00,000 per month or ₹48,00,000 per annum to each of their managerial person. Likewise, companies falling under other slabs of effective capital can pay up to double the amount of the respective ceilings, by complying with the aforesaid requirements and the procedure.

Companies having negative effective capital can pay remuneration up to the revised ceiling [even more] by obtaining Central Government's prior approval.

Besides the aforesaid remuneration, a managerial personnel of a company having no profits or having inadequate profits shall also be eligible to the following perquisites:

- (a) Contribution to provident fund, superannuation fund or annuity fund to the extent these either singly or put together are not taxable under the Income-tax Act, 1961.
- (b) Gratuity payable at a rate not exceeding half a month salary for each completed year of service.
- (c) Encashment of leave at the end of the tenure.

Notification No. G.S.R. 70(E) dated 8-2-2011 specifies that prior approval of the Central Government will be required only for listed companies or their subsidiaries.

Companies in Special Economic Zones (SEZs) - Companies in SEZs have been allowed to pay remuneration to their managerial personnel upto ₹2,40,00,000 (Two Crore Forty Lakhs) per annum or ₹20,00,000 (20 lakhs) per month in respect of companies in Special Economic Zones as notified by Department of Commerce from time to time:

Provided that these companies have not raised any money by public issue of shares or debentures in India:

Provided further that such companies have not made any default in India in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in any financial year.

In addition to the aforesaid perquisites, an expatriate managerial person (including a non-resident Indian) shall also be eligible to the following perquisites:

- (i) Children educational allowance: In case of children studying in or outside India, an allowance limited to a maximum of ₹5,000 per month per child or actual expenses incurred, whichever is less. Such allowance is admissible up to a maximum of two children.
- (ii) Holiday passage for children studying outside India/family staying abroad: Return holiday passage once in a year by economy class or once in two years by first class to children and to the members of the family from the place of their study or stay abroad to India if they are not residing in India with the managerial person.
- (iii) Leave travel concession : Return passage for self and family in accordance with the rules specified by the company where it is proposed that the leave be ' spent in home country instead of anywhere in India.

Part III of Schedule XIII provides that the remuneration payable to a managerial personnel, as aforesaid, shall be subject to approval by a resolution of the shareholders in general meeting.

Government companies exempted - The restrictions with regard to managerial remuneration



contemplated under sections 198 and 309 (including Schedule XIII) do not apply to Government companies [GSR 235, dated 31-1-1978].

Meaning of effective capital - The expression "effective capital", for the purposes of Schedule XIII, means the aggregate of the paid up share capital (excluding share application money or advances against share); amount, if any, for the time being standing to the credit of securities premium account; reserves and surplus (excluding revaluation reserve); long term loans and deposits repayable after one year (excluding working capital loans, overdraft, interest due on loans unless funded, bank guarantee, etc., and other short term arrangements) as reduced by the aggregate of any investments (except in the case of investments by an investment company whose principal business is acquisition of shares, stock, debentures or other securities); accumulated losses and preliminary expenses not written off.

Time when effective capital shall be calculated - Explanation II to Part II of Schedule XIII provides that where the appointment of the managerial person is made in the year in which company has been incorporated, the effective capital shall be calculated as on the date of such appointment. In any other case, the effective capital shall be calculated as on the last date of the financial year preceding the financial year in which the appointment of the managerial person is made.

Reimbursement of Medical Expenses - The Department of Company Affairs vide its Circular No. 2/10/99/6L-VH dated 28-10-1999 has clarified that in case of reimbursement of medical expenses incurred beyond the ceiling mentioned in the total managerial package, the approval shall be granted only in exceptional and deserving cases. Therefore, all proposals for reimbursement on specialised medical treatment abroad must be accompanied by certificate issued and signed by Director General of Health Services of the concerned State Government/Union Territory. The requirement may, however, be waived on the satisfaction of the Central Government in genuine and deserving cases of medical emergency as a special case.

Such proposals may be considered on merits on the basis of the circumstances of the case, financial position of the company, period of association of the concerned managerial personnel with the company, amount of total managerial remuneration and medical reimbursement paid to him in the past and other relevant factors.

Payment of remuneration higher than the ceilings under Schedule XIII - Where a company intends to pay to its managerial person remuneration higher than the X, ceilings of Schedule XIII, it has to seek the approval of the Department of Company Affairs. The Department of Company Affairs, vide its Circular No. 12/7/2000-CL-VII, dated 27-12-2000, has detailed out the steps to be followed and information to be provided by companies which seek the permission of the Department to pay higher remuneration than that permitted under the Companies Act.

The application for the above purpose should be in e-Form 25A (for appointment/re-appointment and remuneration payable to managing/whole-time director(s) or manager(s) and (for increase in the remuneration of the managing/whole-time director or manager). The application shall be accompanied by the prescribed fee.

Further, the application should be accompanied by a detailed note on the following aspects justifying the proposed increase in remuneration:

- (a) reasons for inadequacy of profits;
- (b) steps taken to improve the performance of the company;
- (c) brief financial performance of the company with regard to effective capital, net worth, turnover, profit/loss, dividend declared;
- (d) nature of industry;
- (e) exports and foreign exchange earned;

- (f) general performance of the industry in the relevant sector;
- (g) foreign investment and foreign collaboration;
- (k) future expansion/diversification/upgradation plans;
- (i) details of the personnel whose remuneration is sought to be increased;
- (j) requirement of his personal skill for the challenges ahead;
- (k) past remuneration of the concerned person;
- (l) creativeness and innovation of the concerned person;
- (m) recognition/awards obtained by the concerned person or the company.

Again, through its circular dated 10-11-2000 the Department of Company Affairs has notified that if for any justifiable reasons, it is proposed to pay remuneration in excess of Schedule XIII of the Companies Act, it should be timely resolved in the Board meeting. The Board resolution should clearly justify the increase giving sustainable adequate reasons for payment of remuneration in excess of the amount indicated in the Schedule.

The Circular has further advised companies to make application for Government approval well in time and no payment of remuneration in excess of the limit under Schedule XIII should be made till the Government order is received.

In this connection, the Department has directed auditors of the companies, who audit their accounts, to ensure that remuneration to the managerial personnel is not paid in excess of the limit under Schedule XIII without necessary approvals. The company secretary has been asked to play a constructive role in ensuring that the matters relating to managerial remuneration are dealt with in the company within the stipulated time frame.

1.7.4. Obtaining DIN

Director Identification Number (DIN) - It is an unique Identification Number allotted to an individual who is an existing director of a company or intends to be appointed as director of a company pursuant to section 266A & 266B of the Companies Act, 1956 (as amended vide Act No 23 of 2006).

Any individual, who is an existing director of a company or intends to be appointed as a director of the company, can file an application for allotment of DIN. And Central Government (Office of Regional Director (Northern Region), Ministry of Corporate Affairs, NOIDA) allots the DIN.

Procedure of obtaining DIN-As per the revised procedure for DIN Allotment, any person intending to apply for DIN shall have to make an application in eForm DIN 1 and should follow the following procedure:

1. eForm DIN-1 has to follow the offline eFiling process.
2. Attach the photograph and scanned copy of supporting documents i.e. proof of identity, and proof of residence as per the guidelines. Physical documents are not required to submit at DIN cell.
3. Along with the supporting documents, verification by the applicant for applying for allotment of Director Identification Number (DIN) shall also be attached. This shall contain the Name, Father's name, date of birth and text of declaration and physical signature of the applicant.
4. The eForm shall have to be digitally signed and shall be uploaded on MCA21 portal.
5. Upon upload, Pay the fees for DIN1 eForm. Only electronic payment of the fees shall be allowed (i.e. Netbanking / Credit Card). No challan payment will be accepted under revised procedure of DIN allotment.



The applicant is required to get himself/herself registered on the MCA21 Portal to obtain login id, which is necessary for payment of the fees. After obtaining the login-id, Login to the MCA21 portal and click on 'eForm upload' link available under the 'eForms' tab for uploading the eForm DIN 1. eForm DIN-1 will be processed only after the DIN application fee is paid.

6. Upon upload and successful payment,

- ❖ In case Form DIN 1 is signed by a practicing professional and details have not been identified as potential duplicate, Approved DIN shall be generated and if the details have been identified as potential duplicate, Provisional DIN shall be generated.
- ❖ In case Form DIN 1 is signed by an applicant or by the Managing Director/ existing director of the Company in which the applicant is a Director or the Company Secretary in full time employment of the Company, or details have been identified as a potential duplicate, provisional DIN shall be generated.

7. Processing of eForm DIN 1

In case, DIN 1 gets certified by the professional (i.e. CA/ CS/ CWA in whole time practise), the DIN will be approved by the system immediately online (in case it is not potential duplicate). In case of signing by any other signatory (i.e. director/ Managing Director/ secretary of the company with which applicant is to be associated), the MCA DIN cell will examine the e Form DIN 1 and same shall be disposed of within one or two days.

8. Intimate approved DIN to your Companies

On approval of DIN, intimate your DIN to all the company (ies) (within a period of 30 days from the date of approval) in which you are a Director, in form DIN-2. Form DIN-2 can be downloaded and printed from the 'DIN' link on the homepage of MCA portal.

9. Company to intimate your DIN to ROC

After the Director has intimated the DIN allotted to the company(ies). The Company(ies) is/are then required to intimate the DINs of its directors to the ROC in Form DIN-3 within a period of seven days of receiving form DIN-2. (Filing of DIN-3 is applicable only in cases, where the date of appointment of director(s) in such company(ies), is prior to September 1, 2007)

10. Post-approval changes in particulars of DIN-1

If there is any change in the particulars submitted in form DIN-1, applicant can submit e-form DIN-4 online. For instance in the event of change of address of a director, he/ she is required to intimate this change by submitting eform DIN-4 along with the required attested documents.

Signing of eForm DIN-4 The e-Form DIN-4 is required to be digitally signed only by a Chartered Accountant or a Company Secretary or a Cost Accountant (in whole- time practice).

Things to be taken care of while filling form DIN-1-

No prefixes like Mr. / Ms. / Kumari / Shri etc should be used in filling the applicant's name.

Enter the applicant's name and father's name in full and do not use abbreviations, even if the ID proof contains the name in abbreviated form. Abbreviations in the middle name may be accepted, if such abbreviated middle name is appearing in the enclosed identity proof. Also if middle name is given on the document, same should be mentioned on the application.

The particulars filled in form DIN-1 should match with the details given in the supporting documents to be submitted along with DIN application. Any mis-match will lead to rejection of DIN application.

The e-Form DIN 1 should be digitally signed either by applicant or CA/ CS/ CWA or director/ Managing Director/ secretary of the company with which applicant is to be associated

Fees payable- DIN application fee of ₹100/- is payable w.e.f. 1st July, 2007. Status of the payment made for Form DIN-1 can be enquired from 'Track Payment Status' link on the homepage of www.mca.gov.in.

Scanned documents required to be attached with DIN 1-

- High resolution photograph of the applicant
- Proof of identity;
- Proof of residence;
- Proof of Date of birth
- Proof of father's name. Proof of father's name is not required in the case of foreign nationals
- Affidavit in the case of single name as per the guidelines
- Copy of passport in the case of foreign nationals

Information in an ID proof -

ID proof must be currently valid and issued by the Central / State Government or Instrumentalities of state like PSUs, Public Sector Banks, Universities recognized under the UGC Act. It should contain following information:

- Applicant's name with photograph
- Father's Name
- Date of Birth

1.7.5.Compensation for loss of office - Clause (a) of sub-section (7) of section 284 provides that removal of a director would not deprive the person of any compensation or damage for the termination of appointment as a director or for an appointment terminating with that as director. However, section 318 does not provide for payment of compensation for loss of office or any other payment for loss of office or place of profit except the loss of office held by the director in the capacity of managing director, whole time director or manager. Further, the managing or whole time director or manager would not be entitled to any compensation:

- (a) where the director resigns his office in view of the reconstruction of the company, or of its amalgamation with any other body corporate or bodies corporate, and is appointed as the managing director, manager or other officer of the reconstructed company or of the body corporate resulting from the amalgamation;
- (b) where the director resigns his office otherwise than on the reconstruction of the company or its amalgamation as aforesaid;
- (c) where the office of the director is vacated by virtue of section 203, or any of the clauses (a) to (l) of sub-section (1) of section 283;
- (d) where the company is being wound up, whether by or subject to the supervision of the Court or voluntarily, provided the winding up was due to the negligence or default of the director;
- (e) if it can be shown that he had been guilty of fraud or breach of trust in relation to, or gross negligence in or, gross mismanagement, in the conduct of the affairs of the company or any subsidiary or holding company thereof;
- (f) also, no compensation shall be payable if it can be shown that while he was a director he had instigated or taken part directly or indirectly in bringing about the termination of his office;
- (g) further, in order to be entitled to compensation, it must be shown that winding up of the company did not commence within twelve months of his removal.



Amount of compensation - Sub-section (4) of section 318 puts a ceiling on the amount of compensation payable to a director eligible for compensation for loss of office. The sub-section provides that any payment made to a managing or other director in pursuance of sub-section (1) shall not exceed the remuneration which he would have earned if he had been in office for the unexpired residue of his term or for three years, whichever is shorter.

The amount payable shall be calculated on the basis of the average remuneration actually earned by him during the period of three years immediately preceding the date on which he ceased to hold the office. But, where he held the office for a lesser period than three years, the amount shall be calculated with reference to the period he actually worked.

Payment to director, for loss of office in connection with transfer of undertaking or property [Section 319] - In case of transfer of the whole or any part of any undertaking or property of the company, section 319(1) prohibits every director of a company to receive any payment by way of compensation for loss of office or as consideration for retirement from office. The compensation/consideration cannot be received—

- (a) from such company, or
- (b) from the transferee of such undertaking or property or from any other person.

However, the aforesaid payment may be received if—

- (a) the same had been disclosed to the members of the company; and
- (b) the proposal had been approved by the company in general meeting.

Any amount received by a director in contravention of the aforesaid provisions shall be deemed to have been received by him in trust for the company.

Payment to director for loss of office in connection with transfer of shares [Section 320] - The acquisition of a company may take place either through purchase of an undertaking (as contemplated under section 319) or through purchase of shares. Section 320 prohibits receipt, by any director, of any compensation for loss of office or consideration for retirement from office in connection with the transfer to any person of all or any shares in a company. The compensation/consideration cannot be received either from the company or the transferees of shares or from any other person without disclosure of the same to the shareholders.

The aforesaid transfer of shares may result from—

- (i) an offer made to the general body of shareholders;
- (ii) an offer made by or on behalf of some other body corporate with a view to the company becoming a subsidiary of such body corporate or a subsidiary of its holding company;
- (iii) an offer made by or on behalf of an individual with a view to his obtaining the right to exercise, or control the exercise of, not less than one-third of the total voting power at any general meeting of the company; or
- (iv) any other offer which is conditional on acceptance to a given extent. A director who fails to disclose the particulars, with respect to the aforesaid payment, to the shareholders shall be punishable with fine which may extend to ₹2,500. Besides, any sum received by such director shall be deemed to have been received by him in trust for any persons who have sold their shares as a result of the offer made. The expenses incurred by him in distributing that sum amongst those persons shall be borne by him and not retained out of that sum.

However, if at a meeting called for the purpose of approving any payment, as aforesaid, a quorum is not present and, after the meeting has been adjourned to a later date, a quorum is again not present, the payment shall, for the purposes of that sub-section, be deemed to have been approved.

1.7.6. Waiver of Recovery of Remuneration

Section 309(5A) of the Companies Act, 1956 specifically states that in case a Director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limits prescribed under this Section or without the prior approval of the Central Government, where it is so required, the Director concerned shall refund such sums to the Company and until such sum is refunded, hold such sums in trust for the Company. Sub-section 5B categorically states that the Company shall not waive the recovery of any sum due from a Director under Section 309(5A) unless permitted by the Central Government.

Any payment by way of remuneration in excess of the limits prescribed by the Section or without the approval of the Central Government has to be held by the recipient in trust for the Company and the Director concerned is liable to refund the same to the Company. The recovery of such sums cannot be waived unless permitted by the Central Government.

1.7.7. Loans to Directors, Disclosure of interest, Holding of Office or Place of Profit by a Director/ Relative.

Loans to Directors

Section 295 provides that, without obtaining prior approval of the Central Government, a company (hereinafter referred as lending company' for the purposes of section 295) cannot give, directly or indirectly, any loan to or give any guarantee or provide any security for any loan taken or given by:

- (a) any director of the lending company or of a company which is its holding company or any partner or relative of such director;
- (b) any firm in which any such director or relative is a partner;
- (c) any private company of which any such director is a director or member;
- (d) any body corporate at a general meeting of which not less than twenty-five per cent of the total voting power may be exercised or controlled by any such director, or by two or more such directors together; or
- (e) any body corporate, the Board of directors, managing director or manager whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors of the lending company.

Exemptions - Above restrictions, however, do not apply to any loan made, guarantee given or security provided by:

- (i) a private company (unless it is a subsidiary of a public company);
- (ii) a banking company;
- (iii) a holding company in respect of any loan given by it to its subsidiary or any guarantee given or security provided by a holding company in respect of any loan given to its subsidiary;
- (iv) leasing or hire purchase transaction, as the same is not a loan; and
- (v) loans and advances to a trust in which one or more directors are trustees.

There is also no prohibition against a banking company lending money to concerns of which a director of the bank is also a director - Re Bank of Commerce Ltd, [1947] C.W.N. 662.

Department of Company Affairs, has, through a notification, limited company loans, etc. to its directors and their relatives to 25 times the gross salary of the director in the last six months and pegged the interest rate to more than 4 per cent of RBI's Bank rate.

Please note that the restrictions of section 295 cover not only transactions directly relating to loans, etc., but they equally apply to indirect lendings, etc. The emphasis underlying the expression "directly



or indirectly" used under section 295(1) has been reinforced by the provisions of section 296 which declares that even a book debt would be covered by the restrictions contained in section 295 if it can be shown that, from its very inception, the book debt was in the nature of a loan or advance.

Can a deposit be treated as a loan - Whether a deposit shall be treated as a loan or not will depend upon the nature of the transaction and the facts gathered from the terms and conditions attached to the transaction. The essential requirement of a loan is the advance of money upon the understanding that it shall be returned, and it may or may not carry interest - Dr. Freddie Ardesir Mehta v. Union of India [1991] 70 Comp. Cas. 210 (Bom.).

Penalty- Every person, including the director or any person to whom the loan is made, who is a party to any contravention of section 295 shall be punishable with fine which may extend to ₹50,000 or with simple imprisonment which may extend to 6 months [section 295(4)]. However, where any such loan, or any loan in connection with which any such guarantee or security has been given or provided by the lending company, has been repaid in full, no punishment by way of imprisonment shall be imposed. Further, where the loan has been repaid in part, the maximum punishment which may be imposed under section 295(4) by way of imprisonment shall be proportionately reduced [Proviso to section 295(4)]. Again, all persons who are knowingly parties to any contravention of section 295 shall be jointly and severally liable to make good the amount which the company paid on account of the loan, guarantee or security [section 295(5)].

Disclosure of Interest of a Director

To disclose interest [Sections 299-300]- In respect of contracts with a director, section 299 casts an obligation on a director to disclose the nature of his concern or interest (direct or indirect), if any, at a meeting of the Board of directors. The said section provides that in case of a proposed contract or arrangement, the required disclosure shall be made at the meeting of the Board at which the question of entering into the contract or arrangement is first taken into consideration. In the case of any other contract or arrangement, the disclosure shall be made at the first meeting of the Board held after the director becomes interested in the contract or arrangement.

For the aforesaid purpose, a general notice given to the board by a director, to the effect that he is a director or a member of a specified body corporate or is a member of a specified firm and is to be regarded as concerned or interested in any contract or arrangement which may, after the date of the notice, be entered into with that body corporate or firm, shall be deemed to be a sufficient disclosure of concern or interest in relation to any contract or arrangement so made [Sec. 299(3)(a)].

Any such general notice shall, however, expire at the end of the financial year in which it is given, but may be renewed for further period of one financial year at a time, by a fresh notice given in the last month of the financial year in which it would otherwise expire [Sec. 299(3)(b)].

However, if a disclosure at the beginning of each financial year has been made, that is deemed to be sufficient disclosure in terms of section 299 [ICI v. Parasmurthy Synthetics Ltd. [1998] 17 SCL 51 (Delhi)].

No such general notice, and no renewal thereof, shall be of effect unless either it is given at a meeting of the Board, or the director concerned takes reasonable steps to secure that it is brought up and read at the first meeting of the Board after it is given.

To disclose receipt from transfer of property [Section 319] - Any money received by the directors from the transferee in connection with the transfer of the company's property or undertaking must be disclosed to the members of the company and approved by the company in general meeting. Otherwise, the amount shall be held by the directors in trust for the company. This money may be in the nature of compensation for loss of office but in essence may be on account of transfer of control of the company. But, if it is bona fide payment of damages of the breach of contract, then it is protected by section 321(3). Even no director other than the managing director or whole time director can receive any such payment from the company itself.

To disclose receipt of compensation from transferee of shares [Section 320] -If the loss of office results from the transfer (under certain conditions) of all or any of the shares of the company, its directors would not receive any compensation from the transferee unless the same has been approved by the company in general meeting before the transfer takes place. If the approval is not sought or the proposal is not approved, any money received by the directors shall be held in trust for the shareholders who have sold their shares.

Section 320 also provides that in pursuance of any agreement relating to any of the above transfers, if the director receives any payment from the transferee within one year before or within two years after the transfer, it shall be accounted for to the company unless the director proves that it is not by way of compensation for loss of office.

Section 321 further provides that if the price paid to a retiring director for his shares in the company is in excess of the price paid to other shareholders or any other valuable consideration has been given to him, it shall also be regarded as compensation and should be disclosed to the shareholders. No director can receive any such payment from the company itself.

Effect of Failure to Disclose Interest

1. Fine-As per sub-section (4) to section 299, every director who fails to comply with the aforesaid requirements as to disclosure of concern or interest shall be punishable with fine which may extend to ₹50,000.
2. Exception - Nothing in section 299 will apply to a contract or arrangement entered into or to be entered into between two companies (may be more than two also) where any of the directors of one company or two or more companies together holds or hold not more than 2% of the paid-up capital of the other company.
3. Interested Director not to participate or vote in Board's proceedings - Sec. 300(1) provides that no director of a company shall, as a director, take part in the discussion of, or vote on, any contract or arrangement entered into, or to be entered into, by or on behalf of the company, if he is any way, whether directly or indirectly, concerned or interested in the contract or arrangement.

Besides, his presence shall not count for the purpose of forming a quorum at the time of any such discussion or vote. In case he does vote, his vote shall be void.

The aforesaid bar on an interested director to participate or vote at a meeting shall not apply to:

- (a) a private company which is neither a subsidiary nor a holding company of a public company;
- (b) a private company which is a subsidiary of a public company, in respect of any contract or arrangement entered into or to be entered into, by the private company with the holding company thereof;
- (c) any contract of indemnity against any loss which the director, or any one or more of them, may suffer by reason of becoming or being sureties or a surety for the company; and
- (d) any contract or arrangement entered into or to be entered into with a public company, or a private company which is a subsidiary of a public company in which the interest of the director aforesaid consists solely —
 - (i) in his being a director of such company and the holder of not more than shares of such number or value therein as is requisite to qualify him for appointment as a director thereof, he having been nominated as such director by the company referred to in sub-section (1), or
 - (ii) in his being a member holding not more than 2 per cent of its paid- up share capital;
- (e) a public company, or a private company which is a subsidiary of a public company in respect of which a notification is issued under sub-section (3) to the extent specified in the notification. Sub-section (3) empowers the Central Government to fully or partially relieve the company from



the prohibitions contained in sub-section (1) in public interest (i.e., desirability of promoting or establishing any trade, industry or business).

4. Cessation of office of Directorship - According to sec. 283(1)(i), an office of a director shall fall vacant in case he acts in contravention of sec. 299.

It may, however, be noted that the Companies Act does not debar a company from entering into a contract in which a director is interested. It only requires that such interest be disclosed.

Where the whole body of directors is aware of the facts, a formal disclosure is not necessary – Venkatachalapati v. Guntur Mills AIR 1929 Mad. 353.

Also see Ravi Raj Gupta v. Hans Raj Gupta & Co. (P.) Ltd, [C.S. (O.S.) No. 1944 of 2003, dated 17-2-2009 (Delhi)]. This case also has held that a shareholder simpliciter has no locus standi to question management decision.

Office or place of profit [Section 314]

Section 314 imposes certain restrictions on the holding of office or place of profit in a company by the directors and their associates. Following is the summary of restrictions so provided:

1. No director of a company, shall hold any office or place of profit (carrying any remuneration) under the company, or its subsidiary except with the consent of the company by a special resolution. It shall, however, be sufficient if the special resolution is passed at the first general meeting held after such appointment. [Proviso to sub-section(1)].

Sub-section (3) of section 314 provides that a director shall be deemed to hold an office or place of profit under the company if the director holding an office obtains from the company anything by way of remuneration over and above the remuneration to which he is entitled as such director. Such remuneration may be by way of salary, fees, commission, perquisites, the right to occupy free of rent any premises as a place of residence or otherwise

2. Except by passing a special resolution any of the following persons shall not hold any office or place of profit carrying a total monthly remuneration of such sum as may be prescribed [presently, Rupees ten thousand per month, with effect from 1-3-1994, Notification No. GSR 286(E), dated 3-3-1994]:
 - (i) Partner or relative of a director;
 - (ii) Firm in which a director or a relative of such director is a partner;
 - (iii) Private company of which a director of the company is a director or member; and
 - (iv) Director, or manager of a private company, in which a director of the company is a director or member.

Consent of the company accorded by way of special resolution is not required to hold the office of managing director or manager or banker or debenture trustee of the company or any of its subsidiaries for a director of the company or any of the persons mentioned in (2) above.

Special resolution may be passed at first general meeting held after the appointment. Where, however, the aforesaid appointment in point (i) & (ii) above is made without the knowledge of the concerned director, the consent of the company may be obtained either at the first general meeting after the appointment or within three months from the date of the appointment, whichever is later [Second proviso to subsection (1)(b)].

3. According to sub-section (1B):

- (i) No partner or relative of a director or manager;
- (ii) No firm in which such director or manager, or relative of either is a partner;

- (iii) No private company of which such a director or manager, or relative of either is a director or member;

shall hold an office or place of profit in the company carrying a total monthly remuneration of not less than such sum as may be prescribed [presently, exceeding Rupees two lakh fifty thousand (₹2,50,000) per month, with effect from 2-5-2011, Notification No. GSR 357(E), dated 2-5-2011].

The Delhi High Court in Ravindra Kumar Sanghal v. Auto Lamps Ltd, [1984] 55 Comp. Cas. 742 had held that the expression 'monthly' remuneration excludes all payments what are not paid monthly, like bonus, leave encashment, etc.

The aforesaid appointment may, however, be made with the prior consent of the company by passing a special resolution and the approval of the Central Government.

Restriction on appointment of firm or body corporate to office or place of profit under a company (Section 204) - No company can appoint or employ any firm or body corporate to or in any office or place of profit under the company for a term exceeding five years at a time.

However, the aforesaid restriction does not apply to:

- (i) the initial appointment or employment (it may, with the approval of the Central Government be for a term upto 10 years);
- (ii) re-appointment upto 5 years, each time (provided that any such re-appointment, re-employment shall not be sanctioned earlier than 2 years from the date on which it is to come into force);
- (iii) appointment as a technician or a consultant.

Approval of the Central Government in case of Appointment of Relatives, etc. of Directors - No appointment for an office or place of profit in a company shall take effect unless approved by the Central Government on an application, in respect of—

- (a) Partner or relative of a Director or Manager; or
- (b) Firm in which such Director or Manager, or relative of either is a partner; or
- (c) Private company of which such Director or Manager or relative of either is a Director or Member,

which carries a monthly remuneration exceeding ₹50,000 p.m. Source: Notification No. GSR 89(E), dated 5-2-2003, issued by Department of Company Affairs'.

Procedure of examination of applications - The application under rule 3 shall be examined with respect to the following, in addition to all other requirements under the Companies Act, 1956:

- (1) An undertaking from the appointee that he/she will be in the exclusive employment of the company and will not hold a place of profit in any other company.
- (2) The monetary value of all allowances and perquisites and of total remuneration package (monthly/annually) proposed to be paid to the appointee and details of the services that will be rendered by him to the company.
- (3) Shareholding pattern particularly the shareholding of the directors along with his/her/their relatives, the public holding, institutional holding (each institution separately).
- (4) The educational qualification/experience, pay scale, allowances and other benefits of similarly placed executives in case of the appointment of a relative, then, an undertaking from the Director/Company Secretary of the company that the similarly placed employees are getting the comparable salary shall also be enclosed along with the application.
- (5) List/particulars of the employees who are in receipt of remuneration of ₹50,000 or more per month.
- (6) The total number of relatives of all the Directors either appointed as Managing/whole time Director;



Manager or in any other position in the company; the total remuneration paid to each relative and the total remuneration paid to them altogether as a percentage of profits as calculated for the purpose of section 198 of the Companies Act, 1956.

- (7) The selection and appointment of a relative of a Director for holding office or place of profit in a private company shall be approved by adopting the same procedure applicable to non-relatives. However, in the case of public companies, the selection of a relative of Director for holding place of office or profit in the company shall have to be also approved by a Selection Committee.

Explanation: - For the purpose of sub-rule (7) of rule 4, the expression "Selection Committee" means a Committee, the majority of which shall consist of independent Directors and an expert in the respective field from outside the company.

Remuneration to mean monthly remuneration - While interpreting the scope of the term 'remuneration' for the aforesaid purpose, the emphasis should be on the 'monthly remuneration' and not on what a person gets for a whole year - R.K. Sangal v. Auto Lamps Ltd. [1984] 55 Comp. Cas. 742 (Delhi).

Section 314(2A) casts a duty on every person or entity proposed to be appointed to an office or place of profit covered by section 314, to declare in writing whether he or it is or is not connected with a director of the company in any of the ways mentioned in section 314(1).

Obligation to refund any remuneration received or the monetary amount of any perquisite or advantage enjoyed attaches to every person or entity appointed to a place or office of profit not complying with the procedure contained in section 314(1B) i.e. without prior consent of the company and the prior approval of the Central Government [section 314(2B)].

While a new appointment requires consent of the company by a special resolution and approval of the Central Government, in the case of an already existing appointment, the consent of the company by an ordinary resolution coupled with the consent of the Central Government will be sufficient.

But no special resolution is required for the removal of a director from an office of profit. In the case of a public company, or a private company which is a subsidiary of a public company, such a director may be removed by an ordinary resolution under section 284.

Where the articles of a private company which is not a subsidiary of a public company provide that a director shall be deemed to vacate office if he violates section 314, the Board of directors may treat him as having vacated office under section 283(1) read with section 283(3).

Penalties for contravention [Section 314(2B)&(2C)]- If any director or his associate holds an office or place of profit in contravention of the aforesaid provisions, then:

- (i) he or it shall be deemed to have vacated such office or place of profit as such on and from the date next following the date of the general meeting;
- (ii) he or it shall be liable to refund to the company any remuneration received or the monetary equivalent of the perquisites or advantage enjoyed by him.

The company cannot waive the recovery of any sum refundable to it under section 314(2) unless permitted to do so by the Central Government.

Meaning of 'office or place of profit'[Section 314(3)] - Any office or place shall be deemed to be an office or place of profit under the company:

- (a) In case the office or place is held by a director, if the director holding it obtains from the company anything by way of remuneration over and above the remuneration to which he is entitled as such director, whether as salary, fees, commission, perquisites, the right to occupy free of rent any premises as a place of residence, or otherwise;
- (b) In case the office is held by an individual other than a director, or by any firm, private company

or other body corporate holding it obtains from the company anything by way of remuneration whether as salary, fees, commission, perquisites, the right to occupy free of rent any premises as a place of residence or otherwise.

The Supreme Court of India in *Satrucharla Chandrasekhar Raju v. Vyrichula Pradeep Kumar Dev* - AIR 1992 SC 1959 has described the term 'office of profit' as a position to which certain duties are attached. It involves two elements: (i) that there should be such an office, and (ii) it should carry some remuneration.

The words 'office or place of profit' occurring in section 314(1)(b) include selling and buying agents receiving commission and/or salary – *CIT v. Principal Officer C/o Arkay Wires (P.) Ltd.* [2005] 58 SCL 97 (All).

Exemptions:

1. The prohibition under section 314(1B) is not applicable to the remuneration or compensation given to the concerned persons for providing services of a professional nature rendered to the company in their professional capacity such as a chartered accountant, advocate, engineer or doctor. However, if the professional person(s) renders services even though of a professional nature as a retainer, the remuneration/compensation so received would be hit by the restrictive provisions of section 314(1B).
2. The aforesaid restrictions do not apply where a relative of a director or a firm in which such relative is a partner holds any office or place of profit under the company or a subsidiary thereof having been appointed to such office or place before such director became a director of this company [vide Section 314(1A)].
3. The restrictions, as aforesaid, do not apply to a person who, being the holder of any office or place of profit in the company, is appointed by the Central Government, under section 408, as a director of the company [Sec. 314(4)].
4. Holding and Subsidiary Companies - The section only prohibits a director of a company holding an office or place of profit under the company or its subsidiary. It does not prohibit a director of a subsidiary company holding an office or place of profit in its holding company.

Where a director of a holding company acts also as a director of its subsidiary, any remuneration, even sitting fees, which he gets from the subsidiary, will have to be paid over to the holding company, unless a special resolution according consent as provided in sub-section (1) is passed.

5. Whether section 314 is attracted where relative is an independent director of the company and is a partner of the firm of chartered accountants who are being appointed/reappointed as statutory auditor of the company and such partner not signing the audit report nor participating in the audit function? - Apparently the case does not fall within disqualifications for an auditor mentioned in section 226 of the Act. The director in question does not himself hold an office/ place of profit under the company. The firm being considered for the office of statutory auditor is not partner/relative of the director concerned and the statutory auditor will not be receiving remuneration on a month to month basis. Accordingly, it seems that the provisions of section 314 would be inapplicable. This view is based on the decisions in *A.R. Sudarsanam v. Madras Purasawalkam Hindu Janopakara Saswatha Nidhi Ltd.* [1985] 57 Comp. Cas. 776 (Mad.) and *Ravinder Kumar Sanghal v. Auto Lamps Ltd.* [1984] 55 Comp. Cas. 742 (Delhi).

1.7.8. Interested Director

A director who is interested in a transaction of the company must disclose his interest to the Board. Section 297, in this regard provides that a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm, or a private company of which the



director is a member or director, shall not enter into any contract with the company—

- (a) for the sale, purchase or supply of any goods, materials or services; or
- (b) for underwriting the subscription of any shares in, or debentures of the company.

However, section 297 permits the aforesaid contracts with the consent of the Board of directors by a resolution passed at a meeting of the Board. But, where the paid-up share capital of the company is rupees one crore or more, previous approval of the Central Government shall also be necessary.

Exceptions - In the following cases, the aforesaid approvals shall not be necessary:

1. The purchase or sale of goods and materials from the company, or to the company, for cash at prevailing market prices.
2. Any contract for sale, purchase or supply of any goods, materials and services in which either the company or the director, relative, firm, partner or private company, as the case may be, regularly trades or does business. However, the value of the goods/services should not exceed ₹5,000 in the aggregate in any year.
3. Any transaction with or by a banking or insurance company in the ordinary course of its business.
4. In circumstances of urgent necessity. However, the consent of the Board must be obtained at a meeting within three months of the date on which the contract was entered into.

It may be observed that underwriting contract does not come within the exceptions provided. Where a case of urgent necessity arises in a company having paid-up share capital of ₹1 crore or more, even though the Board's consent may be taken within next three months, the prior consent of the Central Government (i.e., Regional Director in this case), as it appears, is a must. Any contract coming under the scope of section 297, may as well be hit by sections 269, 294AA and 314 of the Act. However, as in the case of section 314, the Department of Company Affairs, Government of India, is of the view that a contract for services of professional nature is out of the scope of section 297. According to some Authorities on Company Law, this view of the Department is not correct.

It may further be noted that a Government company, having paid-up capital of ₹1 crore or more does not require the Central Government's approval when entering into a contract with another Government company (G.S.R. 233 dated 31-1-1978).

Allotment of shares to close relatives of Directors without disclosure of interest - Whether violation of section 300- The Kerala High Court in *Mukkattukara Catholic Ltd, v. M.V. Thomas* [1995] 4 Comp. L.J. [Chartered Secretary : February 1996] held that section 300 does not cover a case of registration of transfer of shares where the company only performs its statutory function. The operation of section 300, the court held, is made limited to contracts or arrangements made by or on behalf of the company. The court further observed that under section 110 of the Companies Act, an application for registration of transfer of shares or other interest of a member of a company may be made. The company, by virtue of section 111, may refuse to register the transfer or transmission. However, in exercising power under section 111 no element of contract or arrangement within the meaning of section 300 is involved with respect to which there can be an "interested director", in the sense in which the expression could be understood under the Act.

Effect of Refusal of Consent by the Board [Section 297(5)] - If consent is not accorded to any contract under this section anything done in pursuance of the contract shall be voidable at the option of the Board.

Penalty - No specific penalty has been provided in section 297 for any breach thereof. As such the provisions of section 629A will apply. The monetary penalty specified in section 629A is, however, compoundable under section 621A – *Otto Burlington Mail Orders (P.) Ltd., In re* [1998] 18 SCL 17.

Disclosure of Interest- Please see discussion under 1.7.7.

1.8 BOARD MEETINGS AND PROCEDURES

1.8.1 BOARD MEETINGS, MINUTES & REGISTERS

BOARD MEETINGS

Provisions of the Companies Act relating to Board meetings. [Sec. 285]

1. Board shall meet at least once in every 3 months and atleast 4 meetings should be held every year. For this purpose, "year" means calendar year.
2. A meeting of the Board duly called but could not be held for want of a quorum, would not be deemed to be contravention relating to frequency of Board meetings [Sec.288(2)].
3. **Exemption:** Central Government may, by notification in the Official Gazette, exempt any class of Companies from this requirement or modify the application of this requirement. [For example, Sec.25 Companies shall hold atleast one meeting within every 6 calendar months.

Calling for a Board Meeting

1. The Act does not contain any provisions as to who can convene/ call for a Board meeting.

SS-1, in this regard provides that every company should have a chairman who would be the chairman for meetings of the Board. Further, it provides that it would be the duty of the Chairman to see that the meeting is duly convened and constituted in accordance with the Act or any other applicable guidelines, rules and regulations before it proceeds to transact business.

2. Regulation 73:

- (a) Table A provides that the Board of Directors may meet for the despatch of business, adjourn and otherwise' regulate its meetings, as it thinks fit.
- (b) A Director may, and the Manager or Secretary on the requisition of a Director shall, at any time summon a meeting of the Board. So, the Secretary cannot convene a meeting unless authorised by a Director and is duty bound to convene a meeting when requisitioned by a Director.

Provisions relating to Notice of Board Meeting. [Sec.286]

1. **Form:** There is no particular form of Notice calling a meeting of the Board of Directors. [Sunder Lal Jain vs Sundeep Paper Mills (P) Ltd 60 CC 77]
2. **Mode:**
 - (a) Notice of every Meeting should be given in writing.
 - (b) Notice sent by facsimile will be adequate notice. [Ferruccio Sias vs Jai Manga Ram Mukhi 93 CC 750]
 - (c) Telephonic invitation / oral invitation cannot amount to Notice within the meaning of Sec.286. [R. Khemka vs Deccan Enterprises (P) Ltd 16 SCL 1]
3. **Addresses:**
 - (a) **Notice should be given to -**
 - ❖ Every Director for the time being in India, and
 - ❖ Directors outside India, at his usual address in India.
 - (b) **Interested Director:** Sec.286 requires that notice must be given to every Director. Therefore, notice must be given to a Director even if he is precluded from voting on a proposed business.



(c) **Alternate/Original Director:** Where the Company has appointed an Alternate Director, notice of the meeting should be given to both the Original Director as well as the Alternate Director.

(d) **Non-compliance:** Every Officer in default shall be punishable with a fine upto ₹1,000.

4. Authority: Notice should be under the authority of the Company. The ADA usually designate an Officer or Director who shall have the power to call Meetings of the Board.

5. Length: Sec.286 does not provide for any specific length of Notice (i.e. certain number of days prior to) for a Board Meeting. Generally, ADA do not provide for any specific length of Notice, since it must be possible for the Company, to call an emergency meeting, in case of a crisis.

6. Definite: Notice must be a definite note. A conditional or contingent Notice is not valid. [Alexander vs Simpson]

7. Notice to Directors abroad: The following decisions are relevant in this regard –

A haste in holding a Board Meeting by giving just 2 days notice when the majority of the Directors were NRI's was an oppressive act. **(Kshounish Chowdry vs Kero Rajendra monolithic Ltd.)**

If notice is sent to a Director who mostly stays outside India, at his usual address in India, the notice shall not serve any purpose, as it would not permit him to make arrangements to attend the notified Board Meeting. Therefore, such a notice is inadequate. Such conduct would show lack of probity and fair play on part of the Directors. Hence, the meeting was held to be null and void. **(Dr. Kamal Kumar Datta vs Ruby General Hospital Ltd.)**

Where the Company has a Foreign Collaborator with a considerable stake, it is desirable and in the fitness of things that there should be a requirement of 1 month notice, or date of next meeting should be fixed at the preceding meeting. **(Boiron vs SBL Ltd.)**

8. Adjourned Meeting:

(a) Article 53 of Schedule I to the Act, where a Meeting is adjourned for 30 days or more, a fresh notice of the adjourned meeting has to be served.

(b) Notice of adjournment of a meeting need not be given unless the AOA otherwise provide. Notice of Adjourned Meeting is not required if time and place of adjourned Meeting is announced at the original meeting. [Promod Kumar Mittal vs Southern Steel Ltd 50 CC 555]

9. Agenda:

(a) Law does not require an agenda for a Board Meeting and any business whatsoever can be transacted at the Board Meeting. The Board can transact business even without a formal agenda.

(b) Where agenda is issued, the Board is not obliged to transact only that business for which the agenda is issued. [Suresh Chandra Marwaha vs Lauls (P) Ltd 48 CC 110]

(c) Even if there is no specific agenda, under the miscellaneous items 'with the permission of the Chairman' any other business may be transacted. **[Kashinath Tapuriah vs Incab Industries Ltd 6 SCL 201]**

(d) The purpose of sending Notice to Director is to inform him about the date, time and place of meeting. Omission to forward the agenda does not invalidate the meeting, unless AOA provides so.

10. Place and Time: The notice must state the date, time and place of the meeting. Unlike the provisions of the Act regarding annual meetings, there is no provision in the Act specifying that Board meetings must be held at the registered office of the company or during business hours and on a day which is not a public holiday. Thus, Board meetings may be held at any place and

outside business hours according to the convenience of the directors.

Power of Board to ratify acts subsequently:

Where notice is not given as required but all Directors attend the meeting and do not object to the absence of notice or where the absentee Directors do not complain of want of notice, the proceedings at the meeting will not be invalid, especially if they are ratified at a subsequent meeting at which the Absentee Directors are present.

It is open to a regularly constituted meeting of the Board of Directors to ratify that action which though unauthorized is done on behalf of the Company. Ratification generally relates back to the date of the act ratified. **(Parameshwari Prasad Gupta vs Union of India)**

Provisions relating to Place, Time and Agenda for conducting Board Meeting

1. **Place:** Board Meeting need not be held only at the "Registered Office". It can be held at any convenient place,

different from the Registered Office also. Also, Directors can hold a Board Meeting in a foreign country, if circumstances justify it.
2. **Time:** Sec. 166 requires that AGM shall be held during business hours, and on a day that is not a Public Holiday. There is no similar provision for Board Meetings, and hence Board Meetings may also be held on Public Holidays or after business hours. So, Board Meeting can also be held on a Public holiday, unless AOA provides otherwise.
3. **Agenda:** Law does not require an agenda for a Board Meeting, and any business whatsoever can be transacted at the Board Meeting. The Board can transact business even without a formal agenda.

Quorum for holding the Board Meeting [Sec.287]

1. **General:** Quorum for a Board Meeting shall be -

- (a) 1/3rd of the total strength of the Board, or
- (b) 2 Directors

whichever is higher.

Note:

- Total Strength = Total Strength of the Board of Directors of a Company
Less: Number of Directors whose places remain vacant
- Interested Directors are not counted for the purposes of forming a quorum at the time of discussion or vote on any matter.
- Any fractions shall be rounded off to nearest 1.

2. **Interested Directors:** Where the number of Interested Directors exceeds or is equal to 2/3rd of the total strength, then the quorum shall be -

- (a) Number of Non-Interested Directors present at the meeting, or
- (b) 2 Directors

whichever is higher.

Note: In calculation of quorum, an Interested Director should be excluded only at the time of discussion or vote on any matter before the meeting in which he is interested. He can be counted for the purposes of quorum with respect to any other matter in which he is not interested.

Where all or more than 2/3rd of the Directors are interested, the remedy in such cases is to increase



the strength of the Board by appointing disinterested Directors or appoint Additional Directors if so authorised by the AOA, who are not interested in the contract. If this is not found practicable, it will be desirable to place the proposed contract before the General Meeting for consent.

3. **Sec. 25 Companies:** Quorum for Board Meeting shall be either 8 members or 1/4 of its total strength whichever is less. However the quorum shall not be less than 2 members in any case.
4. **Committee Meetings:** The presence of all the members of any Committee constituted by the Board is necessary to form the Quorum for meetings of such Committee, unless otherwise stipulated by the Board while constituting the Committee. [SSI-of ICSI]
5. **Time of Quorum:** In case of Board Meeting, quorum should be present not only at the commencement, but throughout the meeting for every item of business.
6. **AOA limits:** Sec.287 indicates only the minimum number of Directors necessary to constitute a proper quorum. It is open to the Company, by its AOA, to indicate a higher, but not a lower number, or proportion as constituting a valid quorum. [Amrit Kaur Puri vs Kapurthala Flour Oil & General Mills Co P Ltd 56 CC 194]
7. **Presumption:** A quorum is presumed to be present, unless - (a) the presumption is questioned at the meeting, or (b) the records disclose that a quorum was, in fact, not present.
8. **Number of Directors below quorum:**
 - (a) Where the number of Directors is reduced below the minimum as per AOA, business may still be transacted, if a quorum exists and is present.
 - (b) Where the number of Directors is reduced below quorum requirement, Directors cannot act unless the number is first made by the Board itself or through a General Meeting,
 - (c) Where out of 3 Directors required to-form a quorum, two had resigned, the single remaining Director has the following options -
 - He could get Members to call a meeting u/s 169, or
 - He could himself call an EGM under the AOA, or
 - He could move Tribunal to call a General Meeting u/s 186. [Sorabjee vs Sind Punjab Co.]
9. **Protection to 3rd Parties:** Absence of quorum in a Board Meeting will not affect contracts entered into with third parties, who are not acquainted with any defect in the constitution of the Board.
10. **Majority Rule:**
 - (a) Quorum constitutes the minimum number competent to transact and vote on any business. Decisions in Board Meetings are by the Majority Rule.
 - (b) A resolution passed at a valid Meeting is binding on the whole Board. All Directors are duty-bound to co-operate in the implementation of the resolution, even if some of the Directors did not participate in the deliberations or voted against the resolution.

Procedure to be followed, when a Board Meeting is adjourned for want of quorum [Sec.286]

In the absence of quorum within 15 minutes of the meeting, the Meeting shall be adjourned as under -

1. **General:** Automatically, to the same day, at the same time and place in the next week. If it happens to be a public holiday to the next succeeding day which is not a public holiday,
2. **Provision in AOA:** When there is provision in the AOA, the day prescribed in the AOA even if it happens to be a public holiday.

Position of an Interested Director in a Board Meeting [Sec.300]

1. Position of Interested Director:

- (a) A Director should not participate in the discussion or voting on any contract in which he is interested or concerned, either directly or indirectly,
- (b) If he votes on the resolution in connection with the interested contract or arrangement, his vote shall be void.
- (c) His presence shall not be counted for the purposes of quorum at the time of the discussion and voting.

2. Consequences of non-compliance: A Director who knowingly contravenes the provisions of Sec.300 shall be liable to pay a fine upto ₹ 50,000.

Cases where Interested Director can be counted for the purposes of quorum at a Board Meeting [Sec.300(2)]

The provisions relating to exclusion of Interested Director is not applicable to -

- 1. Private Company
- 2. Private Company which is a Subsidiary of a Public Company, in respect of contracts with Holding Company.
- 3. Any contract of indemnity against any loss which the Directors may suffer due to becoming a Surety for the Company.
- 4. In case of a Public Company or a Private Company which is a Subsidiary of the Public Company any contract entered into by the Company in which the interest of the Director consists solely of the holding the qualification shares required or he is a member holding not more than 2% of its paid up share capital.
- 5. When a notification has been issued by Central Government, having regard to the desirability of establishing or promoting any industry, business or trade and the public interest, that the provisions do not apply or apply subject to modifications.

Note: Sec.300 is not applicable to a Private Company. Therefore even Interested Directors can constitute a valid quorum for a Board Meeting of a Private Company, In other words, the quorum for a Board meeting of a Private Company need not be a 'disinterested quorum'.

Passing of resolution by circulation [Sec.289]

The Board/ Committee thereof, may pass any resolution by circulation except those resolutions which are required by the Act or the AOA to be passed only at a Board Meeting. The requirements are as under -

- 1. **Minimum Directors in India:** The number of Directors present in India must not be less than the quorum fixed for a meeting of the Board of Directors.
- 2. **Circulation of Draft Resolution:** The draft of the resolution along with all the necessary papers must be circulated to -
 - (a) All the members of the Board or the Committee then in India, and
 - (b) All the other members at their usual address in India.
- 3. **Approval:** The resolution should be approved by -
 - (a) All the Directors who are then in India, and are entitled to vote on the resolution, OR
 - (b) A majority of all the Directors whether in India or outside India who are entitled to vote on the resolution.
- 4. **Date:** The date on which the last of the Directors out of the number of the Directors who are



required to approve the resolution, shall be taken to be the date on which the circular resolution will be deemed to have been passed.

5. **Minutes:** Where a resolution is passed by Circulation, to prove its authenticity, the Company -
- (a) may maintain a separate Minutes Book for recording resolutions passed by Circulation, or
 - (b) may paste the Circular resolution in the Minute Book and "note" the same in the next Board Meeting.

. Matters which require sanction of Board Meetings and not by Circulation.

Sec.	Matters
262	Filling of Casual Vacancy in the Board.
292	Power to (a) Make calls on Shareholders; (b) Issue Debentures; (c) Borrow Moneys otherwise than on Debentures; (d) Invest the Company's funds, and (e) Make Loans.
297	Sanction for certain contracts in which particular Directors are interested.
299	Disclosure to the Board of a Director's Interest in a transaction of the Company.
308	Disclosure to the Board of a Directors' Shareholding.
316 & 386	Appointment of a person as Managing Director/manager of more than one Company.
372A	Sanction for Inter-Corporate Loan, Investments or giving of guarantees or providing security.

Draft the resolution to be passed by Circulation [Sec.289]

Letter Head of the Company

To

Mr. A. Director,
(Address in India).

Dear Sir,

The following resolution, which is intended to be passed as a resolution by circulation as provided in Section 289 of the Companies Act, 1956, is circulated herewith as per the provisions of the said section.

If only you are Not Interested in the resolution, you may please indicate by appending your signature in the space provided beneath the resolution appearing herein below as a separate perforated slip, whether you are in favour or against the said resolution. The perforated slip may please be returned if and when signed within..... days of this letter. However, it need not-be returned if you are interested in the resolution.

Yours faithfully
(Secretary)

..... Ltd

Resolution by Circulation passed by the Directors as per circulation effected 20

RESOLVED THAT :

For / Against
Strike off whichever is inapplicable
Signature

Draft the Confirmation of resolution passed by Circulation.

"RESOLVED THAT the undernoted Resolutions passed by the Board of Directors of the Company by Circulation on be and are hereby confirmed."

MINUTES & REGISTERS

Minutes of the Board meetings. [Sec.193]

1. Minutes of proceedings of Board Meetings or Committee of Board of Directors shall be maintained by the Company.
2. Minutes shall be recorded within 30 days of the conclusion of the meeting.
3. Minutes Book shall be serially numbered.
4. Minutes of the proceedings shall not be attached to any book by pasting.
5. A Company can maintain its minutes in the loose-leaf form, provided it complies with the other procedural requirements, and takes all possible safeguards against manipulation or interpolation of the Minutes and bind up the loose-leaves in books at reasonable intervals, say 6 months.

Minutes of the General and Board Meetings cannot be type-written and then pasted in bound Book. Entering of Minutes in the bound Minutes Book by a chemical process which does not amount to attachment to any book by pasting or otherwise is permissible provided on the mechanic's impression of the Minutes, the original signature of the chairman is given on each page.

Authentication of the minutes of the Board Meetings

Letter No. 8 / 2 / 75 - CL - V, dt 05.05.1975

1. Every page of the Minute Book shall be initialled and the last page shall be dated and signed by the Chairman of the Meeting, or the Chairman of the next succeeding meeting.
2. Minutes of the previous Board Meeting held can be signed by the Chairman at any time before the next Meeting is held.
3. Confirmation of the minutes of any Board Meeting by Members of the Board at the next Meeting is not contemplated by the law. Therefore, there is no requirement of postponing of action on the resolution already passed by the Board for want of confirmation.
4. Any change in Minutes may be effected by adopting fresh resolutions in modification of the earlier resolutions.
5. Minutes Book should be written within the period of 30 days from the date of the Meeting held. It cannot be insisted upon that the Minutes have to be signed within 30 days, [C.No.25/76 dt 01.09.1976].

Presumptions as to the minutes [Sec.195]

The following presumptions can be made in respect of the proceedings in the Board Meetings or Committee Meetings, unless the contrary is proved -

1. Meeting shall be deemed to have been duly called and held.
2. All proceedings in the Meeting have duly taken place,
3. All appointments of Directors or Liquidators made at the Meeting shall be deemed to be valid.
4. Minutes of the Meetings kept as per Sec.193 shall be evidence of the proceedings recorded. [Sec.194]

Provisions in case a Member wants to inspect the Minutes Book of the Meeting of the Board

1. The Companies Act contains no provision either specifically permitting or prohibiting inspection of Minutes Book of Board Meetings, by Shareholders of the Company.
2. The Minutes of Meetings of the Board can be inspected only by the Directors.
3. The Statutory Auditor / Cost Auditor / Secretary in whole-time practice appointed by the Company can also inspect the Minute Books in the course of his audit or certification work.



4. Officers of ROC, or other Government or Regulatory Bodies duly authorised in this behalf under law, during the course of an inspection, can also inspect the Minutes.
5. A Member of the Company has no right to inspect the Minutes of Meetings of the Board or any Committee thereof. So, unless the AOA provide to the contrary, a Shareholder has no right of inspection or of obtaining copies of the Board Meetings. [Department Clarification]

Salient points to be taken into account while drafting the Minutes of the Meetings of Board of Directors.

While drafting the minutes of the Board of Directors, the following points have to be kept in mind-

1. Minutes may be drafted in a tabular form or in the form of a series of paragraphs numbered consecutively and with relevant headings.
2. Place, date and time of the meeting should be stated.
3. Contents of the Meeting, giving serial number of the minutes, brief subject heading, full terms of the resolution adopted including the statistical details, etc.
4. Names of the Persons present at the meeting should be stated.
5. Names of the Directors dissenting or not concurring with any resolution passed, should be specified.
6. Reference about interested Directors abstaining from voting is necessary.
7. Chairman's Signature and Date of Verification of minutes as correct, should be ensured.
8. The Chairman shall exercise his discretion in inclusion or exclusion of any matter in the minutes which in his opinion are –
 - (a) defamatory of any person, or
 - (b) irrelevant or immaterial to the proceedings, or
 - (c) detrimental to the interests of the Company.

Registers

The Companies Act, 1956 requires a company to keep at its registered office certain books known as statutory books and also keep copies of certain documents and deeds. Default in keeping any of the statutory books and returns or to file any of the returns or documents with the Registrar of Companies renders the company and their officers in default liable to penalties provided under the respective provisions of the Act.

Mandatory Statutory Registers under Companies Act, 1956

1. Register of Investments not held by company in its own name (Section 49)
2. Register of Fixed Deposits (Section 58A)
3. Register of Charges (Section 143)
4. Register and Index of Members (Section 150 & 151)
5. Register and Index of Debenture holders (Section 152)
6. Foreign Register of Members and Debenture-holders, if any (Section 158)
7. Minute Books of the General Meetings and of the Meetings of the Board and its Committees (Section 193)
8. Books of Accounts (Section 209)
9. Cost Account Records for companies engaged in industries specified by the Central Government [Section 209(1)(d)]

10. Register of Contracts in which Directors are interested (Section 301)
11. Register of Directors, Managing Director, Manager & Secretary (Section 303)
12. Register of Directors' Shareholding (Section 307)
13. Register of Loans & Investments (Section 372A)
14. Directors' Attendance Book (Reg.71 of Table A)
15. Register of Renewed & Duplicate Share Certificates

Non-Mandatory Statutory Registers under Companies Act, 1956

1. Register of Share Application & Allotment
2. Register of Share Transfer
3. Register of Dividend Mandates
4. Register of Power of Attorney
5. Share Calls Book
6. Debenture Application and Allotment Book
7. Debenture Calls book
8. Debenture Interest Book
9. Register of Probates
10. Register of Sealed Documents
11. Register of Share Warrants
12. Register of Proxies
13. Debenture Transfer Register
14. Register of Lost Share Certificates, etc.

Short notes on Register of Contracts, Companies and Firms in which Directors are interested [Sec. 301]

1. Contracts covered:

Included Contracts	Excluded Contracts / Arrangements
All contracts or arrangements to which Sec.297 or Sec.299 applies, i.e. contracts and arrangements in which Directors are interested.	The following need not be entered in Sec.301 Register – (a) Sale, purchase or supply of any goods, materials or services, the value of which does not exceed ₹1,000 in the aggregate in any year, (b) Those entered into by a Banking Company for the collection of bills in the ordinary course of business, (c) Transactions entered into in the ordinary course of business by a Banking or Insurance Company, with the Directors or interested persons specified u/s 297.

2. Contents: The following particulars should be recorded in the Register -

- (a) Date of contract or arrangement,
- (b) Names of parties thereto,



- (c) Principal terms and conditions thereof,
- (d) Date on which the contract / arrangement was placed before the Board,
- (e) Names of the Directors voting for and against the contract / arrangement, and the Names of those remaining neutral.

Note: The Register should also specify in relation to each of the Directors of the Company the names of the Firms and Body Corporate in respect of which General Notice have been given by the Director to the Board u/s 299(3).

3. Time Limit: Particulars of contract should be entered in the Register-

Contract / Arrangement	Time Limit for entry in the Register
Those requiring Board's approval	Within 7 days (excluding public holidays) of the Board Meeting in which contract or arrangement is approved.
Any other Contract / Arrangement	❖ Within 7 days from the date of receipt of particulars- about the contract at Registered Office of the Company, or ❖ Within 30 days from the date of the contract or arrangement, whichever is later.

4. Place: The Register shall be kept at the Registered Office of the Company.

5. Authentication: After updating the entries within the time limit, the Register shall be -

- (a) placed before the Board in its next Meeting.
- (b) signed by all the Directors present at the Meeting.

6. Inspection: The Members of the Company are entitled to -

- (a) Inspect the Register of Contracts kept at the Registered Office, in the same manner as
- (b) Make extracts therefrom, and for Register of Members.
- (c) Take copies thereof.

Note: As such, Non-Members are not entitled to inspect Sec.301 Register.

7. Non-compliance: Failure to comply with Points 1, 2 & 3 above renders the Company and every Officer in default, punishable with a fine upto ₹ 5,000.

Provisions relating to maintenance of Register of Directors [Sec. 303]

1. Contents of Register of Directors: A Company should maintain a Register of Directors, Managing Director, Manager and Secretary, containing the following particulars –

Category	Particulars to be entered in the Register

(a) Individual	❖ His Name and Surname in full. ❖ His Father's Name and Surname in full. ❖ In case of a married woman, the Husband's Name and Surname in full. ❖ His usual Residential Address. ❖ His Nationality and Nationality of Origin, if any. ❖ His Business Occupation, if any. ❖ Particulars of Office held as Director/MD/Manager/Secretary in any other Body Corporate except in Private Company. ❖ His Date of Birth (Note: This is not applicable for a Pure Private Company)
(b) Body Corporate	❖ Its Corporate Name. ❖ Registered or Principal Office. ❖ Each of the Director's Full Name, Address, Nationality & Nationality of Origin, Father's Name (in case of a married woman, Husband's Name shall be given). ❖ Particulars of Office of Manager/Secretary in any other Body Corporate.
(c) Firm	❖ Name of the Firm. ❖ Each Partner's Full Name, Address, Nationality, Nationality of Origin, Father's Name (in case of a married woman, Husband's Name shall be given). ❖ Date on which he became a Partner. ❖ Particulars of Office of Manager/Secretary in any other Body Corporate.
(d) Nominated Directors	❖ If nominated by Body Corporate, the Corporate Name along with all particulars specified in (a) and (b) above. ❖ If nominated by Firm, the Firm's Name along with all particulars specified in (a) and (c) above.

Note: Any person in accordance with whose directions or instructions the Board is accustomed to act shall also be deemed to be the Director of the Company.

2. Duty of Directors to make disclosure [Sec. 305]:

- (a) **Duty:** Every Director, MD, Manager and Secretary of the Company is duty bound to disclose to the Company, the particulars relating to appointment or relinquishment of office as Director / MD / Manager / Secretary, in any other Body Corporate.
- (b) **Time limit:** Such should be made within 20 days from the date of appointment or relinquishment of office in any other Body Corporate.
- (c) **Default:** Failure to furnish the required particulars is punishable with a fine upto ₹ 5,000.

3. Filing with ROC: The Company should file e-Form 32 containing the particulars stated in the Register of Directors, to the ROC, within the following time limits :-

Situation	Time Limit
Appointment of First Directors	Within 30 days from the date of appointment.
Notification of change in Directors	Within 30 days from the date of change.

4. Consequences of non-compliance: The Company and every Officer in default shall be punishable with a fine upto ₹ 500 for every day of default.



5. Inspection [Sec. 304]:

(a) **Time:** Register of Directors kept by the Company is open for inspection by any person, during the business hours of the Company, subject to reasonable restrictions imposed by the Company in its AOA or in a resolution passed in the General Meeting. However, inspection should be allowed for a minimum of 2 hours in each day.

(b) Fees payable:

Inspection by	Fees Payable
Member	Nil (Members entitled to inspect free of charge)
Any other person	₹ 1 for each inspection.

(c) **Default:** If the inspection of Register is refused,

- ❖ The Company and every Officer in default shall be punishable with a fine upto ₹ 500.
- ❖ The Tribunal may, by order, compel an immediate inspection of the Register.

6. **Register kept by ROC [Sec. 306]:** The ROC shall maintain separate Register(s) in respect of each Company, so that all entries in respect of a Company are kept together. Such Register is open for public inspection, on payment of the prescribed fees.

Register of Directors' Shareholdings [Sec. 307]

1. **Contents of Register:** A Company should maintain a Register showing the following particulars in respect of each of its Directors (including Deemed Directors) -

(a) Number, Description and Amount of the Shares/Debentures of the Company or its Subsidiary or Co-Subsidiary or Holding Company -

- ❖ held - (i) by Himself, or (ii) in Trust for him, or
- ❖ Where he has any right to become the Holder whether on payment or not. [See Note below]

(b) Date of the transaction. [In case of interval between the agreement for the transaction or completion thereof, the date of the agreement shall be entered.]

(c) Price or any other consideration for the transaction.

(d) Nature and extent of any interest or right over any Shares / Debentures. [Note: Point (d) to be recorded in the Register, only if the Director so requires.]

Note: A Director shall be deemed to hold, or to have interest or right in any Shares/Debentures when a Body Corporate other than a Company holds or has interest or right in those Shares/ Debentures, and

- ❖ That Body Corporate or its Board is accustomed to act in accordance with his directions or instructions, [i.e. control over Board]
- ❖ He is entitled to exercise or control atleast 1/3rd of the total voting power at the General Meeting of that Body Corporate [i.e., control over Voting]

2. Duty of Directors [Sec. 308]:

(a) **Disclosure:** Every Director of the Company is required to give notice to the Company, as to the details of his Shareholdings, so as to facilitate the Company to comply with Sec.307.

(b) **Notice:** Such Notice shall be -

- ❖ in writing.

- ❖ given at the meeting of the Board of Directors. If not, the Director concerned should ensure that it is brought and read at the first Board Meeting after it is given.

(c) Default: Failure to comply with Sec.308 is punishable with imprisonment upto 2 years and / or fine upto ₹ 50,000.

3. Place: The Register should be kept at the Registered Office of the Company.

4. Inspection: Register of Directors' Shareholdings is open for inspection, during the business hours of the Company, subject to reasonable restrictions imposed by the Company in its .ADA or in a resolution passed in the General Meeting. However, inspection should be allowed for a minimum of 2 hours in each day, as follows –

Person entitled to inspect	Time for inspection
(a) Any Member or Debentureholder	14 days before the date of AGM and 3 days after its conclusion. Note: In computing the period of 14 days and 3 days, Saturday, Sunday and public holidays should not be considered.
(b) Any person having the right to attend the AGM.	During the continuance of the AGM. [Note: Register shall be produced at the commencement of every AGM]
(c) Any Representative of Central Government or ROC	At any time.

5. Copy of Register: The Central Government or the ROC may, at any time, require a copy of the Register or any part thereof.

6. Non-compliance: The Company and every Officer in default shall be liable in the following manner –

Act/Omission/Failure	Penalty
(a) Failure to produce the Register at the AGM	Fine upto ₹ 5,000
(b) Failure to enter particulars in the Register	Fine upto ₹ 50,000, and further fine upto ₹ 200 per day of default.
(c) Refusal of inspection or providing copies	

Note: In the case of (c) above, the Tribunal may, by order, compel an immediate inspection of the Register.

e.g.-A member wants to inspect the Register of Directors' Shareholdings on a day other than the date on which the AGM of the Company is held. As a Secretary of a Public Company, how will you deal with the above situation?

Member is entitled to inspect the Register of Directors' Shareholdings in the following manner-

Person entitled to inspect	Time for inspection
(a) Any Member or Debentureholder	14 days before the date of AGM and 3 days after its conclusion. Note: In computing the period of 14 days and 3 days, Saturday, Sunday and public holidays should not be considered.
(b) Any person having the right to attend the AGM.	During the continuance of the AGM. [Note: Register shall be produced at the commencement of every AGM]

If a Member wants to inspect the Register beyond the period stipulated above, it is not necessary for the Company to make available the Register for inspection. [Sec.307(5)]



1.1.2. Powers of the Board

GENERAL POWERS

Various Powers of the Board of Directors

1. Exercisable at Board Meeting	Certain powers can be exercised only at the Board Meeting. These include making call on shares, authorizing buy back, issuing debentures, etc.
2. With Consent of General Meeting	❖ These are powers which the Board of Directors can exercise only with the consent of General Meeting. ❖ These affect substantially the very existence of the Company and affect its operations. ❖ These include disposing undertakings of the Company, remission of debt due by Director, investment, borrowal, etc.
3. Others -General Powers	❖ These include all other powers which the Company is authorized to do. ❖ These powers are exercisable by the Board as the custodian to the interest of the Company and its Shareholders. ❖ These include powers of management and administration, institute a suit, etc. ❖ These powers may be exercised either - (a) at Board Meetings, or (b) by Circular Resolutions, or (c) by delegating to Committees or others.

Distinction between the following categories of powers and activities is also relevant -

1. Powers and activities in respect of which the Directors have complete discretion.
2. Activities where approval of the Shareholders is required, but the third parties would be protected if the Board acts without the consent of the Company.
3. Power which only the Shareholders can exercise. At times, the Company can exercise these powers only subject to the approval of the Central Government.

Powers that are exercisable by the Board of Directors [Sec. 291]

1. Primary power: The Board is empowered to exercise all powers and do all acts and things as the Company is authorised to do,

2. Restrictions;

- (a) **Powers of General Meeting:** The Board shall not exercise such powers as are required to be exercised by the Company in its General Meeting under -
- the Companies Act, or any other Act, or
 - MOA and AOA of the Company, or
 - otherwise (say when the General Meeting reserves the right to appoint Additional Directors).
- (b) **Consistency:** The powers exercised by the Board should be in conformity with the provisions of - (i) the Companies Act, (ii) any other Act, (iii) Memorandum or Articles, or (iv) regulations made by the Company in its General Meeting.

Note: Regulations subsequently made by the Company in its General Meeting cannot invalidate any prior act of the Board which was otherwise valid.

3. Powers of Shareholders to Impose Restrictions:

- (a) Power: Shareholders are empowered to impose restrictions on the exercise of any power by the Board of Directors.
- (b) Prospective Restriction and not retrospective: No such restriction shall invalidate any act

done by the Board before such restriction was placed on their powers. Regulations made by the Company in a General Meeting shall not invalidate any prior act of the Board which was otherwise valid.

Company in a General Meeting cannot override the Board's power of carrying on the business, by prescribing a regulation, or passing a resolution, taking away the powers which have been conferred upon the Board by the AOA or the Act. **[Automatic Self Cleaning, etc. vs Cunningham]**

4. Power to Initiate Suit:

- (a) Board's Power: Board is also empowered to initiate legal proceedings. Shareholders cannot fault the decision of the Board to institute legal proceedings.
- (b) No power for Individual Directors: Director, MD or WTD have no implied authority to institute legal proceedings on behalf of the Company, as such.
- (c) Exceptions: A Director may have such a power in any of the following ways –
 - ❖ Board should have authorized the Director vide a resolution passed in a properly convened-meeting,
 - ❖ Power is conferred upon the Director by the AOA of the Company,
 - ❖ Director concerned holds a Power of Attorney authorizing him to institute a suit.

5. Powers of Ratification:

Ratification by Board	(a) (b)	Board can ratify all acts done by others, which the Board could have done itself. It cannot ratify anything which the Company in the General Meeting alone could have done.
Ratification by Shareholders	(a) (b)	Where Board has done certain acts and exercised certain powers which are reserved for the Shareholders by the AOA, then the Shareholders may ratify such acts. If the Board's act is ultravires MOA or contrary to law, the act cannot be ratified.

Agreements to restrain the Directors from exercising their management powers in the interest of the Company in accordance with the Articles of the Company do not bind the Company even if the Directors in their capacity as Shareholders have made themselves a party to the agreement. **(Rolta India Ltd vs Venire Industries Ltd 100 CC 19)**

Conditions incidental to the exercise of general powers by the Board

1. Restraining Powers of Board:

- (a) Shareholders: Shareholders are empowered to exercise all the powers of the Board in the following cases-
 - ❖ Board has been acting malafide,
 - ❖ Board is incompetent to Act.
 - ❖ There is a deadlock in the Board.
- (b) Injunction by Member: Member of the Company can apply to the Court for obtaining an injunction to restrain the Board from acting beyond its powers.

2. Decisions of the Board:

- (a) **Decision by Majority:** Generally, any question arising in any Board Meeting should be decided by a majority of votes.
- (b) **Unanimous Decision:** In case of Public Limited Company, the following powers can be exercised by the Board only by passing a unanimous resolution at a Board Meeting-



- ❖ Appointment of MD/Manager where the Person is already a MD/Manager of any other Company. [Sec.316 and 386]
- ❖ Make any inter-corporate loan or investment, or give any security or guarantee to any other Body Corporate. [Sec.372A]

3. Delegation of Powers: Powers of the Board can be delegated by the Board to the MD or any other Office or Employee of the Company. However, the Board should be authorized by the Company's ADA to do so.

II. POWERS EXERCISABLE AT BOARD MEETINGS

Powers that can be exercised by the Board only at its meeting [Sec.292]

1. Sec.292 Powers: The Board of Directors shall exercise the following powers on behalf of the Company, only by passing resolutions in a properly convened Board Meeting -

- (a) Power to make calls,
- (b) Power to authorise buy-back of Shares,
- (c) Power to issue Debentures,
- (d) Power to borrow moneys otherwise than by Debentures,
- (e) Power to invest the funds of the Company, and
- (f) Power to make loans.

Note:

- In respect of OD/ CC/ other credit facilities with Bankers, the arrangement/ obtaining of such credit facilities is relevant, and not the actual day-to-day operation thereof,
- For Sec. 25 Companies, the last 3 powers may be decided by circulation also.

2. Delegation of powers: By passing a resolution at a Board Meeting, the Board may delegate the following powers -

Power delegated	Resolutions must specify	Posers may be delegated to
To borrow moneys otherwise than on Debentures	Total amount outstanding at any one time up to which the moneys may be borrowed by the delegate.	(a) Committee of Directors, (b) Managing Director, (c) Manger, (d) Any other Principal Officer of the Company, or (e) Principal Officer of the Branch Office, if any.
To invest funds of the Company	❖ To amount up to which the funds may be invested, and ❖ Nature of Investments.	
To make Loans	❖ Total amount up to which Loans may be made, ❖ Purpose for which Loans may be made, ❖ Maximum Amount of Loans which may be made for each purpose in individual cases.	

3. For a Banking Company -

- (a) "Borrowings" does not include acceptance of deposits of money from public in the ordinary course of its business repayable on demand and withdrawable by cheque, draft or otherwise.
- (b) Making Loans excludes placing of moneys on deposits with other Banking Companies, on such conditions prescribe by the Board.

- (c) Borrowings exclude "Borrowing" by one Banking Company from - (i) other Banking Companies, (ii) RBI, (iii) SBI, (iv) any other Bank(s) established under a Statute.

4. Restriction on Powers:

- (a) **Restriction by Shareholders:** Company in General Meeting can impose restrictions and conditions on the exercise of any of the above powers by the Board.
- (b) **Restriction by Board:** While delegating any of the powers as mentioned in Point 2 above, the Board can impose such restrictions and conditions on exercise of powers as it deems fit.

Provisions in case of Borrowings by Board of Directors in excess of its powers

In case of Borrowings by the Board of Directors in excess of its powers, the following points are applicable -

- 1. Repayment:** The Company can repay such loan on its own volition, in the normal course of business. There is nothing to prevent the Company from repaying any such loan, if it wishes to do so.
- 2. Tracing of Loan:**
 - (a) If the whole or any part of such loan can be traced as existing in the Company's hands or as specific investments or in specific shape, the Lender can recover the same by obtaining a tracing order from the Court.
 - (b) Where the moneys received from him still remain in the hands of the company, the Lender has a right to trace them. He can also restrain the Company by injunction from spending them.
 - (c) However, the moneys paid by the Company to third party Creditors in discharge of their debts, out of the ultra vires borrowings, cannot be traced. Tracing applies only where the moneys can still be identified as a separate and distinct fund.
- 3. Subrogation:** If the borrowed- moneys have been used to pay legitimate debts of the Company, the Lender may claim a right of subrogation, i.e. by standing in the shoes of the Creditor(s) paid off with his moneys. He can sue the Company to the extent his moneys have been so used.
- 4. Increase in Assets:** Even though the moneys advanced by the Lender cannot be traced, if it can be shown that the Company has benefited thereby, either by an increase in its assets or in any other manner, the Lender can claim repayment of his moneys from out of such increased assets, or other benefits.
- 5. Breach of Warranty of Authority:**
 - (a) In cases of ultra-vires borrowings, the Directors themselves may also be held personally liable for breach of implied warranty of authority.
 - (b) The Lender may recover damages from the Directors for breach of warranty of authority except where the Lender could have discovered from the Company's documents filed with the ROC that the loan was ultra-vires.
- 6. Guarantee by Directors is valid:** Where the Directors gave a guarantee to the Lender that they would pay him should the Company fail to do so, they were held liable in terms of their guarantees although the loan was ultra-vires. This is based on the principle that a Company is bound by all transactions formulated by its Directors, so long as other party is acting in good faith'

Powers of the Board that requires approval of Shareholders at the General Meeting [Sec.293]

- 1. Applicability:** Board of Directors of a Public Company or its Subsidiary (including Sec. 25 Company).
- 2. Powers to be exercised only with consent of General Meeting:** The following powers can be exercised by the Board only with the consent of Shareholders in a General Meeting -



Power

- (a) Sell, lease or dispose off the whole or substantially the whole of the undertaking(s) of the Company.
- (b) Remit or give time for repayment of a debt due by a Director.
- (c) Invest otherwise than in Trust Securities, the amount of compensation received from compulsory acquisition of -
 - Any undertaking(s) of the Company,
 - Any premises or properties used for any undertaking(s) and without which it cannot be carried on or can be carried on only with difficulty or can be carried on only after a considerable time.
- (d) Borrow money, if the money already borrowed other than Temporary Loans, together with the amount to be borrowed exceeds the aggregate of the Paid Up Capital and Free Reserves of the Company,
- (e) Contributions to Charitable and other Funds not directly related to the business of the Company or welfare of the employees of the Company, if the aggregate of contributions made during the Financial Year exceeds the higher of the following:
 - ❖ ₹ 50,000, or
 - ❖ 5% of the Average Net Profits determined u/s 349 & 350 during the immediately preceding 3 Financial Years.

3. Prior approval:

- (a) The powers are exercisable by the Board only with the prior consent of the General Meeting. The Board cannot exercise the powers in the hope that the General Meeting will ratify their actions.
- (b) However, Shareholders have the powers to ratify the act of the Board of Directors if it is not beyond the powers of the Company as laid down in its MOA.

4. Specifications in Resolutions:

Power accorded to BOD as per resolution	Contents of Resolution
(a) To sell or lease or otherwise dispose of the whole or substantially whole of the undertaking(s).	Conditions regarding the use, disposal or investment of the sale proceeds which may result from the transaction.
(b) To borrow money exceeding the Paid Up Capital & Free Reserves of the Company.	Total amount upto which money may be borrowed by the Board of Directors.
(c) To make contributions to Funds.	Total amount which may be contributed to Charitable and any other Funds during the Financial Year.

5. Special Considerations:

Power	Special Considerations / Points
(a) Sale/Lease/ Disposal of Company's undertaking(s)	❖ Selling or leasing of any property of the Company, where the ordinary business of the Company comprises of selling or leasing does not require approval of the General Meeting. ❖ Title of a Buyer / other person who buys or takes a lease of the undertaking, is not affected if - (i) he takes it in good faith, and (ii) after exercising due care and caution.

(b) Remission of Debt due by Director	Renewal or continuance of an advance made by Banking Company to its Director, in the ordinary course of business, does not require approval in a General Meeting.
(c) Investments of Compensation Amount	Restriction is imposed only on investments otherwise than in Trust Securities. So, the Company may invest in Trust Securities, without approval in General Meeting,
(d) Borrowing in excess of aggregate of Paid Up Capital and Free Reserves	❖ Temporary Loan include loans repayable on demand or within 6 months from the date of the loan as, e.g. (i) Short-Term Loans (including short term loans of a seasonal character), (ii) Cash Credit Arrangements, (iii) Discounting of Bills. ❖ Temporary Loans does not include loans raised for the purposes of financing capital expenditure. ❖ Acceptance of deposits from the customers does not amount to Borrowings made by Banking Company. ❖ Validity of Debt: Debt incurred by the Company in excess of the limit imposed u/s 292 shall not be valid, unless the Lender proves that he has advanced the loan - (i) in- good faith, and (ii) without knowledge of the fact that the limit has been exceeded.

Borrowing of money by the Board of Directors of Sec.25 Company

1. If a Sec. 25 Company has no Paid-Up Capital or Free Reserves, it means that the amount of such Capital or Free Reserves is arithmetically zero. Therefore, the Board of Directors cannot borrow at all, and any borrowing requires the approval of the members in the General Meeting,
2. However, such Company can apply to Central Government to issue an order u/s 25 exempting that Company(ies) from the provisions of Sec.293. [F. No. 38/2/68-CL-III]

POWERS OF DIRECTORS

Section	Description of the matter
A. General Powers of the Board	
291	Exercising all the powers of the Company as authorized by the Act, MOA and ADA, etc.
B. Powers exercisable only at a Board Meeting	
77A	To make declaration of solvency for buy-back of Shares.
262.	To fill up of casual vacancies on the Board.
292(1)(a)	To make calls on Shareholders.
292 (1)(aa)	To authorise buy-back u/s 77A(2)(b) First proviso.
292(1)(b)	To issue Debentures.
292(1)(c)	To borrow money otherwise than on Debentures,
292(1)(d)	To invest Company's funds.
292(1)(e)	To make Loans.
292(1) Proviso	To delegate powers u/s 292(1)(c), 292(1)(d) and 292(1)(e) to a Committee/ MD/ Manager/ Principal Officer.
293A	To make Political Contributions.
297	To give consent to contracts in which Director(s) is interested.
299	To receive notice of disclosure of interest by a Director.
308	To receive notice of disclosure of Director's Shareholdings.
316/ 386	To sanction (by unanimous consent), appointment of a person as MD/ Manager who is already a MD/ Manager of another Company. [Applicable only to Public Companies]



372A	To sanction (by unanimous consent) Inter-Company loans/ investments/ guarantees/ securities,.
488	To make declaration of solvency in case of voluntary winding-up of the Company.
C. Powers exercisable only with consent of General Meeting	
Applicable only to Public Companies and its Subsidiary	
269, 386 & Sch. XIII	Appointment of Managing Director, Whole-Time Director and Manager.
293(1)(a)	Sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking(s).
293(1)(b)	Remission of a debt due by a Director.
293(1)(c)	Investment of compensation money received on compulsory acquisition of any of its properties.
293(1)(d)	Borrow moneys in excess of Paid-Up Capital and Free Reserves of the Company.
293(1)(e)	Contribution to Charitable and Other Funds not related to the business of the Company or welfare of its employees, in excess of prescribed limits.
Applicable to all Companies	
294(2)	Appointment of Sole Selling Agents.
314	Appointment of a relative of a Director, to an Office or Place of Profit.

Draft a resolution proposed to be passed at a General Meeting of a Public Company, giving consent to the Board of Directors for borrowing up to a specified amount in excess of the limits laid down u/s 293(1) (d). Also state the borrowings, which are to be exclude from the said limits.

Draft Resolution of Shareholders

RESOLVED THAT the Company hereby consents to the Board of Directors borrowing monies not exceeding ₹ 50,00,000 (Rupees Fifty Lakhs only) in excess of the aggregate of the Paid-Up Capital of the Company and its Free Reserves, that is to say Reserves not set apart for any specific purpose, as provided in Sec. 293(1)(d) of the Companies Act, 1956, and in addition to any Temporary Loans obtained from the Company's Bankers in the ordinary course of business.

For exclusions from term "Borrowings", refer Powers of the Board that requires approval of Shareholders at the General Meeting [Sec.293]

1.8.3. Corporate Governance & Audit Committee

Corporate Governance

Corporate Governance is the system by which Companies are directed and controlled by the management in the best interest of the stakeholders and others, ensuring greater transparency and better and timely financial reporting, the Board of Directors are responsible for governance of their Companies.

Audit Committee [Sec. 292A]

- 1. Meaning:** Audit Committee is considered as an extended arm to assist in accomplishing Board's objectives. It is a positive step as it strives to enhance the credibility and integrity of Financial Statements.
- 2. Benefits of Audit Committee:**
 - (a) **Reduces burden of top management:** The Committee helps the Board to discharge its responsibilities in an efficient and effective manner with due care and diligence. It reduces the burden of top management by providing the Board with sound recommendations based on interactions with Internal and Statutory Auditors.
 - (b) **Better Involvement:** It facilitates greater personal involvement by all Directors, especially the Non-Executive Directors in financial and audit aspects of the Company.

- (c) **Independence of Statutory Auditors:** The existence of the Audit Committee and facility to attend the meetings of the Committee as a special invitee, reinforces the Auditor's independence in general.
- (d) **Improvement in Internal Control System:** By establishing a direct communication link with the Internal Auditor, the Committee provides him necessary independence and also appraises the effectiveness of the internal controls. It can suggest overall improvement in the internal controls.
- (e) **Management Audit:** The Committee may perform an objective review of management's financial policies, accounting policies and operations, and provides warning signals in case of misreporting and mismanagement.

Provisions relating to Audit Committee u/s 292A.

- 1. Paid Up Capital Condition:** Every Public Company having Paid-Up Capital of not less than ₹ 5 Crores, shall constitute a committee of the Board known as "Audit Committee."
- 2. Number of Members:** The Committee shall consist of not less than three Directors and such number of other Directors as the Board may determine, of which 2/3rd of the total number of members shall be Directors, other than Managing or Whole-Time Directors. The members of the Audit Committee shall elect a Chairman from amongst themselves.
- 3. Rights of Committee:**
 - (a) Every Audit Committee constituted u/s 292A(1) shall act in accordance with terms of reference to be specified in writing by the Board.
 - (b) The Committee shall have full access to information contained in the records of the Company and external professional advice, if necessary, for investigation into any matter u/s 292A or as referred by the Board.
 - (c) The Auditors, the Internal Auditor, if any, and the Director-in-charge of Finance shall attend and participate in the meetings of the Audit Committee but shall not have the right to vote.
 - (d) The recommendations of the Committee on any matter relating to Financial Management, including Audit Report, shall be binding on the Board. If the Board does not accept the recommendations of the Audit Committee, it shall record the reasons therefor & communicate such reasons to the Shareholders.
 - (e) The Annual Report of the Company shall disclose the composition of the Audit Committee.
 - (f) The Chairman of the Audit Committee shall attend the AGM's of the Company to provide any clarification on matters relating to audit.
- 4. Functions of Committee:**
 - (a) To discuss with the Auditors periodically about internal control systems, scope of audit and observations of the Auditors,
 - (b) To review the half-yearly and annual financial statements before submission to the Board,
 - (c) To ensure compliance of internal control systems,
 - (d) To investigate into any matter in relation to the items u/s 292A or referred to it by the Board.
- 5. Penalty for default:** In case of default u/s 292A, the Company, and every Officer who is in default, shall be punishable with imprisonment for a term upto one year, or with fine upto ₹ 50,000, or with both.



Clause 49 of the Listing Agreement of SEBI in connection with Corporate Governance and Audit Committee.

Clause 49 of the Listing Agreement with SEBI lays down the following in respect of Audit Committee -

1. **Applicability:** An Audit Committee shall be set up - (a) All Companies seeking listing for the first time, at the time of seeking in-principle approval for such listing, and (b) all existing listed Companies with a Paid-Up Capital of ₹ 3 Crores or more, or Net Worth of ₹ 25 Crores or more, at any time in the history of the Company.
2. **Composition:** A qualified and independent Audit Committee shall be set up giving the terms of reference, and subject to the following:-
 - (a) The Audit Committee shall have minimum 3 members. 2/3rd of the members of the Audit Committee shall be Independent Directors.
 - (b) All members of the Audit Committee shall be financially literate (i.e. the ability to read and understand the basic Financial Statements i.e. Balance Sheet, P&L Account and Statement of Cash Flows). Atleast one member shall have accounting or related financial management expertise.
 - (c) The Chairman of the Committee shall be an Independent Director,
 - (d) The Chairman shall be present at the AGM to answer Shareholder queries.
 - (e) The Audit Committee should invite such of the executives, as it considers appropriate (and particularly the head of the Finance Function) to be present at the meetings of the Committee, but on occasions it may also meet without the presence of any executives of the Company. The Finance Director, Head of Internal Audit and when required, a representative of the External Auditor shall be present as invitees for the meetings of the Audit Committee.
 - (f) The Company Secretary shall act as the Secretary to the Committee.
3. **Meetings and Quorum:** The Audit Committee shall meet at least 4 times a year and not more than 4 months shall elapse between two meetings. The quorum shall be either 2 members or 1/3rd of the members of the Audit Committee whichever is higher, and minimum of 2 Independent Directors.
4. **Powers of Committee:** The Audit Committee shall have powers, which should include the following –
 - (a) To investigate any activity within its terms of reference,
 - (b) To seek information from any employee,
 - (c) To obtain outside legal or other professional advice,
 - (d) To secure attendance of outsiders with relevant expertise, if it considers necessary.

Clause D deals extensively with the Role of Audit Committee.

5. **Review of Information:** The Audit Committee shall mandatory review the following -
 - (a) Management discussion and analysis of financial condition and results of operations,
 - (b) Statement of significant Related Party transactions (as defined by the Audit Committee), submitted by management,
 - (c) Management Letters / Letters of Internal Control Weaknesses issued by the Statutory Auditors,
 - (d) Internal Audit Reports relating to Internal Control Weaknesses, and
 - (e) Appointment, removal and terms of remuneration of the Chief Internal Auditor.

Draft Board Resolution for constituting an Audit Committee

RESOLVED THAT pursuant to Section 292A of the Companies Act, 1956, an Audit Committee consisting of the following Directors be and is hereby constituted.

1. Shri _____ Nominee of IDBI.
2. Shri _____ Nominee of State Bank of India.
3. Shri _____ Nominee of Canara Bank.
4. Shri _____ Director.
5. Shri _____ Finance Executive.
6. Shri _____ Managing Director.

FURTHER RESOLVED that the Chairman of the Audit Committee shall be elected by its Members from amongst themselves.

FURTHER RESOLVED that the quorum for a meeting of the Audit Committee shall be 1/3rd of the total number of Members or Two Directors (other than the Managing Director) whichever is higher.

FURTHER RESOLVED that the Audit Committee shall have the authority to investigate into any matter that may be prescribed under the said Section 292A and any other matter that may be referred to it by the Board from time to time.

FURTHER RESOLVED that the Audit Committee shall conduct discussion with the Auditors periodically about the internal control systems, the scope of audit including the observation of Auditors.

FURTHER RESOLVED that the Audit Committee shall review the quarterly and annual Financial Statements and submit the same to the Board with its recommendations, if any.

1.1.4. Duties And Liabilities of Directors.

Duties of Directors of a Company.

1. To acquire and maintain a sufficient knowledge and understanding of the Company's business to enable them to properly discharge their duties as Directors.
2. To attend all such Board Meetings as he is reasonably able to. [A Director is not bound to attend all Board and Committee Meetings, and he is not bound to give continuous attention to the affairs of the Company.]
3. To exercise all the powers vested on them in good faith and in fiduciary capacity, since they are Trustees of the Company.
4. Not to divulge confidential information/ insider information -
 - (a) **Prohibited:** Directors are Trustees of the Company and not of any Shareholder. He has access to insider information, which he should not disclose to any shareholder, who upon such information may buy or sell the shares of the Company.
 - (b) **Exception:** Director may owe a fiduciary duty to shareholders in case where they are negotiating terms of sale of issued shares of the Company i.e. where the Directors approach the shareholders and not vice versa for sale of shares.
5. To exhibit as much skill and care as may be reasonably expected from a person of his knowledge and experience in the performance of his duties.
6. To act honestly. A Director is liable to the Company for any of his underhand dealings irrespective of whether or not the Company suffers on account of such underhand dealings.

Examples: Allotment of Shares to Minor, Non-Disclosure of his interest in any transaction, fraudulent misrepresentation to Co-Directors etc. are all dishonest acts.
7. Though the Director is not duty bound to detect the frauds of Officers of the Company, he should



enquire into slightest of suspicions that may rise. Failure to make the enquiry will render him guilty of dereliction of duty and be liable for damage emerging from such dereliction.

8. To ensure that the Company's moneys are properly invested, unless the AOA warrant the delegation of this duty to others.
9. To ensure accurate compilation and updation of records and registers of the Company like Statutory Registers, Financial Records, etc.
10. Not to act in a manner prejudicial to public interest or oppressive to any Members. If they so act, proceedings will be against them u/s 397,

Directors' Liability towards Shareholders.

The liability of Directors towards Shareholders can be summarized as under: -

1. Negligence:

Liabe	Not Liabe
Directors are liable to Shareholders for negligence if they, while acting within their powers, fail to exercise as much reasonable skill and diligence as is expected from persons of their knowledge and experience in the management of the Company.	• Directors are not liable for errors of judgement which might result in loss to the Company, if they acted bonafide for the benefit of the Company and with such a care as may be reasonably expected of them. • The burden of proving bad faith lies on the person who challenges the act of the Directors.

2. Misfeasance and Breach of Trust:

Misfeasance	Directors are liable for any breach of duty in the conduct of the Company's affairs, which causes Misfeasance loss to the Company, e.g. allotment of Shares to a Minor, giving fraudulent preference to a Creditor, etc.
Breach of Trust	Breach of Trust encompasses misapplication of the funds of the Company. Example: Payment of Dividend out of Capital.

3. Ultra-Vires acts:

Meaning	Ultra Vires acts are those which are done by a person which are in excess of the powers conferred on him. If Directors do any act which is beyond their authority as defined by the AOA, it is called ultra vires Directors.
Ratification	If such acts are not beyond the powers of the Company as laid down by its MOA, the Company). Such Shareholders may ratify such ultra vires acts (which are intra vires the ratification will make these acts valid and binding on the Company.

4. **Acts of Co-Directors:** Generally Directors are not responsible for the acts and defaults of Co-Director, unless he has expressly or impliedly authorized the same. However, Directors are jointly and severally liable for a breach of trust. **[Cargil vs Bower]**

Directors' Liability towards Third Parties.

The liability of Directors towards Third Parties can be summarized as under –

1. Contracts on behalf of Company:

Not Liabe	Liabe
Generally, Directors are not personally liable in respect of contracts entered into by them on Company's behalf, since they act as agents of the Company.	• They are personally liable if they act, without the authority of the Company, on the ground of breach of warranty of authority. • They may also be liable, if they have expressly or impliedly undertaken to be personally responsible for their act.

2. Frauds and Tortuous Acts:

Not Liable	Liable
A Director would not be liable for the fraud of his Co-Director, unless it has been authorized by him, or he has participated therein.	Directors are personally liable - (a) if they commit or authorise a tortuous act, even if are acting as agents of the Company. (b) for commitment or authorization of fraud, e.g. issue of a fraudulent prospectus.

3. Statutory Liabilities: A brief list of liabilities imposed on Directors by the Companies Act are as under -

- (a) Mis-statement in Prospectus u/s 62 to prospective subscribers,
- (b) Irregular Allotment u/s 71
- (c) Failure to return application moneys where minimum subscription has not been raised within the prescribed period, u/s 69 or u/s 73.

Provisions of the Companies Act relating to unlimited liability of the Directors. [Sec.322 & 323]

Generally, in a Company with limited liability, the liability of Directors is limited to the amount remaining unpaid on their Shares. However, if the MOA permits the Company to have Directors with unlimited liability, then their liability is unlimited. A Limited Company may also alter its MOA by special resolution so as to make the liability of its directors unlimited. [Sec.322 and 323]

1. Condition in MOA:

(a) **Clause in MOA:** In a limited Company, the MOA may provide for unlimited liability of the Directors or Manager.

(b) Alteration of MOA:

- ❖ Where MOA does not contain provide for unlimited liability, the Company may, if authorised by its AOA, pass a special resolution altering the MOA so as to render unlimited liability of any Director or Manager.
- ❖ On passing of the special resolution, the provisions thereof shall be as valid as if they had been originally contained in the MOA.
- ❖ The alteration of MOA making the liability unlimited shall not apply to the Director who was holding office before the date of alteration, until the expiry of his then term, unless he has given his consent to his liability becoming unlimited.

2. **Statement of Unlimited Liability:** In a Limited Company in which the liability of a Director or Manager is unlimited, the - (a) Directors, (b) Manager, and (c) Member who proposes a person for appointment to the office of Director/Manager, shall add to that proposal, a statement that the liability of the person holding that will be unlimited.

3. **Notice of Unlimited Liability:** A written notice of his unlimited liability should be given to the Director or Manager, before his acceptance of office, by-(a) Promoters, or (b) Directors, (c) Manager, or (d) Officers of the Company.

4. **Non-compliance:** Persons who fail to comply with Points 2 and 3 above shall be -

- (a) punishable with a fine which may extend to ₹ 10,000.
- (b) liable for any damages sustained by the person due to default.

Note: However, the liability of the person appointed shall not be affected by the default.



Rights and liabilities of Directors for their ultra vires acts.

- 1. Classification:** Ultra vires acts of Directors may be classified as -
 - (a) Those which are beyond their authority but within the Company's powers (i.e. intra vires the Company), and
 - (b) Acts which are beyond their authority as well as the Company's.
- 2. Ratification of acts ultra vires Directors but intra vires Company:**
 - (a) Directors are agents of the Company, and hence cannot do anything, which the Company itself cannot do under its MOA.
 - (b) Where they make a contract within the powers of the Company (i.e. intra vires the MOA) but ultra vires the powers conferred on them, then the Company may ratify the contract in General Meeting and be bound by it. **[Grant vs United Kingdom Switchback Railway]**
 - (c) If the Company does not ratify such contract then the Company will not be bound by the contract. Consequently, Directors will remain liable to the other party to the contract for the breach of an implied warranty of their authority. **[Weeks vs Proper, Starkey vs Bank of England]**
- 3. Acts ultra vires Directors and Company, e.g. payment of interest out of capital:**
 - (a) Payment of interest out of Capital is ultra vires act, since funds of a Company can be applied in carrying out its permitted objects. Therefore, Directors can be compelled to repay the money to the Company even after it goes into liquidation. **[Sharpe]**
 - (b) Directors so compelled to refund the money to the Company could claim to be indemnified by the Payees who received the money from the Directors with the knowledge that the payment to them was ultra vires. This is because Payees would be Constructive Trustees of the money. **[Russel vs Wakefield Water Co.]**

1.1.5. Powers related to- Political Contributions, Sole Selling agent, Loans to Directors, Interested Directors, Office or Place of Profit.

Powers related to Political Contribution [Sec.293A]

1. Meaning of Political Contribution:

- (a) Political Contribution means contribution of amount(s), directly or indirectly, to -
 - Any Political Party (i.e. a Political Party registered u/s 29A of Representation of the People Act, 1951), or
 - Any person for any political purpose.
- (b) Deemed Political Contribution:
 - Donations resulting in support to a Political Party: Donation, subscription or payment made by a Company to a person who to its knowledge is carrying on any activity which is likely to effect public support for a political party, shall be deemed to be subscriptions made to such person for political purposes.
 - Advertisement in Publications: Amount of expenditure incurred directly or indirectly by a Company, on advertisement in any publication in the nature of a souvenir, brochure, tract, pamphlet, by or on behalf of a Political Party or for its advantage shall also be deemed to be political contributions.

2. Companies Prohibited: The following Companies are prohibited from making any political contribution -

- (a) Government Company,

(b) Any other Company which has been in existence for less than 3 Financial Years.

3. Restriction on amount of contribution: Other Companies (i.e. Non-Government Companies which are in existence for 3 years or more) may make political contributions. But, the aggregate amount of contribution in a financial year shall not exceed 5% of Average Net Profits determined u/s 349 & 350 during 3 immediately preceding financial years.

4. Conditions for making Political Contribution:

(a) The power to make political contribution shall be exercised only by way of passing a resolution at a Board Meeting.

(b) The Company shall disclose the following particulars in its P&L A/c -

- Total amount of Political Contribution, and
- Name of the Political Party or person(s) to whom such amount has been contributed.

5. Penalty: Contravention of Sec. 293A shall give rise to the following -

(a) The Company shall be punishable with a fine upto 300% of the amount contributed.

(b) Every Officer in default is punishable with imprisonment upto 3 years and shall also be liable to fine.

Note: Donations u/s 293A is in addition to the limits specified in Section 293(1)(e).

Contravention: Contravention of Sec. 293A shall give rise to the following -

(a) The Company shall be punishable with a fine upto 300% of the amount contributed.

(b) Every Officer in default is punishable with imprisonment upto 3 years and shall also be liable to fine.

Contributions to the National Defence Fund and Defence related Funds. [Sec. 293B]

1. Contributions u/s 293B:

By	To
(a) Board of Directors of any Company, (b) Any person/ authority exercising the powers of the Board, or of the Company in the General Meeting.	(a) The National Defence Fund (b) Any other Fund approved by the Central Government for the purposes of National Defence.

2. Power to contribute: Such contributions can be made notwithstanding anything contained in-

(a) Sec.293/ 293A/ any other provision of the Act,

(b) MOA or AOA or any other instrument relating to the Company.

3. Disclosure: The Company should disclose the total amount contributed by it to the Fund during the Financial Year in its Profit & Loss A/c.

4. List of Approved Funds:

(a) The Chief Secretary to the Government of Andhra Pradesh, Hyderabad, National Defence Fund.

(b) The National Defence Fund, Andhra Pradesh State People's Committee.

(c) Bihar State National Defence and Jawan's Welfare Fund.

(d) The National Defence Fund, Madras.

(e) The Chief Minister's Defence Fund, Kerala.



- (f) The Chief Minister's Defence Services Welfare Fund, Rajasthan.
- (g) The Chief Minister's Defence Forces Welfare Fund, Lucknow.
- (h) The Chief Minister's Defence Purposes Fund of Uttar Pradesh, Lucknow.
- (i) The Chief Minister's West Bengal Account National Defence Fund,
- (j) The Prime Minister's National Relief Fund,
- (k) Gujarat Chief Minister's Sainik Fund.

Sole Selling Agents [Sec. 294A, 294AA]

Meaning of Sole Selling Agent (SSA).

1. A SSA is a person (Individual or Firm or Body Corporate), appointed by a Company, with exclusive rights to sell specified product(s) of the Company in specified area(s), to the exclusion of the Company itself or other parties.
2. In case of appointment of SSA, the Company is the Principal and SSA is the Agent. SSA has all rights and duties as per Contract Act. For e.g., he can exercise lien on good incase his commission is not paid to him.
3. SSA does not "purchase" goods from the Company. It only deals in those goods, under the principle of Agency.
4. SSA is not an Employee or Officer of the Company.
5. A mere Distributor of Company's products cannot become a SSA, unless such Distributor is given exclusive rights to sell the Company's goods.
6. The relationship between the Company and Appointee is relevant, and not the name by which SSA is called. If the tenor of the agreement is that of appointing a Sole Distributor for an area, such Distributor is a SSA, even if the agreement uses the words "principal-to-principal" basis. **[Shalagram Jhajharia National Company Ltd 35 CC 706]**
7. SSA is an "Office or Place or Profit". Hence Sec, 314 will be applicable to such appointments.

Authority /formalities for appointment of Sole Selling Agents and the grounds on which approval of Central Government is required for appoint of SSA.

Appointment of SSA is subject to the following formalities –

Case	Paid up Capital of Company	SSA's Interest in Company	Formalities for SSAs appointment			
			Board Resolution	Shareholders' Ap- proval	Central Govt. Approval	Sec.
1	Less than ₹ 50 Lakhs	No Substantial Inter- est	Yes	Ordinary Resolu- tion	Not required	294(2)
2	₹ 50 Lakhs or more	No Substantial Inter- est	Yes	Special Resolution	Required	294AA(3)
3	Less than ₹ 50 Lakhs	Substantial Interest	Yes	Ordinary Resolu- tion	Previous ap- proval required	294AA(2)
4	₹ 50 Lakhs or more	Substantial Interest	Yes	Special Resolution	Previous ap- proval required	294AA(2) & 294AA(3)

Course of action to be taken by a Company Secretary in case SSA does not have substantial interest

1. Call a meeting of the Board of Directors and determine the name of the SSAs to be appointed. If the Paid Up Share Capital of the Company is less than ₹ 50 Lakhs and the Appointee does not

have a substantial interest in the Company, the Board may resolve to appoint him as SSA subject to the approval of the General Meeting.

2. Fix the date for the General Meeting at the Board Meeting, where the SSA is appointed.
3. In case the Appointee either has a substantial interest in the Company, or the Paid-Up Share Capital of the Company is ₹ 50 Lakhs or more, application for the approval of Central Government should be made in Form I of the Companies (Appointment of Sole Agents) Rules, 1975.
4. See that the terms and conditions of appointment/re-appointment do not contain the tenure exceeding 5 years at a time.
5. Issue notices for holding the General Meeting. Where the Paid-Up Share Capital of the Company is ₹ 50 Lakhs or more, a special resolution should be passed, otherwise an ordinary resolution shall be sufficient.
6. Forward 3 copies of the notices and a copy of the proceedings of the General Meeting to the Stock Exchanges with which the Shares of the Company are listed (in case of Listed Companies only).
7. If the proposed SSA is to be appointed in a foreign country, obtain the prior permission of RBI (wherever applicable).

“Substantial Interest” in the context of SSA u/s 294AA

In the context of SSA, the SSA will have “Substantial Interest” in the Company -

If SSA is	Beneficial Interest is held by	Subject matter of interest
Individual	Individual or any of his relatives, whether singly or taken together.	Shares of the Company, the aggregate paid-up amount thereon exceeds the least of the following - ❖ ₹ 5,00,000, or ❖ 5% of the Paid-Up Share Capital of the Company.
Firm	One or more Partner(s) of the Firm or any relative of such Partner, whether singly or taken together.	
Body Corporate	Body Corporate or one or more of its Director(s) or their relatives, whether singly or taken together.	

Example:

If the Paid-Up Capital of a Company is-	SSA will have substantial interest if Shareholding exceeds
₹ 60 Lakhs	₹ 3 Lakhs (i.e. 3 Lakhs or 5 Lakhs, whichever is less)
₹ 120 Lakhs	₹ 5 Lakhs (i.e. 6 Lakhs or 5 Lakhs, whichever is less)

Board Resolution for appointing SSA is always conditional. Explain.

1. Appointment of SSA is valid only if the agreement contains a clause that “the appointment shall cease to be valid if it is not approved by the Company in the First General Meeting held after the date of appointment”.
2. If there is no such clause, the agreement is void ab initio. The Company / Shareholders cannot approve any agreement, which is void from the start. [Arante Manufacturing Corporation vs. Bright Bolts (P) Ltd 37 CC 758],
3. Such clause is not required where the appointment is made by the Company (directly) in a General Meeting.

Need for obtaining Central Government approval when, after appointment of SSA- (a) Paid Up Capital of the Company is increased, or (b) SSA acquires substantial interest in the Company.

From the Table given in Authority/formalities for appointment of Sole Selling Agents above, it can be observed that -

- (a) Central Government approval is required only if Paid Up Capital is ₹ 50 Lakhs or more.



(b) Prior approval of Central Government is required only if SSA has substantial interest.

If subsequent to appointment of SSA	For remaining duration of current tenure	For re-appointment
(a) Paid Up Capital increased to ₹ 50 Lakhs or more.	Central Government not required. [C.No.1/78 date 7-3-78]	Sec. 294AA (3) will apply, Special Resolution & Central Government approval is required;
(b) SSA acquires substantial interest in the Company,	Central Government not required. [C.No.11/77 date 3-11-77]	Sec. 294AA (2) will apply, prior approval of Central Government is required.
(c) Both(a)'&(b)	Central Government not required. [As per Circulars stated above]	Prior approval of Central Government & Special Resolution is required for re-appointment.

Agreement with SSA is valid only if Shareholders' approval is obtained. Explain.

Shareholder's Resolution [Sec. 294(2) & (2A)] and Validity of acts by SSA

Situation	Conditional Clause	Validity of acts done by SSA
(a) Shareholders' approval obtained	Available in SSA agreement	Subject to other formalities (Central Government approval is required) acts of SSA are valid.
(b) Shareholders' approval not obtained	Available in SSA agreement	Agreement will cease to be valid from the date of the General Meeting. All acts of SSA done upto the time of non-approval would be valid.
(c) Whether Shareholders' approval obtained or not	Not available in SSA agreement	Agreement is void ab initio. Validity of acts done by SSA is based on principles of the Contract Act.

Term of office of SSA

- SSA can be appointed for a maximum term of 5 years at a time.
- SSA can be re-appointed, or its time extended for further periods not exceeding 5 years on each occasion.

Board Resolution for appointment of a SSA who is having substantial interest in the Company.

Draft Board Resolution

RESOLVED THAT subject to the consent of the Shareholders in an Extraordinary General Meeting by a Special Resolution and subject to the approval of the Central Government, Shri.....(name) be appointed as the Company's Sole Selling Agent for a period of 5 years effective from.....(date) on a Commission of.....(percent), pursuant of the provisions of Section 294AA of the Companies Act, 1956. The appointment shall cease to be valid if it is not approved by the Company in the First General Meeting held after the date of appointment.

FURTHER RESOLVED that an Extraordinary General Meeting of the Company be convened at...(time).....(day) the.....(date) at.....(venue) to secure the consent of the Members in this regard.

ALSO RESOLVED that the Secretary of the Company be authorised to submit the application to the Central Government and comply with the necessary formalities in this regard.

Powers of the Central Government in connection with SSAs

A. No SSA for certain goods [Sec. 294AA]: The Central Government may, by Notification in Official Gazette, declare that SSA shall not be appointed by a Company for the sale of goods for specified period, if the Central Government is of the opinion that -

- Demand for goods of that category is substantially in excess of the production or supply of such goods.

2. Services of SSA will not be necessary to create a market for such goods.

B. Inquiry into existing appointments:

Particulars	Where Company has a SSA in any area	Where Company has more than one Selling Agent (SA) in any Area(s)
1. Central Govt. may require the Company to furnish information regarding terms and appointment of SSA/SA	To determine whether or not such terms and conditions are prejudicial to the interest of the Company.	To determine whether any of those Selling Agents should be declared as SSA of such area(s).
2. Scope of Central Government Order	To make such variations in those terms and conditions so as to make them no longer prejudicial to the interest of the Company.	To declare that Selling Agent be the SSA for that area, even though one or more selling Agents may be operating that area. To make suitable variations in those terms and conditions that are prejudicial to the interests of the Company.
3. Effect of Central Government order	From the date specified in the order, the appointment of SSA shall be regulated by the terms and conditions as varied by Central Government.	From the date specified in the order, the appointment of the Selling Agent declared as SSA, shall be regulated by the terms and conditions as varied by Central Government. (Note: Agreements with other Selling Agents are not affected.)

Note: In both cases –

- Investigation:** If the Company refuses or neglects to furnish the information, the Central Government may appoint a suitable person to investigate and report on the terms and conditions of appointment of SSA/ all Selling Agents.
- Duty of the Company:** It shall be the duty of the Company -
 - To produce to the Investigator, all books and papers of or relating to the Company which are in its custody or power.
 - To give all reasonable assistance in connection with the investigation, which the Company is reasonably able to give.
- Non-compliance:** If a Company refuses or neglects to furnish information or to produce any books and papers or to give any assistance to the Investigator, the Company and every Officer in default shall be punishable with fine upto ₹ 50,000 and with a further fine of not less than ₹ 500 for every day after the first day during which the refusal or neglect continues.

C. Granting approval to appointment of SSA: For appointment of SSAs –

- Central Government approval is required, if Paid Up Capital is ₹ 50 Lakhs or more.
- Prior approval of Central Government is required, if SSA has substantial interest.

Payment of compensation for loss of office [Sec. 294A]

1. Maximum Compensation:

- Maximum Compensation for loss of office payable by a. Company to its SSA shall be the remuneration which he would have earned if he had been in office for - (i) the unexpired residue of his term, or (ii) 3 years, whichever is shorter.



- (b) The remuneration shall be calculated on the basis of the average remuneration actually earned by him during a period of 3 years immediately preceding the date on which his office ceased or was terminated, or where he held his office for a lesser period than 3 years during such, period.

2. No Compensation: A Company shall not pay or be liable to pay any compensation for the loss of office to the SSA in the following cases -

- (a) Invalid appointment: The appointment of the SSA ceases to be valid due to disapproval by the Company in its General Meeting,
- (b) Re-appointment after amalgamation: The SSA resigns his office in view of the reconstruction of the Company or of its amalgamation with any other Body Corporate(s), and is appointed as the SSA of the reconstructed Company or of the Body Corporate resulting from the amalgamation.
- (c) Resignation: The SSA resigns his office as such (i.e. other than reconstruction or amalgamation)
- (d) Guilty of fraud: The SSA has been guilty of - (i) fraud, or (ii) breach of trust, or (iii) gross negligence in the conduct of his duty as the SSA.
- (e) Instigation of termination: The SSA has instigated or has taken part directly or indirectly in bringing about the termination of the Sole Selling Agency.

Loans to Directors [Sec.295]

Procedures to be complied by the Company with respect to providing Loans to its Directors [Sec. 295]

1. Transactions covered: A Company should obtain the prior approval of Central Government (by applying in e-Form 24AB), in respect of the following transactions -

- (a) Making any Loan to "Specified Person(s)", or
- (b) Giving any guarantee or provide any security, in connection with a loan made -
by any other person to the specified person, or] directly or indirectly
by a specified person to anyother person

2. Specified Persons: For Sec.295 purposes, "Specified Persons" are -

- (a) Any Director of the Lending Company,
- (b) Director of the Holding Company of the Lending Company,
- (c) Any Partner or Relative of the Director of the Lending Company,
- (d) Any Firm in which the Director or Relative is a Partner,
- (e) Any Private Company in which the Director is a Director or Member,
- (f) Any Body Corporate in which not less than 25% of the voting power is exercised by a Director singly or jointly with 2 or more Directors.
- (g) Any Body Corporate the Board of Directors / MD / Manager which is accustomed to act in accordance with the directions of the Board or Director(s) of the Lending Company,

3. Exceptions: Sec.295 restriction is not applicable to Loans, Guarantee or Security provided by -

- (a) Private Company, (unless it is a Subsidiary of a Public Company)
- (b) Banking Company,
- (c) Holding Company to its Subsidiary Company.

Penalty for contravention of Sec. 295 restrictions as to Loans to Directors

1. Every person (including the person who has availed the loan) who is knowingly a party to the contravention shall be -
 - (a) Punishable with fine upto ₹ 50,000 or imprisonment upto 6 months.
 - (b) Liable jointly or severally to the Lending Company, for the repayment of the loan or for making good the sum which the Lending Company may be called upon to pay by virtue of the guarantee or security provided.
2. In case where the loan has been repaid in full, no imprisonment shall be imposed. In case of proportional repayment, imprisonment shall be proportionately reduced.
3. No Officer of the Company shall be liable, unless at the time when the loan/guarantee/ security was made/provided by the Lending Company, he knew or had express notice of the contravention.

Relative under the Companies Act [Sec. 2(41)]

A person shall be deemed to be a Relative of another, if and only if they are -

1. Members of a HUF, or
2. Husband and Wife, or
3. Related to the other as indicated below -
 - (a) Father
 - (b) Mother
 - (c) Son (Including Step Son)
 - (d) Sons' Wife
 - (e) Daughter (including step daughter)
 - (f) Father's Father
 - (g) Father's Mother
 - (h) Mother's Mother
 - (i) Mother's Father
 - (j) Son's Daughter
 - (k) Son's Daughter's Husband
 - (l) Daughter's Husband
 - (m) Daughter's Son
 - (n) Daughter's Son's wife
 - (o) Daughter's Daughter
 - (p) Daughter's Daughter's husband
 - (q) Brother (including Step-brother)
 - (r) Brother's Wife
 - (s) Sister (including Step-sister)
 - (t) Sister's Husband.

DRAFT BOARD RESOLUTION



RESOLVED THAT the Company furnishes a guarantee for the repayment of principal and interest of the Loan of ₹ 90 Lakhs (Rupees Ninety Lakhs only) for a term of.....years, given by.....Housing Finance Company to Mr. KMP, Director, as per the loan sanction letter dated....., provided however that the total liability of the Company at any time shall be limited to ₹ 1 Crore (Rupees One Crore only inclusive of principal and interest on the loan.

RESOLVED FURTHER THAT Mr. M and Mr. O, the Directors of the Company, be and hereby are jointly authorized to execute the guarantee in this connection under the common seal of the Company, in accordance with the Articles of Association of the Company.

Office or Place of Profit [Sec. 314]

Meaning of Office or Place of Profit

1. **Office or Place of Profit (herein referred to as OPP):** Any Office or Place shall be deemed to be an OPP under the Company where the person holding the office receives -

Person holding the Office		Remuneration
(a)	Director	Receives from the Company, any remuneration in addition to the remuneration he is entitled to receive as Director.
(b)	• An Individual other than a Director, or • Any Firm, or • Private Company, or • Other Body Corporate.	Receives from the Company any remuneration.

2. **Remuneration:** Remuneration includes any payment by way of - (a) Salary, (b) Fees, (c) Commission, (d) Perquisites, (e) Right to occupy free of rent any premises as a place of residence, or (f) otherwise.

ISSUES IN “OFFICE OR PLACE OF PROFIT”

1. **Agents:** OPP includes Selling / Buying Agents. Hence, Sole Selling Agency is an OPP. OPP need not held necessary be an employment “in the Company”. Sec.314 uses the words “under the Company”.-**Sec.314**
2. **Remuneration:** To be considered as OPP, the person should be in receipt of some remuneration. If the MD of a Company is also Director of another Co, which has been appointed as Selling Agent of the Company, and nothing has been received by him apart from his remuneration as MD, he cannot be said to holding an OPP. [But otherwise, sole selling agency is an OPP.]-**Firestore Tyre & Rubber Co. vs Synthetic & Chemicals Ltd 41CC**
3. **Professional Services:**
 - Professional Services rendered on a case-to-case basis, do not, per se, attract the provisions of Sec.314.
 - If Professional Services (Advocate, CA, CS, etc.) are on regular retainer basis, binding them to render services as and when called upon by the Company, Sec.314 will apply.

If a Director receives any remuneration for professional services as Solicitor, Technician, etc, Sec.314 will be attracted.-**Department Clarification**
4. **Technical Advisor:** Appointment of a Director as a “Technical Advisor” should also be covered u/s 314. If a person does not possess any technical qualifications, merely calling him a “Technical Advisor” will not make him one. -**Department Clarification**
5. **MD / WTD:** Office of MD / WTD is not considered an OPP if the following conditions are satisfied -

- (a) Appointment is made u/s 269 either with the approval of Central Government, or as per Schedule XIII.
- (b) Remuneration drawn by them is within Schedule XIII limits.

Note: The above principles apply even if a relative of a Director or MD is appointed as MD/WTD.-**C. No. 4 / 76 dated 11.02.1976**

- 6. Manager & Secretary:** If the Director of a Company functions as Manager and Secretary, and draws remuneration thereof, then, he in fact, is a MD, and holds OPP in the capacity of Secretary.

Sec.314 does not apply if a Director holds office as MD. But, Sec.198, 269, 309, etc. will be attracted.-**L.No,8/16(I)-61-PR dated 09,05.61**

- 7. Statutory Auditor:** In view of Professional Ethics, where a Partner or Relative of a CA is a Director in the Company who has substantial interest, the CA should not audit the Financial Statements of such Company.-**Clause 4 Part I - Second Schedule – CA Act**

Restrictions with respect to appointment to an “OPP”. [Sec. 314]

Sec. 314 regulates the appointment to an “Office or Place of Profit” restrictions are given below under the Company. The salient features of the restrictions are given below-

Particulars	Sec.314(1) [Shareholders' approval only]	Sec.314(1B) [Shareholders' & CG approval]
1. Restriction applies to	(a) Director of a Company, (b) Following persons if the total monthly remuneration is not less than ₹10,000 - (i) Partner of the Director, (ii) Relative of the Director, (iii) Firm in which the Director is a Partner, (iv) Firm in which, the Relative of a Director is a Partner, (v) Private Company in which the Director is a Director or Member, (vi) Director or Manager of a Private Company in which the Director is a Director or Member.	Following appointments to OPP, if the monthly remuneration is not less than ₹ 50,000 (w.e.f 06.04.2011 not less than ₹ 2,50,000 - Refer Notification below). (a) Partner of a Director or Manager, (b) Relative of a Director or Manager, (c) Firm in which Director or Manager is a Partner, (d) Firm in which the Relative of the Director or Manager is a Partner, (e) Private Company in which - (i) a Director, or (ii) Manager, or (iii) relative of either, is a Director or Member.
2. Monetary Limits [See Note 1]	(a) Directors: No limit, (b) Other Persons as above: ₹10,000 or more, p.m.	All persons as above: ₹ 50,000 or more p.m. (w.e.f 06.04.2011 ₹ 2,50,000 p.m.- Refer Notification below)
3. Restrictions relevant for Director or Manager	Only for Directors, his relatives, etc. Restriction does not extend to Managers.	Restriction applies to both Directors and Manager, and their relatives, etc.
4. Exceptions to restriction [See Note 2]	The following positions are not covered by the restriction - ❖ Managing Director of the Company, ❖ Manager of the Company, ❖ Banker of the Company, ❖ Trustee for Debentureholders of the Company.	These exceptions are not available here. Appointment of specified persons (as in 1 above), to these positions will also attract the provisions of Sec.314(1B)



5. Co. to which restriction applies [See Note 3]	Such OPP cannot be held – (a) under the Company, or (b) under any Subsidiary of the Company.	Such OPP cannot be held “in the Company”. [There is no restriction to hold such OPP in the Subsidiary.]
6. Shareholders' approval	By Special Resolution.	By Special Resolution.
7. Nature of Shareholders' approval	Subsequent consent in the first General Meeting held after the holding of OPP is sufficient. [See Notes 4 & 5].	Prior consent is required.
8. Central Govt. approval	Not required.	Required if the remuneration exceeds the monetary limits specified in (1) above. Application for approval should be made in e-Form 24B.

Notes:

1. Monthly Remuneration:

Bonus, Leave Encashment, Medical Reimbursement, etc. are not included in computing the prescribed monthly remuneration, as they are not a part of the monthly income. The term “monthly” connotes anything taking place once a month. **[Ravindra Kumar Singhal vs. Auto Lamps Ltd 55 CC 742]**

2. Other Exceptions: Both Sec. 314(1) and Sec. 314(1B) shall not apply to -

- (a) Director appointed by Central Government u/s 408. [Note: Nominee Director of Central Government is not hit by restriction u/s 314. However, Nominee Director of other Lending / Financial Institution cannot hold any OPP except as per Sec.314.]
- (b) Where - (i) a Relative of a Director, or (ii) a Firm in which such Relative is a Partner has been appointed to the OPP, before such Director becomes Director of the Company.

3. Subsidiary / Holding Company:

- (a) Restriction will not apply if the remuneration received from the Subsidiary in respect of such OPP (held in the Subsidiary) is paid over to the Subsidiary or its Holding Company.
- (b) OPP can be held in the Holding Company, since restriction applies only to a Subsidiary.

4. Appointment without Directors' knowledge:

If - (a) a Relative of a Director, or (b) a Firm in which such Relative is a Partner is appointed to the OPP without the knowledge of the Director, the consent of the Company may be obtained in the

- First General Meeting held after the holding of OPP, or Whichever is later.
- Within 3 months from the date of the appointment 4

5. Timescale in Special Resolution:

- (a) Sec. 314(1) shall apply to every subsequent appointment on a higher remuneration not covered by the Special Resolution passed earlier, unless the appointment on a time scale has already been approved by the Special Resolution.
- (b) So, where any person covered by Sec. 314(1) is promoted, and is proposed to be paid a higher remuneration, it will require a fresh Special Resolution, unless the higher remuneration was approved in the earlier Special Resolution.

6. Declaration by Appointee:

- (a) Content: Every person proposed to be appointed to any OPP shall declare in writing, whether he / it is or is not connected with a Director of the Company in any of the ways referred above.
- (b) Time: Such declaration may be made either before or at the time of such appointment.

7. Appointment of a Relative of a Director [Rule 7 of Director's Relatives (Office or Place of Profit) Rules, 2003]:

- (a) The selection and appointment of a relative of a Director holding OPP in the Company shall be approved by adopting the same procedure applicable to non-relatives.
- (b) In the case of listed public companies, the selection of Director for holding OPP in the Company shall have to be also approved by a Selection Committee.
- (c) "Selection Committee" means a committee, the majority of which shall consist of Independent Directors and an Expert in the respective field from outside the Company. In case of Unlisted Companies, Independent Directors are not necessary but outside experts should be there in the Selection Committee. In the case of Private Companies, Independent Directors and outside Experts are not necessary.

Director's Relatives (Office or Place of Profit) Amendment Rules, 2011: (Gist of amendment)

- Limit increased from ₹ 50,000 p.m. to ₹ 2,50,000 p.m. [in sec 314(1B)]
- Outside expert to form part of selection committee in case of unlisted companies u/r 7.

Note: The limit of ₹ 10,000 p.m. in section 314(1) remains the same.

Notification No. 17/75/2011-C.L.V dated 6-4-2011

Effects of holding an OPP in contravention of Sec.314

Particulars	If Shareholders' consent is not obtained [Sec.314(1)]	Prior consent of Shareholders, and CG approval is not obtained [Sec.314(1B)]
1. Validity of appointment	Appointment is basically valid. Acts done by the appointee till date of vacating his office, are valid.	Appointment is void ab initio. All acts of the appointee are invalid.
2. Vacation of office	The person shall be deemed to have vacated the office on and from the date next following the date of the General Meeting of the Company, or the date of the expiry of the 3 months period.	There is no need for "vacation of office", as such appointment was not valid at all, in the first place.
3. Liability to refund	The person concerned shall be liable to refund - • any remuneration received, or • the monetary equivalent of any perquisite or advantage enjoyed. Note: The Company shall not waive the recovery of any sum refundable, unless is permitted to do so by the Central Government.	



Interested Directors [Sec. 297, 299]

Procedure to be adopted in case any of the Directors are interested in the contracts proposed to be entered into by the Company [Sec. 297].

Status of Party		Nature of Contract
- Director, - Relative of the Director, - Firm in which the Director or Relative is Partner, - Any other Partner of such a Firm, - Private Company in which the Director is a Member or Director.	Entering into a contract with the company for → This contract requires approval	- Sale, Purchase, or Supply of any goods, materials or services, or - Underwriting the subscription of any Shares in, or Debentures of the Company.

If Paid Up Capital of Company	Nature of Approval required
Less than ₹ 1 Crore	Consent of Board of Directors
₹ 1 Crore or more	Consent of BOD + Previous Approval of Central Government. Note: e-Form 24A should be filed for obtaining previous approval of Central Government. (Note: Power of CG Delegated to Regional Director - Refer notification below)

LNo.3/2/75 09.07.1975	dt	Subsequent increase in Paid Up Capital: If the contracts are entered by the Company when the Paid Up Capital was less than ₹ 1 Crore and if the Paid Up Capital is increased to ₹ 1 Crore or more, approval of the Central Government would not be required for existing contracts, but would be required when the contracts are modified or renewed.

Procedure for obtaining consent of Board of Directors for a contract u/s 297. Consequences if Board Consent is not obtained

A. PROCEDURE FOR BOARD CONSENT

1. Resolution: The consent of the Board shall be accorded by a resolution passed in a properly convened Board Meeting. [Note: No circular resolution, and no delegation to MD].
2. Time Period: The Board should accord its consent before the contract is entered onto, or within 3 months of the date on which it was entered into.
3. Specific consent: Consent u/s 297 is not a general consent for all contracts with the involved parties, but a consent referable to such particular or specific contract.

B. Failure to obtain Consent

1. Where consent is not accorded by the Board, the actions shall be voidable at the option of the Board.
2. When prior approval of the Central Government is not obtained, the contract is void.

List of Contracts and transactions which do not require Board Consent, even if covered u/s 297. Exceptions to the applicability of Sec.297.

Sec.297 stipulations as to Board Consent/Prior Approval of Central Government, does not apply to-

1. Contracts for purchase or sale of goods and materials made for cash, at prevailing market prices. [Note: A Cheque will be treated as equivalent of cash payment for the purposes of Sec. 297. **[Letter No. 8/2/ 75 / CL - V dt. 06.06.1975].**

2. Where the aggregate value of the contract(s) do not exceed ₹ 5,000 in any year during the period of contract, in respect of purchase or sale of goods and materials or services in which the Company or the interested persons regularly trades or does business.
3. In case of a Banking Company or Insurance Company, any transaction in the ordinary course of its business.
4. Contracts may be entered into without Board's consent, in circumstances of urgent necessity, if the Board's consent is obtained subsequently within 3 months of the date of the contract. If this consent is not given within 3 months, but is given at a later date, even then it will be good, so long as the contract has not been avoided by the Board.

Note: Special Issues & Department Clarifications

- Sec.297 is not applicable if the contract is entered into, with -
 - (a) A Public Company in which a Director is a Member or Director. (Restriction is only for Private Company not Public Company.)
 - (b) A Private Company in which a Relative / Partner of the Director is a Member or Director. (Restriction applies only when the Director himself is a Member or Director of such Private Company.)
 - (c) A Body Corporate or Co-operative Society, in which a Director or Relative is a Member or Director.
- The words "Goods and Materials" includes Capital Goods but not immovable property- So, a proposal for taking on rental premises for office of the Company is not covered by Sec.297 since this section does not apply to transactions in immovable properties.

Disclosure of interest by an interested Director in the contracts entered into by the Company [Sec.299]

1. Basic Principle of Disclosure of Interest:

Sec.297, 299 & 300 are founded on the principle that a Director is precluded from dealing on behalf of the Company as himself and from entering into engagements in which he has a personal interest conflicting with the interest of those with whom he is bound by fiduciary duty. If a Director makes a contract with the Company and does not disclose his interest, he will be committing breach of trust. **[Yashovardhan Saboo Vs Groz Beckirt Saboo Ltd 83 CC 371]**

2. Disclosure required: Any Director of a Company who is directly or indirectly concerned or interested, should disclose his concern or interest in respect of -

- (a) Contract or Arrangement entered into by or on behalf of the Company, or
- (b) Proposed Contract or Arrangement to be entered into by or on behalf of the Company.

Note:

- Sec.299 cannot be evaded by appointing an Alternate Director, because an Alternate Director is affected by the interests of his Appointor, as well as his own interests.
- Sec.299 is applicable to Government Nominated Directors and other Nominee Directors. **[L.No.8/19 (299) 63 -PR dt 20.09.1963].**

Situations under which an interested Director is not required to make a disclosure of his interest

Exception to Disclosure Requirement [Sec.299(6)]: A Director is not required to disclose his interest in any contract or arrangement entered into between 2 Companies, if not more than 2% of the. Paid Up Share Capital in the other Company is held by -

1. any of the Directors of the Company, or
2. two or more of them together.



Nature of Directors' Interest requiring disclosure to the Board u/s 299.

1. Sec.299 applies to direct or indirect concern or interest of a Director in a contract or arrangement.
2. Sec.299 covers contracts / arrangements where a Director has personal interest conflicting with his duties towards the Company as its Director.
3. However, even where the Director himself has no personal interest in any contract / arrangement but any of his relative has, the Director would be deemed to be "indirectly interested" u/s 299.
4. Disclosure is required for any contract to which Sec.299 applies, regardless of amount, however petty transaction it is, e.g. purchase of books worth ₹ 23.25 from a Firm in which the Director had an interest, or sale of one tin of Ghee to a Director.

An illustrative list of transactions / contracts / interest which are required to be disclosed to the Board, in terms of Sec.299.

A. Matters requiring disclosure of interest "generally":

1. Director's Managerial Interest in the other Firm / Body Corporate.
2. Director's Shareholding / Proprietary Interest in the other Firm / Body Corporate.
3. Director's Relationship Interest.
4. Director's Relative's Managerial Interest in the other Firm / Body Corporate.
5. Directors' Relative's Shareholding / Proprietary Interest in the other Firm / Body Corporate.

B. Matters in respect of which disclosure is required "specifically":

1. Every contract which attracts Sec. 297(1).
2. Every contract which attract Sec. 297(1) but which do not require its compliance because of the exemptions u/s 297(2).
3. Any transaction in which any of the parties specified in Sec. 297(1) is a Contractee but which is not one of the two kinds of contracts mentioned in Sec.297(1), e.g. transactions relating to immovable property.
4. Transactions of any kind between two Public Companies, if a Director of one Company is a Director or Member of the other Company, provided that the Director alone or two or more of the Directors, together hold more than 2 % of the Paid Up Capital in the other Company.
5. Transactions of any kind between two Companies, Public or Private, if a Director's relative of one Company is a Director or Member of the other Company.
6. Dealings with the Company and Relative of the Director.
7. In a resolution to appoint one of the Director's relative as a Managing Director at a remuneration, there is a contract between the Company and the Director's relative.
8. Any appointment of a Director's relative under the Company or any Office or Place of Profit [Sec. 314],
9. Transaction of Loan, Guarantee and Securities between any of the parties specified in Sec.295(1) and the Company.

Manner in which an Interested Director is required to disclose his interest at a Board Meeting. [Sec.299(3)]

1. Meeting in which disclosure is to be made:

In case of -	Meeting in which disclosure is to be made	Remarks
Proposed Contract or Arrangement	Meeting at which the question of entering into the contract is first taken into consideration.	If Director was not interested at the date of that Meeting, disclosure shall be made in the First Meeting of the Board held, after he becomes interested or concerned.
Any other Contract or Arrangement	First Meeting of the Board held after the Director becomes interested or concerned in the contract or arrangement.	Note: This covers - - existing contracts / arrangements - contracts entered into before this person was appointed as Director, etc.

2. Disclosure to Board, at a Meeting:

- (a) Disclosure is to be made at a Board Meeting and not merely by circulation or otherwise.
- (b) Disclosure should be made to the Board, and not to any Committee or to the MD alone. However, if the matter is already known to the whole Board, formal disclosure is not required.

3. General Notice: The disclosure of interest can be made by giving a General Notice to the Board. Such a notice shall be deemed to be sufficient disclosure of interest in relation to any contract or arrangement. The essentials of a valid notice are as under -

- (a) Form: For the purpose of Sec.299, a general notice should be given in Form No. 24AA to the Board of Directors.
- (b) Meeting: (i) The General Notice should be given at the Board Meeting, or (ii) the Director concerned takes reasonable steps to secure that the notice is brought up and read at the first Board Meeting after it is given.
- (c) Contents: The Notice shall disclose the nature of concern or interest. It shall specify that the Director is –
 - ❖ a Director or Member of a Specified Body Corporate, or Member of a Specified Firm, and
 - ❖ to be regarded as concerned or interested in any contract or arrangement that the Company proposes to enter into with that Body Corporate or Firm, after the date of the notice.
- (d) Full Disclosure: The Director concerned must make full disclosure of his interest including its extent and the amount of his profit or reward.

Note:

- The expression "Body Corporate" includes Private Companies, Public Companies, Corporations and Foreign Companies.
- The word "Firm" includes Partnership Firms and other Unincorporated Organizations, such as, Sole Proprietary Concern, Hindu Undivided Family, Association of Persons, etc.

4. Validity of Notice:

- (a) The General Notice is valid till the end of the Financial Year in which it is given.
- (b) Renewal of notice: Renewal of notice can be made for a further period of 1 financial year at a time, by giving a fresh notice in the last month of the financial year in which it would expire.



Company News & Notes dated 01.07.1963

If the Director has given a general notice u/s 299(3) he will not be liable for prosecution provided the general notice covers the relevant contract in question.

NOTE:

- Sec. 299(3) regarding general notice only specifies the method as to how to comply with matters specified in 299(1) & (2).
- General Notice u/s 299(3) requires merely specifying the names of Bodies Corporate of which the Director is a Member or Director and of Firms of which he is a Member. However, Sec.299(1) requires disclosure of the nature of concern or interest in the contracts and arrangement.
- Sec. 299(3) is not a mandatory provision. So, a Director may not specify in General Notice the names of such Bodies Corporate or Firms, and may, instead, opt for specific disclosure in case of each contract. Thus, violation of 299(3) is not punishable.

Consequences of non-disclosure of interest by a Director

The consequences of non-compliance with Sec.299 requirements are -

1. **Vacation of Office [Sec. 283]:** The office of the Director shall become vacant if he fails to disclose his interest u/s. 299, [This is automatic and cannot be ordered otherwise by the Court],
2. **Voidable Contract:** Non-compliance with Sec.299 does not avoid or invalidate the contract but will it make it voidable at the option of the Company.
3. **Penalty:** Every Director who fails to comply with the disclosure requirements shall be liable to -
 - (a) Fine upto ₹ 50,000 u/s 299(4),
 - (b) Fine upto ₹ 5,000 per day u/s 283(2A),
 - (c) Refund to the Company all remuneration received as Director after the date of cessation of his Directorship.

CASE LAW: Failure to make the required disclosure renders the Director liable to punishment and gives an option to the Company to avoid the contract, but does not make the contract illegal, void or unenforceable. [Amritsar Rayon & Silk Mills Ltd Vs Amirchand Saidik]

1.9 INSPECTION AND INVESTIGATION

INSPECTION

Inspection of books of account, etc., of companies

Section 209A(1) provides that the books of account and other books and papers of every company shall be open to inspection during business hours—

- (i) by the Registrar; or
- (ii) by such officer of Government as may be authorised by- the Central Government in this behalf.
- (iii) by such officers of the Securities and Exchange Board of India (SEBI) as may be authorised by it.

Such inspection may be made without giving any previous notice to the company or any officer thereof. The inspection by the SEBI shall be made in respect of matters covered under sections referred to in section 55A.

It is not necessary for the Registrar or the Central Government /SEBI to disclose to the company reasons for conducting inspection nor is it necessary to come to any conclusion regarding existence of certain circumstances as is necessary before ordering investigation into the affairs of a company under section 237(b) of the Act.

Inspection is a useful instrument and the preliminary step for finding out materials and facts which would justify initiation of investigation under section 235 or 237. It is noticed from the Annual Reports of the Department of Company Affairs that the books of account and other records of the companies are inspected selectively by officers of the Directorate of Inspection authorised for this purpose under this section. Inspection, inter alia, covers the companies with paid up capital exceeding certain paid-up capital level, companies incurring losses and companies in respect of which complaints are received. The material brought out in the inspection reports is made use of for taking actions under important provisions of the Act including, inter alia, appointment of Government directors under section 408, ordering investigations into the affairs of the companies under sections 235 and 237-247, and consideration of application seeking approval for the appointment of managerial personnel in companies. In certain cases, prosecutions are also launched on the basis of the finding contained in the inspection reports. Besides, cases involving non-compliance of certain provisions of the Act, including inadequate maintenance of statutory records noticed during such inspections, are also taken up with the companies for necessary remedial action. Information of interest to other Government Departments/agencies as brought out in the inspection reports is also communicated to them for suitable and appropriate action.

Documents to be inspected

Under section 209A(1)(i), the Registrar or the inspecting officer is authorized to inspect books of account, such as ledger, cash book, journal and vouchers, and 'other books and papers', which has been defined in section 2(8) to include deeds, writings and documents.

The scope of inspection was brought out in **C.V. Karupunni v. Joint Director, Inspection, Company Law Board [1986] 59 Comp. Cas. 814**. The Kerala High Court in this case, held that the principle of *ejusdem generis* has to be applied in deciding the question as to the type of books and documents the inspecting officers are entitled to inspect. In other words, the documents and papers referred to in section 209A(1) which the inspecting officers are entitled to inspect must be those which have the character of books of account. Books and papers as per section 2(8) include vouchers, deeds, writings and documents. Applying the principle of *ejusdem generis*, the inspecting officer can inspect vouchers, deeds and documents relevant to entries in books of account. However, in the guise of carrying out an inspection of books of account and other books and papers, the inspecting authorities cannot make a roving enquiry into all the affairs of the company. The scope of inspection of books of account and other books and papers under section 209A has its limits and has to be distinguished from the investigation under section 237.

It may be observed that this decision is not in harmony with the definition of the expression "books and papers" as given in section 2(8) of the Act.

Department's views

The views of the Department on the subjects are as under:

- (a) The inspecting officer has a right to examine the books and records of any firm in which the company concerned is a partner (Letter No. 7/9/74-CL: II, dated 24-1-1976).
- (b) The inspecting officer has a right to examine the books and records of any joint venture in which the company concerned has an interest (Circular No. 25/75, dated 19-11-1975).

Place and time of inspection

The place at which inspection may be carried out need not be the registered office of the company. The books of account have to be kept either at the registered office of the company or at some other place, after an intimation to the Registrar. The books of account can be inspected at such other place also. Besides, clause (iii) of subsection (5) permits inspection at any place. Thus, the authorised officer or the Registrar was held entitled to demand inspection of the books of account even in his office – **Indra Prakash Karnani v. ROC [1985] 57 Comp. Cas. 62 (Cal)**.



Duties of directors, officers, employees of the company to assist in inspection

Sub-section (2) of section 209A casts a duty on every director, other officer or employee of the company to produce to the person making inspection of such books of account and other books and papers of the company in his custody or control and to furnish him with any statement, information or explanations relating to the affairs of the company as the said person may require of him within such time and at such place as he may specify.

Further, it shall also be the duty of every director, other officer or employee of the company to give to the person making inspection under this section all assistance in connection with the inspection which the company may reasonably be expected to give [Section 209A(3)].

Powers of the inspector

- 1. Power to make copies** - A person making the inspection under this section may, during the course of inspection make or cause to be made copies of books of account and other books and papers.
- 2. Power to place identification marks** - The inspector may, during the course of inspection place or cause to be placed any marks of identification thereon in token of the inspection having being made.
- 3. Powers of civil courts** - Sub-section (5) of section 209A provides that notwithstanding anything contained in any other law for the time being in force or any contract to the contrary, any person making an inspection under section 209A shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit, in respect of the following matters, namely:
 - (i) the discovery and production of books of account and other documents, at such place and such time as may be specified by such person;
 - (ii) summoning and enforcing the attendance of persons and examining them on oath;
 - (iii) inspection of any books, registers and other documents of the company at any place.
- 4. Powers of Registrar** - Any officer authorised to make an inspection under section 209A shall have all the powers that a Registrar has under the Companies Act in relation to the making of enquiries [Section 209A(7)].

Penalty for default - If default is made in complying with the provisions of section 209A, every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees, and also with imprisonment for a term not exceeding one year [Section 209A(8)]. It may be noted that the company cannot be made liable for committing the default - **Indra Prakash Karnani v. ROC (supra)**.

It may further be noted that the offence under this section is not compoundable by the Regional Director or the Company Law Board under section 621 A. However, the offence under this section is not a continuing one and is deemed to be committed on a particular date. Limitation begins to run on that date. A prosecution launched more than one year after the date of the offence is barred by limitation - **State v. S. Seshamal Pandia [1986] 60 Comp. Cas. 889 (Mad.)**.

Supply of report

Where an inspection of the books of account and other books and papers of the company has been made under section 209A, sub-section (6) requires that the person making the inspection shall make a report to the Central Government. The Central Government is not required to forward a copy of the inspection report to the company, unlike an investigation report under section 241. However, in case of prosecution arising out of the inspection report, the complainant may rely on the report and make available the relevant extracts thereof to the accused.

Inspection by Reserve Bank

In case of all the non-banking companies, the Reserve Bank has also a right of inspection of their books and papers under section 45N of the Reserve Bank of India Act, 1934, sub-section (1) of which provides as follows :—

“The bank may, at any time, cause an inspection to be made by one or more of its officers or employees or other persons (hereafter in this section referred to as the inspecting authority)—

- (i) of any non-banking institution, including a financial institution, for the purpose of verifying the correctness or completeness of any statement, information or particulars furnished to the bank or for the purpose of obtaining any information or particulars which the non-banking institution has failed to furnish on being called upon to do so; or
- (ii) of any non-banking institution being a financial institution, if the bank considers it necessary or expedient to inspect that institution.”

INVESTIGATION

Investigation

Sections 235 to 251 contain provisions relating to investigation into the affairs of companies. Section 235 has been recast by the Amendment Act of 1988. The section gives right to members of a company to make an application to the CLB for conducting investigation into the affairs of a company. While the power to appoint inspectors and to conduct investigation and to act on the report of investigation remains with the Central Government, the CLB has been empowered to consider such application and cause an investigation to be made by the Central Government. Action on the report of the inspector also vests in the Central Government. The provision for appointment of an inspector by the Central Government on a report of the Registrar under section 234(6)/(7) exists, independent of CLB.

Investigation- Scope & Eligibility

- 1. On the report of Registrar-** Section 235(1) empowers the Central Government to order investigation into the affairs of a company on the report of the Registrar.

Section 235 of the Act provides as follows:

Where a report has been made by the Registrar under section 234(6) or under section 234(7) read with sub-section (6), the Central Government may appoint one or more competent persons as inspectors to investigate the affairs of a company and to report thereon in such manner as the Central Government may direct.

It may be noted that section 234(6) empowers the Registrar to report in writing to the Central Government if the information or explanation called for by him under section 234(1) is not furnished in time, or if, on perusal of such information or explanation or on examination of the books and papers produced before him, he is of the opinion that the state of affairs of the company is unsatisfactory. Under section 234(7), the Registrar can report to the Central Government if a contributory or creditor, etc., makes a representation to him that the business of the company is being carried on in fraud of creditors, etc., or otherwise for fraudulent or unlawful purpose.

It is not necessary that the sole object of the operations complained of, should be fraudulent or unlawful. It is sufficient if one of the objects is fraudulent or unlawful.

Where a company is consistently violating provisions of the Act, and is yet carrying on substantial business, the Registrar is competent to take steps for investigation of the affairs of the company - **Standards Brand Ltd., In re [1980] 50 Comp. Cas.75 (Cal.).**

- 2. Shareholders** - Section 235(2) of the Act, empowers the CLB to consider an application from a specified number of shareholders and to declare that an investigation be conducted into the affairs of the company. Upon such declaration by the CLB, the Central Government shall appoint



one or more competent persons to investigate the affairs of the company and to report thereon in such manner as the Central Government may direct. The shareholders competent to make an application to CLB are:

- (i) in case of a company having share capital not less than 200 members or members holding not less than 1 /10th of the total voting power therein;
- (ii) in case of a company having no share capital not less than 1/5th of the persons on the company's register of members.

Composite petition under sections 397,398 and 235 - While test of eligibility to make a valid petition for the purposes of sections 397 and 398 can be fulfilled by obtaining consent of other shareholders, the same will not be acceptable for the purpose of section 235 as petition under section 235(2) cannot be sustained by 'consent' of other shareholders - **Haranadh v. Shri Laxmi Durga Paper Products (I) Ltd. [2005] 62 SCL 279 (CLB)**.

The application by members should be supported by such evidence as the CLB may require for the purpose of showing that the applicants have good reason for requiring the investigation [Section 236]. The Central Government may, before appointing an inspector, require the applicant to give security, for such amount not exceeding one-thousand rupees as it may think fit, for payment of the costs of the investigation.

The CLB, after hearing the parties, may declare that the affairs of the company ought to be investigated and on such declaration, the Central Government shall appoint one or more inspectors to investigate the affairs of the company in such manner as directed by the Central Government.

3. The company, by passing special resolution [Section 237(a)(i)].

4. The Court, by order [Section 237(a)(ii)]- The Central Government shall appoint one or more competent persons as inspectors to investigate the affairs of a company and to report thereon in such manner as the Central Government may direct, if the Court, by order, declares that the affairs of the company ought to be investigated by an inspector appointed by the Central Government. For passing an order for investigation, it is not necessary that a proceeding be pending before the court; even a petition simpliciter can be entertained - **Delhi Flour Mills Co. Ltd., In re [1975] 45 Comp. Cas. 33**.

It has been contended in several cases that the power and discretion of the Government were uncontrolled and the court could direct an investigation whenever it suspected that all was not well with the company, and it was not necessary for the petitioner to prove his allegations before the court for, he could prove them before the Inspectors. However, in **Mrs. U.A. Sumathy v. Digvijay Chit Fund (P.) Ltd. [1983] 53 Comp. Cas. 493 (Ker.)**, the High Court observed:

"No doubt, clause (a)(ii) of section 237 does not lay down what circumstances are to be proved before the Court and on what materials, the Court could act but that does not mean that mere allegations are sufficient. A Court can act only on the materials placed before it and those materials should at least be such as to satisfy the Court that a deeper probe into the company's affairs is desirable in the interest of the company itself." [Also see **A.P. Civil Supplies Corpn. Ltd v. Delta Oils and Fats Ltd. [2007] 73 SCL 242 (AP)**].

It may be noted that company court itself is not vested with any powers of investigation under section 237. All that it can do is to consider the plea of the petitioners as to whether it is a fit case to direct the Central Government to do so. [**Unet India Ltd, v. I.C. Rao [1998] 93 Comp. Cas. 41 (AP)**].

In **Safia Usman v. Union of India [1999]22SCL372(Ker.)**, it has been held that before invoking High Court's discretionary jurisdiction, CLB, the statutory body created specifically for the purpose under section 237, must first be approached. The Court further held that the High Court can only issue a declaration with reference to affairs of a company and cannot direct Central Government to conduct investigation.

- 5. Investigation by the Central Government** - Section 237(b) provides that the Central Government may appoint inspectors if, in the opinion of the CLB, there are circumstances suggesting:
- (i) that the business of the company is being conducted with intent to defraud its creditors, members or any other persons, or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive of any of its members, or that the company was formed for any fraudulent or unlawful purpose; or
 - (ii) that the persons concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards the company or any of its members; or
 - (iii) that the members of the company have not been given all the information with respect to its affairs which they might reasonably expect, including information relating to the calculation of the commission payable to a managing or other director or the manager of the company.

Thus, under section 237(b) although the power to appoint inspectors to conduct investigation and to act on the reports of the investigation rests with the Central Government, it can do so only if CLB expresses its opinion as regards existence of circumstances calling for investigation.

It is important to note that the above three grounds limit the justification for ordering investigation under section 237(6), and it cannot go on a fishing expedition to find evidence - **Barium Chemicals Ltd. v. Company Law Board [1966] 36 Comp. Cas. 639 (SC)**.

Economic working of a company cannot be a matter for investigation. There must be allegation of illegal acts or malpractices, malfeasance, etc., to sustain an order of investigation - *Delhi Flour Mills Company Ltd. (supra)*. Contravention of the provisions of the other laws for the time being in force, is, of course, within the scope of clause (b) of section 237 - *New Central Jute Mills Company Ltd. v. Deputy Secretary, Ministry of Finance [1966] 36 Comp. Cas. 512*

The power to form an opinion regarding investigation under section 237(b) is an exclusive jurisdiction conferred on the CLB and as such no other forum including District consumer forum or authority including the Central Government can exercise this power. The fact that the petitioner was an insignificant shareholder shall have no bearing. [**Chandrika Prasad Sinha v. Bata India Ltd, [1996] 9 SCL 108 (CLB).**]

Investigation is to be ordered if a prima facie opinion is formed by the CLB that the business of the company is being/has been conducted with intent to defraud creditors, members or any other persons or the conduct of company is oppressive to any of its members or there is misfeasance or misconduct on the part of the management in carrying on the affairs of the company [**Incab Industries Ltd., In re [1996] 10 SCL 390 (CLB)**]. The Bombay High Court in **Panther Fincap & Management Services Ltd. v. Union of India [2007] 74 SCL 202** has held that when a company is found to be engaged in any business authorised by its memorandum, even though its dominant business might remain stalled by various orders of the Government, nevertheless, the company has to be treated as running its business and the requirement if section 237(b)(i) will be satisfied :

In **Charanjit Singh Ghuman v. Dr. Reddy's Laboratories Ltd. [1997] 30 SCL 111** the issue was whether a shareholder can ask for order for investigation of company's affairs in other cases, say, for violation of the legal provisions in regard to issue of duplicate share certificate. The court, based on facts and circumstances of the case, held that although violations have taken place of the requirements of sections 108(1), 113(2), 84(3), 111, 206A and Companies (Issue of Shares Certificates) Rules, 1960, the company had taken sufficient precautions so that the interest of the petitioner is not affected and as such ingredients of section 237(b)(i) are not attracted.

To order investigation, requirements of section 237(b) must be complied with. On a single instance of alleged oppression, extraordinary powers could not be invoked. In **N.M. Pimpalkar v. Shree Narkeshari Prakashan Ltd. [1998] 17 SCL 259 (CLB-New Delhi)**, investigation was sought for an allegation that one R, who was appointed as managing director for one year in AGM, was relieved of his post within 2 months on obtaining resignation under pressure exerted by the chairman, but the petitioner had not



been able even prima facie to prove how a fraud or oppression of members had been committed based on the instances cited by him which is a requirement under section 237(b) and on the other hand, the company proved that resignation was voluntary and further R, though a shareholder, did not join petitioners, investigation could not be ordered.

In a petition under section 237, the company and its managing director or other directors are necessary parties and in the absence of impleading such parties in petition, relief cannot be granted - **Safia Usman v. Union of India (supra)**.

The CLB in **Union of India v. Sunair Hotels Ltd. [2007] 81 SCL 283** has held that the scope of section 237(6) is wide enough to include past acts alleged to be fraudulent. The CLB has the onerous duty to form an opinion as regards intent to defraud before ordering an investigation on the ground of fraudulent conduct of business. Also, see **Union of India v. Shonkh Technologies International Ltd. [2007] 78 SCL 41 (CLB)**.

Guidelines for ordering investigation into company's affairs

In exercising the discretionary powers under this section, the Central Government, while examining each case on its merits, applies certain tests which are calculated to ensure that a substantial and worthwhile basis exists, warranting investigation. Where the allegations are more of a recriminatory nature arising out of factional fights between two or more predominant groups of shareholders, the Government will not ordinarily lend itself to be a party to such disputes. In other cases, based on the relevant provisions of the company law or any law in force, the following objectives may generally form the prerequisite for ordering of an investigation:

- Where an inspector can bring to light any major contravention of company law or any other law on the basis of which necessary corrective or remedial measures can be applied.
- Where the application of such measures alone will be enough to lend succour to the aggrieved parties, where necessary, or to set right the affairs of companies so as to bring them in conformity with the accepted principles and standards of good and efficient management.
- Where the allegations bring out clearly or, by implication, a charge of irregular accounting, the truth of which can be established only by the analysis of the books by a qualified chartered accountant.

Complaint for violation by SEBI- Whether a bar to investigation – A complaint by SEBI for violation of the provisions of the SEBI Act by itself is not a bar to investigation into the company's affairs when substantial reason exists for investigation - **Sonkh Technologies Ltd. v. Union of India [2009] 89 SCL 335 (Delhi)**. Again, in **Rasoi Ltd. v. Jaideep Halwasiya [2009] 89 SCL 317 (Kol)**, it was held that where violation of SEBI Take Over Code is alleged and also a petition under section 111A for rectification of the membership register is pending, application for relief under section 250(1) cannot be entertained unless circumstances suggest that investigation under section 247(1 A) is called for. In a petition under section 397/398 an allegation of diversion of fund by the company was found supported by audit report. The CLB ordered investigation under section 237(6) while continuing with the petition **[2009] 89 SCL 80 (CLB) Securities Ltd. v. Kowa Spinning Ltd.**

Fraud on creditors and on the court - The Allahabad High Court in **United Western Bank Ltd. v. Khaitan Hostombe Spinel Ltd. [2009] 91 SCL 221** ordered the Official Liquidator of the company in respect of which winding up petition was filed to inform the Central Government to order investigation of the company under sections 235-237 as the court found that the directors of the company did not file the Statement of Affairs of the company and had left the country misleading the court and the creditors by a fake scheme of merger which was approved by the appropriate Court, so as to get the company wound up without payment to the creditor.

Firm, body corporate or association not to be appointed as inspector

Section 238 disallows the appointment of a firm, body corporate or other association as an inspector

under section 235 or 237. Thus, only an individual or individuals may be appointed as an inspector(s). However, section 238 disallows appointment of persons other than individuals as inspectors only for the purposes of section 235 or 237. Thus, an inspector appointed under, say, section 247 (for determining ownership of a company) may be a firm or body corporate or an association. A firm of chartered accountants or of company secretaries may, therefore, be appointed under section 247.

Powers of inspectors

An inspector or inspectors appointed under section 235 or 237 to investigate the affairs of a company shall have the following powers :

- 1. Power to carry investigation into affairs of related companies (Section 239)** -Section 239 states that if the inspector considers it necessary to investigate even the affairs of another company under the same management or in the same group, he may do so. Under this section, an inspector is empowered to investigate the affairs of the following persons and/or bodies corporate and report on their affairs also, if he thinks that such an investigation is relevant to the affairs of the company under investigation:
 - (a) any other body corporate which is, or has at any relevant time been the company's subsidiary or holding company or a subsidiary of its holding company or a holding company of its subsidiary;
 - (b) any other body corporate which is or has at any relevant time been managed by any person as managing director or as manager, who is, or was, at the relevant time either the managing director or the manager of the company under investigation;
 - (c) anybody corporate which is, or has, at any relevant time been, managed by the company or whose Board of directors comprises nominees of the company or is accustomed to act in accordance with the directions or instructions of—
 - (i) the company, or
 - (ii) any of the directors of the company, or
 - (iii) any company, any of whose directorships is held by the employees or nominees of those having the control and management of the first-mentioned company;
 - (d) any person who is, or has been at any relevant time, the company's managing director or manager.

The inspector is required to obtain the prior approval of the Central Government before undertaking any investigation into the affairs of the company or the persons mentioned in (c) and (d) above. Before granting its approval, the Central Government is required to give such persons, or body corporate, a reasonable opportunity to show cause as to why such approval should not be accorded.

Duties of inspectors are not judicial or quasi-judicial in nature; there are no litigants before him, nor is he bound by any procedure; nor is his report binding on Government - **Coimbatore Spinning & Weaving Co. Ltd, v. M.S. Srinivasan [1959] 29 Comp. Cas. 97 (Mad.)**.

Inspector is not debarred from taking help of other persons in conducting enquiry, but he should himself consider all materials thus collected, while preparing his report - **Titagarh Paper Mills Co. Ltd v. Union of India [1986] 59 Comp. Cas. (Cal); New Central Jute Mills Co. Ltd. v. Deputy Secretary(supra)**.

- 2. Power to compel production of documents** -Section 240 deals with the powers of the inspector as also the duties of officers, employees and agents of any company or related body corporate under investigation in connection with the actual work of investigation. All officers, employees and agents of the company or related body corporate, as the case may be, are required to co-operate not only in producing all books and papers but also ensuring that they are not destroyed, mutilated or secreted away. This duty or power also extends to furnishing information which the inspector may require. It may be noted that officers, in the first instance, include also trustees for



debenture holders. Besides, 'officers' also include past officers. Similarly, employees and agents include both present and past employees and agents.

Under clause (a) of sub-section (1) of section 240, the officers, employees and agents of the company or body corporate, as the case may be, would be asked to produce the books and papers not only to the inspector but also to any person authorised by him in this behalf. However, the inspector must obtain the previous approval of the Central Government before he authorises any other person to act on his behalf.

- 3. Power to examine on oath** - The inspector may examine on oath past and present officers of the company and other employees and agents and for this purpose require their personal attendance. Where an inspector finds that a person whom he has no power to examine on oath, ought to be so examined, he may apply to the Central Government for necessary orders. Notes of any such examination are to be taken in writing and signed by the person examined and may be used in evidence against him.

Penalty [Section 240(3)] - If any person fails without reasonable cause or refuses—

- (i) to produce to an inspector or any person authorised by him in this behalf any book or paper required by him; or
- (ii) to furnish any information which it is his duty to furnish; or
- (iii) to appear before the inspector personally or to answer any question; or
- (iv) to sign the notes of any examination;

he shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to twenty thousand rupees. In addition, he shall be fined ₹2,000 for every day after the first during which the failure or refusal continues.

- 4. Power to take down notes of examination in writing**- Under sub-section (5) of section 239, an inspector is empowered to take down, in writing, the notes of examination of any person in relation to investigation. This sub-section also permits the notes of examination, when reduced to writing, to be signed by the person examined after the notes have been read over to him. Thereafter, these notes may be used as evidence against him.
- 5. Power of seizure of documents** - Section 240A of the Act provides that where an inspector has reasonable grounds to believe that relevant books or papers may be destroyed/falsified/altered or secreted, he may make an application to a Magistrate and obtain an order for seizure of such books and papers. The order may authorise him to enter the place, where such books and papers are kept, to search the place and seize them. At the conclusion of the investigation, he must return these books and papers. Before returning the books, the inspector can place identification marks on them or any parts thereof.

Report of the Inspector

Under section 241 of the Act, the inspector has to prepare and submit a report to the Central Government. The inspector may, in his discretion, make interim report. But if he is so directed by the Government, he is required to make and submit such interim reports as may be required.

The Central Government:

- (a) shall forward a copy of any report (other than an interim report) made by the inspectors to the company at its registered office and also to anybody corporate dealt with in the report by virtue of section 239;
- (b) may furnish a copy thereof to a member of the company, anybody corporate dealt with in the company's report or a creditor of the company on request and on payment of the prescribed fee;

- (c) shall, where the inspectors are appointed in pursuance of the provisions of sub-section (2) of section 235 at the request of the members of the company, furnish a copy of the report to applicants for investigation at their request;
- (d) shall, where the inspectors are appointed under section 237 in pursuance of an order of the Court furnish a copy of the report to the Court;
- (e) shall, where the inspectors are appointed in pursuance of the provisions of sub-section (2) of section 235, furnish a copy of the report to the CLB;
- (f) may also cause the report to be published.

Follow up action by the Central Government on the investigation report of the inspector

On receipt of the report of the inspector appointed to investigate the affairs of the company, the Central Government may take one or more of the following actions:

- (i) **Prosecution for criminal offence** - If the report reveals that any person has, in relation to the company or in relation to any other body corporate whose affairs have been investigated by virtue of section 239, been guilty of any offence for which he is criminally liable, the Central Government, after taking such legal advice as it thinks fit, prosecute such person along with officers. In such a case it shall be the duty of all officers and other employees and agents of the company to render to the Central Government all assistance in connection with the prosecution which they are reasonably able to give [Section 242].

It should be noted that the provisions of section 242 of the Act do not bar the cognizance of offence, if punishable under the Indian Penal Code. Further, section 242 does not contemplate a hearing to the company before launching prosecution - **Titagarh Paper Mills Co. Ltd. v. Union of India (supra)**.

- (ii) **Winding up of the company** - If the report reveals that—

- (a) the affairs of the company are being conducted with intent to defraud its creditors, members or other persons or for a fraudulent or unlawful purpose or in a manner oppressive of any of its members; or
- (b) the persons concerned with the formation of the company or of the management of its affairs have been guilty of fraud or misconduct,

the Central Government, unless the company is already being wound up, may cause taking of the following action, by a person authorised by the Central Government, namely :—

- (i) present a petition to the court for winding up of the company or the body corporate on the ground that it is just and equitable to do so; or
- (ii) make an application for order under section 397 or section 398 of the Act for grant of relief against oppression or mismanagement of the company; or
- (iii) make a petition for winding up as well as make application for relief under section 397 or section 398 of the Act [Section 243].

- (iii) **Recovery of damages** - Section 244 provides that where from the inspector's report it appears that a fraud or misappropriation of property has been committed and the company is, therefore, entitled to bring an action for damages for misconduct or for the recovery of any property which has been misapplied or wrongfully retained, the Central Government may itself in public interest bring proceedings for that purpose in the name of the company. In such proceedings the report shall be admissible as evidence of the opinion of the inspection in relation to any matter contained in the report.

The Central Government should indemnify the company against any cost or expenses incurred by it or in connection with any proceedings brought by it.



Expenses of investigation

According to section 245, the expenses of investigation are to be defrayed in the first instance by the Central Government. But the Central Government is entitled to be reimbursed: (i) by any person, who has been convicted on a prosecution instituted in pursuance of the report or required to pay damages as a result of the report; (ii) the company in whose name proceedings are brought. The company is bound to reimburse the Central Government to the extent of the amount or value of any sums or property recovered by it as a result of the proceedings; (iii) similarly, cost can be recovered from any managerial personnel dealt with by the report; and (iv) reimbursement may also be claimed at the discretion of the Central Government, from the applicants where inspector was appointed in pursuance of section 235(2) (i.e., on an application by the members).

Protection of employees during investigation

Section 635B of the Act protects against dismissal, discharge, removal, etc., of the employees of the company under investigation, who make disclosure during the course of investigation. The section provides that if during the course of investigation under sections 235, 237, 239 and 247 the company proposes to discharge any employee from service or punish him by way of dismissal, removal or reduction in rank, then the company must send to the CLB a previous intimation in writing of the action proposed to be taken against the employee. If the CLB has any objection to the action proposed to be taken, it must send a notice thereof to the employer. The CLB is not bound to hear the company or any other person before issuing the notice -**Ashoka Marketing Ltd. v. Company Law Board [1968] 38 Comp. Cas. 519 (Cal.)**. If the company does not receive any notice of objection from the CLB within thirty days of sending of the previous intimation of the action proposed against the employee, then the company may proceed to take the proposed action against the employee.

If the company is dissatisfied with the objection raised by the CLB, it may, within thirty days of the receipt of the notice of the objection, prefer an appeal to the Court in the prescribed manner and on payment of the prescribed fee.

The decision of the court on such appeal shall be final and binding on the CLB and on the company.

The aforesaid provisions of section 635B are without prejudice to the provisions of any law for the time being in force.

Investigation of ownership of a company [Section 247]

It may sometimes become necessary in public interest for the Central Government to know the persons who are financially interested in a company and who control the policy or materially influence it. For this reason, section 247 provides that where the Central Government is satisfied that there is good reason to do so, it may appoint one or more inspectors to investigate and report on the membership of the company and other matters relating to it, for the purpose of determining the true persons:

- (i) who are or have been financially interested in the success or failure, whether real or apparent of the company; or
- (ii) who are or have been able to control or materially influence the policy of the company.

A new sub-section (1A) has been added after sub-section (1) of section 247 as detailed above, by the Amendment Act, 1988. According to the new subsection, the Central Government shall appoint one or more inspectors under sub-section (1), if the CLB, in the course of any proceedings before it, declares by an order that the affairs of the company ought to be investigated, as regards the membership of the company and other matters relating to the company, for the purpose of determining the true persons:

- (a) who are or have been financially interested in the success or failure, whether real or apparent, of the company, or
- (b) who are or have been able to control or materially influence the policy of the company.

In **Bakhtawar Construction Co. (P.) Ltd. v. Blossom Breweries Ltd. [1997] 24 CLA 211 (CLB)**, it was alleged that the names of shareholders given by the company were fictitious, non-existent or benami and that the Registrars for Shares & Securities had not complied with the provisions of law in processing the applications for shares, their allotment and transfers where applicable and urged that an investigation under section 247(1A) would help to find out the relevant facts about the true owners of the shares. The CLB dismissed the petition on the ground that it had been instituted purely on unfounded apprehensions and suspicions. The power of investigation under section 247(1A) could be invoked bona fide in public interest only.

The provisions of sections 239, 240 and 241 apply *mutatis mutandis* to the investigation under this section in relation to all persons whom the inspector has reasonable cause to believe to be financially interested in the success or failure of the company or who have been able to control or materially influence the policy of the company.

On completion of his investigation, the inspector is required to submit his report to the Central Government, but the Central Government is under no obligation to supply copies of the inspector's report to the company or companies or any other person, if it is of the opinion that there is good reason for not divulging the contents of the report or any part thereof. However, a copy of such report to the extent there is no good reason to hold back shall be kept by the Registrar.

Publication of Inspector's Report

As regards publication of the inspector's report the CLB has expressed the following opinion:

"It has now been decided by the Company Law Board that in important cases where the reports of investigation into the affairs of ownership of companies by inspectors appointed for the purpose are likely to be of interest to the general public, such reports will be published. The criterion for selection would be the size, the extent of public interest and participation, the nature of industry engaged in, the extent of consumer and creditor's interest and the relationship, if any, with other companies fulfilling these requirements"—Company News and Notes, dated 17-8-1964, page 10.

However, a report made under section 239 should not be disclosed to the public before its acceptance by the Central Government - **Swadeshi Cotton Mills Ltd. v. Swadeshi Polytex [1982]52 Comp. Cas. 483 (All.)**.

Imposition of restrictions upon shares and debentures and prohibition of transfer of shares or debentures in certain cases [Section 250]

Section 250 contains one of the important provisions of the Act dealing with corporate takeovers. Corporate takeovers cannot take place without acquisition of the controlling block of shares of a company. That is why provisions have been made empowering the CLB to impose restrictions with regard to shares and debentures issued or to be issued as also with regard to transfer of these instruments, which has either taken place or is likely to take place. The first set of restrictions is dealt with in sub-sections (1) and (2) while the second set of restrictions is dealt with in sub-sections (3) and (4). The objective being the same, namely, to prevent an undesirable take-over, there is an unavoidable element of overlapping in the provisions dealing with both sets of restrictions".

Under sub-section (1) a reference may be made by the Central Government to the CLB in connection with any investigation under sections 247, 248 or 249 to find out the relevant facts about any shares/debentures. A complaint may also be made by any person in this behalf to the CLB. Where it appears to the CLB that there is good reason to find out the relevant facts about any shares/debentures (whether issued or to be issued) and it is of the opinion that such facts cannot be found out unless the restrictions specified below are imposed, it may, by order, direct that the shares/ debentures shall be subject to these restrictions. Such restrictions shall be for a period not exceeding three years as may be specified in the order.

Section 250 does not confer upon CLB a power to grant any interim relief during pendency of a proceeding. CLB has no inherent powers nor can it assume that said power is vested in CLB implicitly.



Thus, till the CLB comes to a conclusion that there are good reasons to find out the relevant facts to which conclusion the CLB can come only after going through the merits of the case, there is no scope for any power vested in CLB to impose the restrictions' as provided under section 250(2). [Bakhtawar Construction Co. (P.) Ltd. v. Blossom Breweries Ltd. (supra)]

Restrictions

Restrictions in relation to shares - Restrictions that may be imposed under sub-section (2) are:

- (i) where those shares are to be issued, they shall not be issued.
- (ii) no voting right shall be exercisable in respect of those shares.
- (iii) no rights issue shall be made in respect of those shares.
- (iv) except in a liquidation, no payment shall be made to any sums due from the company on those shares, whether in respect of dividend, capital or otherwise.

Any issue or any transfer of those shares, if made, shall be void.

Further, where shares in any company are issued in contravention of any of the above restrictions, the company and the every officer of the company who is in default, shall be punishable with fine which may extend to rupees fifty thousand [Section 250(10)].

A prosecution under section 250 shall not be instituted except by, or with the consent of, the Central Government.

Change in the composition of the Board of directors - Where a transfer of shares in a company has taken place and as a result thereof a change in the composition of the Board of directors of the company is likely to take place and the CLB is of the opinion that any such change would be prejudicial to the public interest, it may, by order, direct that

- (a) the voting rights in respect of those shares shall be frozen for such period as not exceeding three years, as may be specified in the order;
- (b) no resolution passed or action taken to effect a change in the composition of the Board of directors before the date of the order shall have effect unless confirmed by the CLB.

Sub-section (3) can be invoked, and only if, the following three links in a chain exist. What is more important is that the first link in the chain should give rise to the second and second to the third. That is, there must exist a causal relationship in the chain. These links are :

- (i) there must be a transfer of shares;
- (ii) the transfer of shares should be likely to result in a change in the composition of Board of directors; and
- (iii) such change would be prejudicial to the public interest.

It is clear, therefore, that unless the contemplated chain relationship is established, the provisions of sub-section (3) cannot be applied. It will also be seen from these provisions that the stimulation for the reaction has to start from transfer of shares. Thus, transfer of shares is a sine qua non for setting the machinery of sub-section (3) in motion - In re, Shawallas Company Ltd., CLB Order, dated 31-10-1985.

Sub-section (4) guards against the likely change in the composition of Board of directors as a result of transfer of shares likely to take place and the CLB is of the opinion that such consequent change in the composition of the Board of directors shall be prejudicial to public interest. The CLB*, on forming such an opinion, may, by order, direct that any transfer of shares in the company during the specified period (not exceeding three years) shall be void.

Sub-section (5) empowers the CLB at any time to vary or rescind any order made by it. Any order made by the CLB, in this regard, shall be served on the company within fourteen days of the making of the

order. Any person who exercises or purports to exercise any right to shares issued or to be issued or votes or appoints proxy where he is the holder of shares or transfers any shares, which are subject to CLB's order under sub-sections (2), (3) and (4) of section 250, he shall be punishable with imprisonment for a term that may extend to six months or with fine up to ₹fifty-thousand or with both. A failure by any holder of shares which are subject to restrictions as above to give notice to a person who otherwise may act on the rights in those shares without having knowledge of the restrictions is also exposed to same punishment.

Application of section 250 in relation to debentures -The provisions of section 250 apply in relation to debentures as they apply in relation to shares [Section 250(12)].

Voluntary winding up of a company, etc., not to stop investigation proceeding [Section 250A] - An investigation may be initiated notwithstanding that an application has been made for an order for prevention of oppression or mismanagement or that the company has passed a special resolution for voluntary winding up. Also, no investigation shall be stopped or suspended by reason only of the fact that an application for prevention of oppression or mismanagement has been made or a special resolution for winding up has been passed.

Saving for legal advisors and bankers [Section 251]

A legal advisor need not disclose to the CLB or to the Central Government or to the Registrar or to an inspector appointed by the Central Government, a privileged communication made to him except as respects the name and address of his client. Again, a banker of the company shall not disclose any information as to the affairs of his customers other than the company or its associates under investigation.

Non-disclosure of information in certain cases [Section 635AA]

Notwithstanding anything contained in any other law for the time being in force, the Registrar, any officer of the Government or any other person shall not be compelled to disclose to any Court, Tribunal or other authority when he got any information which—

- (a) had led the Central Government to direct a special audit under section 233A or to order an investigation under sections 235, 237 or 247; or
- (b) is or has been material or relevant in connection with such special audit or investigation.

Difference between Inspection and Investigation

1. Inspection of books of account and other books and papers of the company is authorised under section 209A of the Companies Act, while investigation can be ordered under section 235 or 237 or 239 or 247 of the Act.
2. Inspection of books of account and other books and papers is not an investigation though it may lead to investigation in case anything wrong or objectionable is found during inspection. Its object is to ensure that there is nothing objectionable in the books of account and other books and papers. Investigation into the affairs of the company is wider in scope. It includes investigation of all the business affairs, profit and loss, assets including goodwill, contracts and transactions, investment and other property interests and control of subsidiary, holding and other related companies too.
3. Inspection can be done either by the Registrar or by an officer authorised by the Central Government or by SEBI. But, investigation can be conducted by competent persons only, appointed as inspectors (investigators) by the Central Government. Inspectors may be appointed by the Government from amongst the officers of the Government or persons from outside the Government.
4. Under section 209A, to inspect books of account and other books and papers the inspecting authority need not assign any reason. Further, no prior notice of inspection to the company is



necessary. The object of inspection is to keep a watch over the companies to ensure that the statutory books and papers are maintained and the business of the company is being managed at proper level of efficiency. Investigation, on the other hand, may be ordered by the Central Government under section 235(1) on the report of the Registrar, though it must be ordered by the Central Government under section 235(2) if a declaration to this effect is made by the CLB on a petition by specified number of members of the company. Under section 237(a), the Central Government is bound to order investigation into the affairs of the company if the company by special resolution or the Court by order declares that the affairs of the company ought to be investigated. Clause (b) of section 237, however, gives discretionary power to the Central Government to order investigation, if in the opinion of the CLB there are circumstances suggesting that the affairs of the company are being conducted : (i) with a view to defrauding members or other persons or for fraudulent or unlawful purpose or in a manner oppressive of any members or the company was formed for any fraudulent or unlawful purposes; or (ii) the managerial personnel or persons involved in the formation of the company are guilty of fraud, misfeasance or other misconduct towards the company or any of its members; or (iii) the members have not been given all the information about the affairs of the company including information on calculation of commission payable to a managing or other director. Investigation of ownership of the company may also be ordered by the Central Government under section 247. The Supreme Court in **Barium Chemicals Ltd, v. Company Law Board (supra)** held that unless the circumstances under section 237 (b) exist it cannot order investigation. Inspection can be ordered without disclosing any grounds as there is no such provision under the Act.

5. During inspection, the inspecting officer can ask for copies of books of account and other papers whereas during investigation the inspectors have powers for the seizure of the books and documents which they consider necessary for the purpose. Both the inspecting officer and the inspectors have powers to examine the persons concerned on oath.
6. An inspecting officer can inspect only that company for which he is so authorised by the Central Government. But an inspector has the power to investigate the affairs of the holding company, or the subsidiary of the company being investigated and the affairs of the managing director or the manager of the company without the approval of the Central Government and the affairs of the connected companies with the approval of the Central Government [Section 239].
7. Further, no company or member can ask for a copy of inspection report made under section 209A, while it is obligatory on the part of the Central Government to forward a copy of investigation report to the company concerned and on request and on payment of prescribed fee to any member or creditor of such company.
8. The expenses of inspection are borne entirely by the Government and are not recoverable. In the case of investigation, the expenses, in the first instance, are borne by the Central Government but may be reimbursed partly or fully by the applicants in the case of investigation under section 235 in accordance with any direction of the Central Government in this regard [Section 245]. Besides, the Central Government under section 236 has the right to ask for a security deposit not exceeding ₹1,000 from applicants under section 235(2). In respect of investigation under section 237 the cost of investigation can be recovered in certain circumstances.
9. While inspection under section 209A and investigation under sections 235, 237 and 239 can be done only by individuals, investigation under section 247 can also be carried out by firms etc.

1.10. PREVENTION OF OPPRESSION AND MISMANAGEMENT

The management of a Company is based on the majority rule, but at the same time the interests of the minority can't be completely overlooked. While talking of majority and minority, we are not talking of numerical majority or minority but of majority or minority voting strength. The reason for this distinction is that a small group of shareholders may hold the majority shareholding whereas the

majority of shareholders may, among them, hold a very small percentage of share capital. Once they acquire control, the majority can, for all practical purposes, do whatever they want with the Company with practically no control or supervision, because even if they are questioned on their acts in the general meeting, they always come out winners because of their greater voting strength. So, the modern Companies Acts contain a large number of provisions for the protection of the interests of minorities in companies. Section 397 to 409 of the Companies Act, 1956 contain the specific provisions which empowers (i) Company Law Board and (ii) the Central Government to deal with such situations preventing oppression and mismanagement in the company.

Meaning of Oppression: As per section 397 of the Act, where the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members, may be termed as oppression. The members complaining may apply to the CLB for appropriate relief subject to section 399.

Meaning of Mismanagement: As per section 398 of the Act, Mis-management is said to be done if:

- the affairs of the company are being conducted in a manner prejudicial to the interests of the company or;
- a material change (not being a change brought about by, or in the interests of, any creditors including debenture holders, or any class of shareholders, of the company) has taken place in the management of control of the company, whether by an alteration in its Board of directors, or if its managing agent or secretaries and treasurers, or in the constitution or control of the firm or body corporate acting as its managing agent or secretaries and treasurers, or in the ownership of the company's shares, or if it has no share capital, in its membership, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to the interests of the company.

1.10.1. Majority Rule but Minority Protection

Rule of majority

The principle of rule by majority has been made applicable to the management of the affairs of companies. The members pass resolutions on various subjects either by simple majority or by three-fourth majority. Once a resolution is passed by the requisite majority then it is binding on all the members of the company. As a resultant corollary, the court will not ordinarily intervene to protect the minority interest affected by the resolution, as on becoming a member, each person impliedly consents to submit to the will of the majority of the members. Thus, if wrong is done to the company, it is the company which is the legal entity having its own personality, and that can only institute a suit against the wrongdoer; and shareholders (members) individually do not have a right to do so.

The aforesaid rule was laid down in the leading case of **Foss v. Harbottle**.

According to Palmer "the rule in Foss v. Harbottle" is a phrase used to refer to two distinct, but linked, propositions of law. The first (proposition, which is that the court will not ordinarily intervene in the case of an internal irregularity if the matter is one which the company can ratify or condone by its own internal procedure. The second is that where it is alleged that a wrong has been done to a company, prima facie, the only proper plaintiff is the company itself.

Briefly, the facts in Foss v. Harbottle were as follows:

An action was brought by two shareholders, 'F' and T, of a company, on behalf of themselves and all other shareholders against the directors and solicitor of the company, alleging that by concerted and illegal transactions they had caused the company's property to be lost. It was alleged that the directors were acting in concert and effecting various fraudulent and illegal transactions whereby the property of the company was misapplied and wasted. It was prayed that the defendant might be decreed to make good to the company the losses. The question was as to the maintainability of the suit.



The Court held that the action could not be brought by the minority shareholders. The wrong done to the company was one which could be ratified by the majority of members. The company was the proper plaintiff for wrongs done to the company, and the company can act only through its majority shareholders. The majority of the members should be left to decide whether to commence proceedings against the directors.

The pre-eminently procedural character of 'the rule in Foss v. Harbottle' was clearly expressed in the following restatement of the rule by **Jenkins, L.J. in Edwards v. Halliwell**:

"The rule in Foss v. Harbottle, as I understand it, comes to no more than this. First, the proper plaintiff in an action in respect of a wrong alleged to be done to a company or association of persons is prima facie the company or the association of persons itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company or association and on all its members by a simple majority of the members, no individual member of the company is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company or association is in favour of what has been done, then cadit quaestio (cannot be questioned)."

Similarly, in **Rajahmundry Electric Supply Co. v. Nageshwara Rao AIR. 1956 SC 213**, the Supreme Court observed that:

"The Courts will not, in general, intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of the company by its directors so long as they are acting within the powers conferred on them under articles of the company. Moreover, if the directors are supported by the majority shareholders in what they do, the minority shareholders can, in general, do nothing about it."

Application of Foss v. Harbottle Rule- How far relevant in India- The Delhi High Court in **ICICI v. Parasrampuriah Synthetic Ltd, SCL July 5, 1998** has held that a mechanical and automatic application of Foss v. Harbottle Rule to the Indian situations, Indian conditions and Indian corporate realities would be improper and misleading. The principle, in the countries of its origin, owes its genesis to the established factual foundation of shareholder power centering around private individual enterprise and involving a large number of small shareholders, is vastly different than the ground realities in our country. Here the modern Indian corporate entity is not the multiple contribution of small individual investors but a predominantly and indeed overwhelmingly state-supported funding structure at all stages by receiving substantial funding up to 80% or more from financial institutions which are entirely state-controlled or represent substantial interest and, thus, their shareholding may be small but it is these financial institutions which provide entire funds for the continuous existence and corporate activities. If the Foss v. Harbottle Rule is applied mechanically, it would amount to giving weightage to that majority of the shareholding having notionally holding more percentage of shares, than to the financial institutions which may own a small percentage of shares though contributed 80% or more in terms of the finances to such companies. It is these financial institutions which have really provided the finance for the company's existence and, therefore, to exclude them or to render them voiceless on an application of the principles of Foss v. Harbottle Rule would be unjust and unfair.

Personal rights of members

It should, however, be noted that the aforesaid 'principle of Foss v. Harbottle' only applies where a corporate right of a member is infringed. The rule does not apply where an individual right of a member is denied.

The individual rights of a member arise in part from the contract between the company and himself which is implied on his becoming a member, and in part from the general law. Under the contract implied from his membership, he is entitled to have his name and shareholding entered on the register of members and to prevent unauthorised additions or alterations to the entry, to vote at meetings of members, to receive dividends which have been duly declared or which have become due under the articles, to exercise pre-emption rights over other members' shares which are conferred by the articles, and to have his capital returned in the proper order of priority in the winding up of the company or on a

duly authorised reduction of capital. Under the general law he is entitled to restrain the company from doing acts which are ultra vires; to have a reasonable opportunity to speak at meetings of members and to move amendments to resolutions proposed at such meetings, to transfer his shares, not to have his financial obligations to the company increased without his consent, and to exercise very many rights conferred on him by the Companies Act, 1956, such as his right to inspect various documents and registers kept by the company, to have a share certificate issued to him in respect of his shares, and to appoint a proxy to vote on his behalf at meetings of members.

The dividing line between personal and corporate rights is very hard to draw, and perhaps the most that can be said is that the court will be inclined to treat a provision in the memorandum or articles as conferring a personal right to a member only if he has a special interest in its observance distinct from the general interest which every member has in the company adhering to the terms of its constitution. A consequence of the distinction between personal and corporate rights is that a member cannot bring a personal action for the loss he has suffered by the diminution in the value of his shares resulting from breaches by the defendants of provisions of the company's memorandum or articles which do not confer personal rights on members, or from breaches of fiduciary duties owed by the defendants to the company; even if the member can prove a conspiracy between the defendants to commit the breaches complained of the diminution in the value of his shares is merely a reflection of the loss suffered by the company, and the proper remedy therefore is for the company to sue the defendants or, in appropriate circumstances for a derivative action to be brought.

Exceptions to 'the rule in Foss v. Harbottle'

In the following cases the rule in Foss v. Harbottle does not apply, i.e., the minority shareholders may bring an action to protect their interest:

Ultra vires and illegal acts - The rule in Foss v. Harbottle 'does not apply where the act complained of is ultra vires the company, since not even a unanimous vote of the shareholders can ratify such an act. In such cases it appears that the plaintiff shareholder can bring either a personal action, basing himself upon the company's breach of its memorandum, or a derivative action, basing himself upon the wrong done to the company by those who have caused it to act ultra vires.

If the action is designed to prevent a threatened ultra vires act, the plaintiff may bring either a personal or a representative action against the company, and the directors may be joined as co-defendants so that an injunction may be made against them too but if the plaintiff member seeks an order that the company shall recover compensation for an ultra vires act which has already been committed, or shall recover property disposed of by an ultra vires transaction, the action must be a derivative one.

Breach of fiduciary duties - A derivative action may be brought against directors and promoters who have been guilty of a breach of their fiduciary duties to the company, if they are able to prevent the company from suing them in its own name because they control a majority of the votes at a general meeting, or because they are otherwise able to prevent a general meeting from resolving that the Company shall sue them. Thus, derivative actions have been permitted against directors who were in control of the company for misappropriating the company's property or misapplying it in breach of the Companies Act, to compel such directors to account to the company for profits made by appropriating for themselves a business opportunity which the company would otherwise have enjoyed, or to deprive the members who controlled the company of their power to control it in the future, and to compel such directors to make a call on their own shares equal to a call which they had made on the shares of the other members. Likewise, derivative actions have been permitted against promoters who were in control of the company to rescind contracts made between them and the company when they had been guilty of misrepresentations or had failed to disclose a secret profit which they obtained from the transaction, and in those cases the court ordered the promoters to repay to the company all money received by them under the contracts.

In **Satya Charan Lal v. Rameshwar Pd. Bajoria [1950] S.C.R. 394**, it was observed that when a director is



in breach of fiduciary duty, every shareholder may be regarded as an authorised organ to bring the action.

Fraud or oppression against minority- Where the majority of a company's members use their power to defraud or oppress the minority, their conduct is liable to be impeached even by a single shareholder - **Edward v. Halliwell [1950] 2 All ER 1064.**

The fraud or oppression need not amount to a tort at common law, but it must involve an unconscionable use of the majority's power resulting, or likely to result, either in financial loss or in unfair or discriminatory treatment of the minority, and it must certainly be more serious than the failure of the majority to act in the interest of the company as a whole, which will induce the court to annul a resolution altering the company's memorandum or articles.

In the words of Lord Davey, in **Burland v. Earle [1902] A.C. 83**, fraud embraces all cases where the wrongdoers "are endeavouring, directly or indirectly, to appropriate to themselves money, property or advantages which belong to the company or in which the other shareholders are entitled to participate".

The leading example of the kind of fraud or oppression of this kind is found in **Menier v. Hooper's Telegraph Works Ltd.** In that case a company was formed to lay down a transatlantic telegraph cable which was to be made by Hooper's Telegraph Works Ltd. The majority shareholder 'Hooper' found that it could make a greater profit by selling the cable to another company which wished to lay it down on the same route, but which would not buy unless it had the necessary Government concessions for the undertaking. The first company had obtained such concessions, and so Hooper induced the trustee in whom they were vested to transfer them to the second company, which they bought the cable from Hooper. To prevent the first company from suing to recover the concessions, Hooper procured the passing of a resolution that the first company should be wound up voluntarily, and that a liquidator should be appointed whom Hooper could trust not to pursue the company's claim against Hooper and the trustee. Menier, a minority shareholder of the first company, brought a derivative action against Hooper to compel it (Hooper & Co.) to account to the company for the profits it derived from the improper arrangements it had made. It was held that Hooper's machinations amounted to an oppressive expropriation of the minority shareholders, and that a derivative action would therefore lie against it. **Sir W.M. James, L.J.**, said:

"The defendants, who have a majority of shares in the company, have made an arrangement by which they have dealt with matters affecting the whole company, the interest in which belongs to the minority as well as to the majority. They have dealt with them in consideration of their obtaining for themselves certain advantages. . . . The minority of the shareholders say in effect that the majority has divided the assets of the company, more or less, between themselves, to the exclusion of the minority. I think it would be a shocking thing if that could be done, because, if so, the majority might divide the whole assets of the company, and pass a resolution that everything must be given to them, and that the minority should have nothing to do with it. Assuming the case to be as alleged in the bill, then the majority have put something into their pockets at the expense of the minority. If so, it appears to me that the minority have a right to have their share of the benefits ascertained for them in the best way in which the court can do it, and given to them."

Inadequate Notice of a resolution passed at a meeting of members - It has been held in many cases that if an insufficiently informative notice is given of a resolution to be proposed at a general meeting, any member who does not attend the meeting, or who votes against the resolution, may bring a representative action to restrain the company and its directors from carrying out the resolution.

Qualified majority- Where the Act or the articles require a qualified (or special) majority for passing of a resolution, 'the rule in *Foss v. Harbottle* cannot be invoked to override these requirements. If this were not so, provisions requiring qualified majorities would be valueless because a bare majority could always confirm a special resolution passed irregularly. The action brought by a shareholder to complain of an irregularity in the passing of a special resolution would seem to be a personal one.

Where the personal rights of an individual member have been infringed- As already noted, the principle of majority rule is applicable only to the corporate membership rights of a member. Infringement of a member's individual rights like right to vote, right to receive dividends, etc., entitles him to proceed in his own name.

Statutory exceptions - The Companies Act, 1956, vide certain specific provisions, extends protection to the minority shareholders by conferring certain rights on them:

- (i) **Variation of class rights [Section 106]** - Where the share capital of a company is divided into different classes of shares, the rights attached to the shares of any class can be varied as provided in the memorandum or articles of the company with the consent of the 3/4th majority of the shareholders of that class. Where this is done and the rights are varied by the requisite majority vote, the holders of not less than ten per cent of the issued shares of that class who had not assented to the variation may apply to the "court for cancellation of the variation under section 107 of the Act.
- (ii) **Scheme of reconstruction and amalgamation** - Section 394 which provides for schemes of reconstruction also gives protection to minorities. Proviso to section 394(1) provides that no compromise or arrangement in connection with a scheme for the amalgamation of a company which is being wound up shall be sanctioned by the Court unless the Court has received a report from the CLB or the Registrar that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest.
- (iii) **Oppression and mismanagement** - The principle of majority rule does not apply to cases where sections 397 and 398 are applicable for prevention of oppression and mismanagement. A member, who complains that the affairs of the company are being conducted, in a manner oppressive to some of the members including himself, or against public interest, he may apply to the "court by petition under section 397 of the Act. In *O.P. Guptas. Shiv General Finance (P.) Ltd.* [1977] 47 Comp. Cas. 297, the Delhi High Court held that a member's right to move the Court under section 397 was a statutory right, and cannot, be affected by an arbitration clause in the articles of association of a company.
- (iv) **Rights of dissentient shareholders under take-over bids [Section 395]**- When an offer for the purchase of all the shares is received and the offer is accepted by the holders of 90 per cent of the shares, the party making the offer may, on the same terms acquire the remaining shares also. But a notice is to be given to the dissenting shareholders who have a right to apply to the court praying that their shares should not be allowed to be acquired on the terms of the scheme. On hearing the parties concerned, the Court makes an order, as it may think fit.

1.1.2. Prevention of Oppression and Mismanagement

In addition to the protection afforded to the minority by the exceptions to the Rule of the supremacy of majority, the Companies Act contains special provisions for prevention of oppression and mismanagement. The aim of such provisions, contained in Chapter VI of Part VI (Sections 397 to 409) of the Companies Act, 1956, is to safeguard the interest of investors, including minority shareholders in companies and also to protect the public interest.

PREVENTION OF OPPRESSION

In addition to the protection afforded to the minority by the exceptions to the Rule of the supremacy of majority, the Companies Act contains special provisions for prevention of oppression and mismanagement. The aim of such provisions, contained in Chapter VI of Part VI (Sections 397 to 409) of the Companies Act, 1956, is to safeguard the interest of investors, including minority shareholders in companies and also to protect the public interest.

Application to Company Law Board (CLB)- The first remedy in the hands of oppressed minority is to move the CLB. Whenever the affairs of a company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members, an application can be made to



the CLB under section 397. Alternatively, an application can be made under section 397 when facts would justify that an winding up order on the ground of “just and equitable” is maintainable but the winding up would unfairly prejudice the applying member(s). Requirements of section 399 of the Act need to be satisfied in making the application.

Who can apply [Section 399]- The requisite number of members who must sign the application is given in section 399. The requirement varies with the fact as to whether the company has a share capital or not and is discussed below:—

1. In case of a company having a share capital, the application must be signed by: (i) at least one hundred members, or (ii) by at least 1/10th of the total number of its members, whichever is less.

In the alternative, a valid application may be made by any member(s) holding not less than 1/10th of the issued share capital of the company.

The application to be valid, the applicant or applicants must have paid all calls and other sums due on their shares. Joint holders of shares shall be counted as one member. The CLB in *Kishan Khariwal v. Ganganagar Industries Ltd.* [2004] 50 SCL 567 has held that if a person's shareholding which was 10% or more gets below 10% by issue of further shares, such person can maintain the petition provided he has challenged further issue in his petition.

2. In case of a company not having share capital, application will be valid if signed by at least 1/5th of the total number of members of the company.

Central Government's Power - Primarily section 399 allows the right to make application to the CLB on two criteria - numerical strength of the members or shareholding strength of the members. Overriding these two, sub-section (4) of section 399 enables the Central Government to authorise any member(s) to make the application to the CLB notwithstanding that such member(s) does not fulfill any of the criteria. This, the Central Government may do, if it is of the opinion that circumstances exist which make it just and equitable so to do and authorise any member or members of the company to apply to the CLB [Section 399(4)].

Sub-section (4) is intended to waive the minimum requirements of section 399(1) and, normally, it is the nature of the allegations made, rather than the number or proportion of members who make an application to it, that is considered by the Central Government while granting permission. The Central Government has to satisfy itself that the member or members concerned would have had the right to apply to the CLB but for the statutory requirements specified in sub-section (1).

Secondly, it should be satisfied that prima facie the matters complained of fall within the purview of section 397 or 398. Thus, the scope of the inquiry postulated by subsection (4) is two-fold. First, to ascertain whether indeed, prima facie, any case is made out of oppression or mismanagement so as to affect public interest prejudicially, as postulated by section 397 or 398. Secondly, whether the applicant or applicants are indeed members who should in the circumstances be allowed to move the CLB not for their personal gain but in the interest of the company and the general body of shareholders and the public. Also see **Universal Music India Ltd. v. Union of India** [2008] 87 SCL 51 (Delhi).

Consent for Application - Where any members of a company are entitled to make an application by virtue of sub-section (1), any one or more of them having obtained the consent in writing of the rest, may make the application on behalf and for the benefit of all of them [Section 399(3)].

The question now arises is how to take consent in writing from other members who are not the applicants as such on the body of the application but nevertheless consented that the application is to be made. In this context, it is reiterated that the consent has to be in writing and the cumulative number or share holding strength of the consent givers and the applicant(s) meets the minimum required by the provisions and such minimum is not vitiated by any one or more members being defaulters to the company in regard to the calls made on the share capital or other dues on the share capital e.g., the concerned share(s) being in lien for certain transaction, in terms of the Articles of Association. In reckoning the minimum, the joint holders of shares will be counted as one.

The applicant(s) under section 397/398, in the context of sub-section (3) of section 399 are representative applicants in the eye of law and obtaining the consent in writing from other members is a condition precedent to make the application.

Section 399(3) has made it abundantly clear that when the representative application is to be made, the application should be not only for the applicant(s) but also should be for and on behalf of the consent givers and for their benefit as well. Consent in writing as stipulated in section 399(3) is consent to the filing of a particular petition with particular allegations and for a particular relief under section(s) 397 and/or 398.

Parameters to be applied for deciding validity of consent in writing –

- (1) Member(s) giving consent should have applied his mind to the issue before consenting in writing and should have known what relief has been claimed in the petition. There cannot be a blanket consent divorced from issues, grounds and relief.
- (2) Members who desire to file a petition under section 397/398 will have to file the petition in their own names and they have to file an affidavit verifying the petition and also have to indicate that they hold the prescribed number of shares and that all calls made have been paid. Sub-section (3) is an exceptional provision, according to which, with the consent of other members, a member or members can file a petition. In cases where they have the consent of other shareholders which would make the petition maintainable, unless their consent in writing are enclosed with the petition, it would not be possible to determine whether, on the date of filing the petition, the requirements of section 399 are fulfilled. Therefore, obtaining the consent in writing is a condition precedent to the making of the application. **[Makhan Lai Jain v. Amrit Banaspati Co. Ltd, [1953] 23 Comp. Cas. 100 (All.)]**.
- (3) It should be noted that consent obtained subsequent to making of the application is ineffective. It is, however, not necessary that the consenting members should have the petition before them before they give their consent. It is enough if they have considered the question of petition being moved under section(s) 397 and/or 398, as the consent envisaged in section 399(3) is not consent to the petition as such but a consent to certain action being taken, namely, an application under section 397/398. **[Rai Bahadur Satish Ch. Chowdhary v. Bengal Luxmi Cotton Mills Ltd. [1965] 1 Comp. Law Journal 35 (Cal.)]**.
- (4) Mere consent to an application under section 397 and/or 398 being filed is not enough. If consent is given on the basis of one set of facts and the application is made on another, the application cannot be said to be in pursuance to the consent. **[V.K. Mathur v. K.C. Sharma [1987] 61 Comp. Cas. 143 (Delhi)]**.
- (5) A mere consent to represent them for the proposed action against the management for gross mismanagement of the company's affairs and oppression of members is not sufficient. **[Kilpest (P.) Ltd. v. Shekhar Mehra [1987] 62 Comp. Cas. 717 (MP)]**.
- (6) A petition with defective consent is liable to be dismissed as not being in accordance with legal requirements **[P.S. Nanawati v. Jaipur Metals & Electricals Ltd. [1990] 69 Comp. Cas. 769 (Raj.)]**. The question of validity of signatures appended in a schedule to the petition was examined by the CLB in **S.S. Laxminarayanan v. Mather Platt (India) Ltd. [1997] 26 CLA 245**. In this case two applicants submitted the petition alleging oppression and mismanagement. Along with the petition they submitted a schedule containing signatures of 146 members signifying their consent to the petition. The CLB held that the schedule containing the signatures of the share holders who were purported to have given their consent did not meet the requirement of section 399(3). Mere, signature unaccompanied by affirmation of the consent is not enough.
- (7) In **Kuttanad Rubber Co. Ltd. v. K.T. Ittiyavirah [1997] 88 Comp. Cas. 438 (Ker.)**, in a petition under section 397 of the Act, the company raised an objection that the petition did not satisfy the statutory requirement of section 397 in that for any member to be entitled to make an application



he should hold a minimum of 1/10th of the shares; it was not enough that the requirement of 1/ 10th share holding was satisfied by the shares held by the petitioners as well as shareholders who had given their consent.

The Kerala High Court dismissed the plea of the company. In terms of sub-section (3) of section 399, when a petition was moved with the consent in writing of some of the shareholders, such a petition was on behalf of and for the benefit of all of them, namely, the petitioners and the consenting shareholders.

- (8) It has been held by the Supreme Court in **Rajahmundry Electric Corporation v. A. Nageshwara Rao AIR 1956 SC 213** that if some of the consenting members have, subsequent to the presentation of the application, withdrawn their consent, it would not affect the right of the applicant to proceed with the application. The Punjab High Court went a little further in **Jagdish Chandra Mehra v. New India Embroidery Mills [1964] 1 Comp. LJ 291** by holding that where a petition has been properly presented, it does not cease to be maintainable merely because three of the applicants have transferred their shares and ceased to be shareholders of the company. The validity of the petition must be judged on the facts as they were at the time of its presentation. Neither the right of the applicant to proceed with the application, nor the jurisdiction of the CLB to dispose it of on its own merits, can be affected by events happening subsequent, to the presentation. In **Gees Marine Products (P) Ltd. [2005] 63 SCL 82 (CLB)**, it has been held that if original petitioners do not want to continue the proceedings, the CLB may allow substitution of the names of petitioners, on the basis of the merits of the petition. The Madras High Court in **L. Rama Subbu v. Madura College Board[2007] 73 SCL 146** has held that a consent giver cannot be held bound to his past action contrary to the consent, if there arises a new Conviction or understanding relating to the subject matter.

Trust as Petitioner/consent giver- The legal position is that all trustees should be Parties to the proceedings and they cannot delegate or give consent to one of them to initiate proceedings. Consent could be given only in respect of matters which one could do by himself. Trustees cannot authorise one of them to launch a proceeding in the name of a trust and therefore the consent given by the trustees is something which they cannot give on their individual rights and as such any petition made on the basis of consent given to one or more trustees is not maintainable [**Duli Chand v. Mahavir Prasad Trilok Chand Charitable Trust AIR 1984 Delhi 145**].

In **Sir J.P. Srivastava & Sons (Rampur)(R)Ltd. v. Gwalior Sugar Co. Ltd.[1999]2I SCL 142**, the Principal Bench of the CLB has held that a petitioner describing herself as a petitioner on her behalf and on behalf of a trust is not acceptable. It was observed that as long as the petitioners held requisite number of shares, wrong or incorrect mention of the number of shares held was immaterial. However, if one acts on behalf of the other, then, it should be either by virtue of a power of attorney or any other written authority given by such persons.

In a related reference the Supreme Court has settled the issue of maintainability of petition under sections 397 and 398 by & trust by deciding that the trust can be a party to the petition and the same was maintainable as the appellants along with the trust held more than 10% of the share capital including 1029 preferential shares - **J.P. Srivastava & Sons (Rampur) Pvt. Ltd. v. H.K. Srivastava - SLP(C) Nos. 10235-36 of 2005 dated 3-9-2008**.

Deletion of shareholders' names- Deleting shareholders' names from the Register of members after a petition under section 397/398 has been filed - Whether valid - In a petition under sections 397 and 398 filed against the company, the petitioner company alleged that three petitioners in the petition did not have the requisite share qualifications to initiate the proceedings in that the Board of directors had rectified the register of members by deleting their names on the ground that the stamps on the reverse of the share transfer deeds had not been cancelled and that therefore, registration of the shares in their names was illegal and improper. Since these three petitioners were no longer the shareholders of the company they did not have the qualifications to proceed with the main proceedings. (**Vide Sayedabad Tea Co. Ltd. v. Samarendra Math Ghattak [1995] 83 Comp. Cas. 504**). The contention urged

on behalf of the shareholders was that when the main petition was filed they had the requisite share qualification and that it was only after the initiation of the main proceedings almost four years after it was filed that the directors themselves had chosen to delete their names from the register. The directors, it was claimed, had no authority to rectify the share register without giving any notice to them and without taking recourse to the provisions of section 155 of the Act. In support of their case they had relied upon the decision of the Madras High Court in **Damodara Reddi v. Indian National Agencies Ltd. [1945] 15 Comp. Cas. 148**, which held that the register of members of a company was a public document and there was no provision in the Act which permitted the directors or any officer to make any alteration to the register by removing the names of certain members on the ground that they had been improperly added to the register, and that the remedy of the company was to apply to the court for the rectification of the register and not to take upon itself the power to alter such register. The Calcutta High Court held that the company could have refused to register the shares on the ground that the stamps had not been cancelled. Once having not done so, it was not open to the company suo moto to deregister that without taking recourse to law. It was held in **Rajahmundry Electric Supply Corporation Ltd. v. A. Nageswara Rao (supra)** that the validity of a petition must be judged on the facts as they were at the time of its presentation and where a petition was valid when it was presented, it could not cease to be maintainable by reason of events subsequent to its presentation. Withdrawal of consent by some of the members subsequent to the presentation of the application would not affect either the right of the applicant to proceed with the application or the jurisdiction of the court to dispose of the application on merits.

Indirect supersession of the board not allowed

In a very comprehensive decision, the Principal Bench, CLB (New Delhi) in the Shaw Wallace case cited earlier, has held :

- (i) petition under sections 397 and 398 can be pursued by the petitioners concurrently with a petition under section 408;
- (ii) motive for the petition is a relevant consideration when relief sought is examined and ulterior motive, if established, would be a ground for refusal to grant the relief, notwithstanding merit of the case;
- (iii) prayer for supersession of the entire Board is not sustainable when allegations are against only two directors;
- (iv) acts of the directors/company leading to a situation of financial crisis are prejudicial to the interests of the shareholders and the company; however, if a charge against a director for misuse of fiduciary position or for fraud/ misfeasance could not be established, he would not be removed from the Board merely on suspicion.

In this case, the CLB ordered for restructuring of the Board as against supersession and held that if majority in the Board becomes, as a result of the petition, Government appointees, it would amount to indirect supersession and accordingly, ordered restricted number of appointments by the Government and the financial institutions so that they do not constitute majority in the Board. Presence of eminent persons in the Board of a company, ipso facto, cannot stop appointment of Central Government nominees under section 408 of the Act, where mismanagement has taken place. However, such number should be reasonable - *Union of India v. Eveready Industries India Ltd.* [2005] 62 SCL 34 (CLB).

Besides members, the following may also apply for relief under section 397:

- (i) Under section 401, the Central Government, or any person authorised by the Central Government, has a right to file a petition.
- (ii) Under section 243, any person authorised by the Central Government under the circumstances mentioned in that section can also file a petition.
- (iii) A legal representative of a deceased member, on whom title to the shares devolves by operation



of law. Even though not registered as a member he is entitled to present a petition under section 397 - *World Wide Agencies (P.) Ltd. v. Margaret T. Desor* [1989] 2 CLA 345 and affirmed on appeal by the Supreme Court [1990] 3 CLA 248 and *Kalitara Glass Moulding (P) Ltd., In re* [1992] 8 CLA 98 (CLB). Also see *Rajkumar Devraj v. Jai Mahal Hotels (P.) Ltd.* [2007] 73 SCL 328 (CLB).

- (iv) Trustees of a shareholder/member may also make a petition. The Calcutta High Court, in *Power Tools & Appliances Co. Ltd. v. Jaladhar Chakraborty* [1992] 8 CLA 50, held that refusal of one of the four trustees (of a public-charitable trust) who held bulk of the shares of the company to participate in the proceedings did not render the petition filed by the other three trustees infructuous. In this context, the High Court cited the following passage from Halsbury's Laws of England:

"In trusts of a public or charitable nature a majority of the trustees may as a rule bind the minority, but in a private trust where there is more than one trustee the concurrence of all is, in general, necessary in a transaction affecting the trust property and a majority cannot bind the minority."

- (v) Shareholder in management - As per the CLB there is no bar to any shareholder in management in making petition under section 397/398 - *K.N. Bhargava v. Track Parts of India Ltd.* [2000] 23 SCL 320. However, the application has to be in the capacity of a shareholder alone and not a mixed one as shareholder and lessee of a property leased to the company concerned. *M. Gopalan v. Narmada Consumer Stores (P) Ltd.* [2004] 51 SCL 89 (CLB - N. Delhi). However, the CLB in *Dinesh Sharma v. Vardaan Agrotech (P) Ltd.* [2007] 73 SCL 338, has held that when a promoter, holding shares as also the managing directorship, is irregularly removed from directorship, it is a case of oppression. This decision also held that reduction of petitioner's shareholding by irregular allotment of further shares, below 10% is also an act of oppression.

Who cannot apply- The following cannot apply for relief under section 397:

- (i) a member/(s) whose calls are in arrears [Section 399(1)(a)].
- (ii) a holder of a letter of allotment of a partly paid share
- (iii) a holder of a share warrant
- (iv) a holder of a share certificate to bearer
- (v) a transferee of shares who has not lodged the shares for transfer to the company.
- (vi) Shareholders of a holding company cannot file petition against a subsidiary of the holding company. *Herbertson Ltd. v. Kishore Rajaram Chhabria* [1999] 21 SCL 99 (CLB). Also the Board of Directors of the holding company, where the directors did not hold shares in the subsidiary cannot make petition under section 397/398. *BDA Ltd. v. Kishore Rajaram Chhabria* [1999] 22 SCL 284 (CLB).

Notice of application to be given to Central Government- Section 400 requires the CLB to give notice of every application made to it under section 397 or 398 to the Central Government. The CLB has to take into consideration any representation made by the Central Government in connection with a particular application.

Relief against oppression - Members of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members including any one or more of themselves may apply to the CLB for an order under section 397. If, on such application, the CLB is of opinion—

- (a) that the company's affairs are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members; and
- (b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up; the CLB may, with a view to bringing to

an end the matters complained of, make such order as it thinks fit. [Vide section 397(2)] While mere non-payment of dividend does not constitute oppression, the CLB, if it is of opinion that the conditions stated in section 397(2) exist, it can pass appropriate order to bring to end matters complained of and it is not necessary to quote the exact provisions of section 397(2) in the application - *Indowind Energy Ltd. v. ICICI Bank Ltd.* [2010] 103 SCL 513 (CLB -Chennai).

Conditions for relief under section 397- In *K.P. Chackochan v. Federal Bank* [1989] 66 Comp. Cas. 953 (Ker.), it was observed that in order to grant relief under section 397, a petitioner must show three things:

1. The affairs of the company are being conducted in a manner oppressive to some part of the members/shareholders including the petitioners. It is to be noted here that the section does not require that the oppressed members should be the minority. 'Shareholders with a minority beneficial interest may, by having control over voting, be able to oppress those with majority beneficial interest.'
2. The facts pleaded justify the making of a winding-up order on the 'just and equitable' ground. In case, winding up of the company is not justified, the Supreme Court in *Kilpest (P.) Ltd, v. Shekhar Mehra* [1996] 10 SCL 233 held that the petition for oppression and mismanagement shall not be maintainable.
3. To wind up the company would unfairly prejudice the oppressed members.

Interestingly, the CLB in *Dipak G. Mehta v. Shree Anupar Chemicals (India) P. Ltd.* [1999] 21 SCL 107, has held that dismissal of a winding up petition on deadlock in management will not be a ground of non-maintainability of petition under section 397 where oppression is proved.

However, if facts fall short of a case upon which the company should be wound up on just and equitable ground and no ingredient of oppression is otherwise present, relief under section 397 cannot be granted - *Hanuman Prasad Bagri v. Bagress Cereals (P.) Ltd.* (supra).

Meaning of oppression

As per Sec.397 of the Act, where the affairs of the Company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members, may be termed as oppression. The members complaining may apply to the Company Law Board for appropriate relief subject to section 399.

The meaning of the term "oppression" as explained by Lord Cooper in the **Scottish case of Elder v. Elder & Watson Ltd.**, was cited with approval by Wanchoo, J. (afterwards CJ) of the Supreme Court of India in *Shanti Prasad Jain v. Kalinga Tubes*. "The essence of the matter seems' to be that the conduct complained of should, at the lowest, involve a visible departure from the standards of their dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to the company is entitled to rely." The complaining shareholder must be under a burden which is unjust or harsh or tyrannical. 'Legitimate expectation' in the capacity of shareholder can also constitute a basis to construe act or acts as oppressive [vide *Elgindata Ltd., In re* [1991] BCLC 959 Ch. D. and *Chatterjee Petrochemical (Mauritius) Co. v. Haldia Petrochemicals Ltd.* [2008] 143 Comp. Cas. 726.

The complaining member must show that he is suffering from oppression in his capacity as member and not in any other capacity. "Oppression involves at least an element of lack of probity or fair dealing to a member in the matter of his property right as a shareholder" - *Kalinga Tubes Ltd. v. Shanti Prasad Jain* [1964] 1 Comp. LJ 117. In *Lundi Bros. Ltd., Re* [1952] 2 All ER 692, a minority shareholder of a private company was removed from his position as a working director. As an ordinary shareholder he would have gained nothing as the company had never paid any dividend, director's remuneration being the only return on investment. Yet he could not complain of it because he had suffered as a director and not as a member. Thus, to constitute oppression, persons concerned with the management of the company's affairs must in connection therewith be guilty of fraud, misfeasance or misconduct towards the members. It does not include mere domestic disputes between directors and members



or lack of confidence between one section of members and another section in the matter of policy or administration. Much less it covers mere private animosity between members and directors.”¹ This statement has been cited with approval in *Kalinga Tubes Ltd v. Shanti Prasad Jain*, where Misra, J. of the Orissa High Court dismissed a petition under the section and his decision was affirmed by the Supreme Court in *Shanti Prasad Jain v. Kalinga Tubes Ltd*.

Oppression to be of continuing nature - The facts alleged must reveal an oppression of continuing nature. In **Col. Kuldip Singh Dhillon v. Paragaon Utility Financiers (P.) Ltd. [1988] 64 Comp. Cas. 19 (Punjab & Har.)**, the Punjab and Haryana High Court observed that there must be continuous acts on the part of majority shareholders, continuing up to the date of the petition, showing that the affairs of the company were being conducted in a manner oppressive to some part of the members. In this case, the acts complained of related to 1978-79. Later, when one of the complainants was appointed as the managing director, they kept quiet and subsequently filed the petition in 1982. It was held that the petition was not maintainable as it could not be said that there were continuous acts of the majority shareholders which had been oppressive to the petitioners. Also see **Anil Kumar v. Vee Kay Oils (P) Ltd. [2007] 74 SCL 60 (CLB)**.

However, in **Surinder Singh Bindra v. Hindusthan Fasteners Ltd. AIR 1990 Delhi 32**, it was held that past acts shall be relevant if they constitute continuing whole with the present facts or if the single past act complained of is capable of unleashing a continuing oppression. In **R. Khemka v. Deccan Enterprises (P) Ltd.**, the A. P. High Court held that continuity of burdensome, harsh and wrongful conduct of one party against another is necessary to bring such conduct within the ambit of the word “oppression”—[1999] 19 SCL 290. However, the CLB in **Dipak G. Mehta v. Shrae Anupar Chemicals (I) (P) Ltd. (supra)** has held that even though the act of oppression are not continuous but are successive, yet the petition is maintainable on just and equitable ground. However, as held in **P. Ramkumar v. T.V. Chandran [1994] 1 Comp. L.J. 469 (Ker.)** the Court cannot take cognizance of events occurring after filing of the petition.

Minor acts of mismanagement, however, are not to be regarded as oppression. As far as possible, shareholders should try to resolve their differences by mutual readjustment. Moreover, the Courts will not allow these special remedies to become a vexatious source of litigation. In **Lalita Rajya Lakshmi v. Indian Motor Co.** the petitioner alleged that the board of directors were guilty of certain acts detrimental to the minority shareholders. The allegations were mainly on improper management. It was held that even if each of these allegations were proved to the satisfaction of the Court, there would have been no oppression.

Acts held as oppressive - Looking to the various judicial pronouncements, some of the acts amounting to oppression may be summarised as under:

- 1. Not calling a general meeting, and keeping shareholders in dark – Hindustan Co-operative Insurance Society Ltd., In re [1961] 31 Comp. Cas. 193 (Cal.)**. In this case, the shareholders were left completely in the dark, because no annual general meeting was called, with no information regarding the manner in which the affairs of the company were being conducted, while those men who purported to act as directors dealt with the company’s money in any fashion they liked and prejudicial to the interest of the company. It was held that these acts of the respondent who had the majority backing no doubt amounted to oppression by them of the minority shareholders and also, oppression in the conduct of the affairs of the company and these were to the detriment of both the company and its members.
- 2. Non-maintenance of ‘statutory records and not conducting affairs of the company in accordance with the Companies Act - Bhajirao G. Ghatke v. Bombay Docking Co. (P.) Ltd, [1984] 56 Comp. Cas. 428 (Bom.)**.
- 3. Depriving a member of the right to dividend - Mohan Lai Chandu Mal v. Punjab Company Ltd. [1962] 32 Comp. Cas. 937 (Punjab.)**-The Court in this case held that if the non-voting members were being dominated and had to submit to excessive use of authority, such a conduct amounted to

unjust hardship. "To take away the right of partaking of dividends earned by their contribution is not merely oppressive but even confiscatory". Therefore, such a case calls for an interference by the CLB under section 397.

4. **Transfer of shares held by a company to some shareholders otherwise than by making an offer to all** - In **Col Kuldip Singh Dhillon v. Paragaon Utility Financiers (P.) Ltd. (supra)** at a board meeting, the shares held by the company were transferred to some of the directors although it had earlier been resolved that they would be offered to all the shareholders. It was held that before deciding to whom the shares should be sold, an offer of sale should have been made to all the shareholders; shares should have been transferred to one who made the highest offer.
5. **Allotment of shares by directors in a manner by which an existing majority of shareholders is reduced to a minority** - **Gluko Series (P) Ltd., In re [1987] 61 Comp. Cas. 227 (Cal)**, **Anand Kumar Saigal v. Manu Properties (P) Ltd. [2001] 32 SCL 367 (CLB)**; **State Bank of India v. Business Development Consultants (P) Ltd, [2005] 61 SCL 226 (CLB)**.
6. **Continuous refusal by company to register shares with an ulterior motive of retaining control over affairs of the company** - **Kumar Exporters (P) Ltd. v. Naini Oxygen and Acetylene Gas Ltd. [1986] 60 Comp. Cas. 984 (All)**. Though refusal once by the company may not be oppressive, but a continuous refusal by the company to register the shares with an ulterior motive of retaining the control over the affairs of the company may be a case where the CLB is obliged to interfere and grant relief under section 397. Refusal to register transfer of shares held by a company, on its merger with another company, in favour of that other company without sufficient cause is oppression - '**e**' **First Technologies (P) Ltd. v. Hyperworld Cybertech Ltd. [2005] 60 SCL 9 (CLB)**.
7. **Failure to distribute the amount of compensation received on nationalisation of business of company among members, where required to be so distributed** **Hindusthan Co-operative Insurance Society Ltd., In re [1961] 31 Comp. Cas. 193 (Cal.)**. In this case, the insurance business of the company was nationalised in 1956 and a compensation of Rupees thirty-five lakhs was received by it. The directors did not call any annual general meeting thereafter. In January 1959, the Board resolved to call a general meeting and pass a resolution to continue the company and carry on other businesses authorised by the Memorandum with the compensation money received by the company. Section 39 of the Life Insurance Corporation Act envisaged distribution of compensation to shareholders and dissolution of the company. The question was whether the conduct of directors was oppressive. Held that, the resolution and the persistent conduct of the respondent in the affairs of the company since 19-1-1956 clearly would be that they never intended to distribute the compensation money amongst the shareholders, who were entitled thereto, but to hold it in their hands and at their disposal and benefit by the strength of their majority or controlling voting power. This conduct of the respondent was no doubt oppressive to the company and to the applicant's minority shareholding in the company.
8. **Countermanding decisions of Board by a director who controls majority voting power, and not allowing Board to perform its functions** - **H.R. Harmer Ltd., In re [1959] 29 Comp. Cas. 305 (CA)**.
9. **Where directors of a private company pass a resolution in which they are interested without disclosing nature of their interest** - **Col. Kuldip Singh Dhillon v. Paragaon Utility Financiers (P) Ltd. (supra)**.
10. **If a sale of its assets is made by a company to some of its directors and simultaneously loan is made to purchasers to finance this sale** - **Col Kuldip Singh Dhillon v. Paragaon Utility Financiers (P) Ltd (supra)**. The company whose own financial position was not sound, sold some of its assets to some of its directors and the purchasers adjusted the purchase price partly against the amount due to them from the company, and partly against a loan made to them by the company, it was held that the latter part of the transaction was oppressive to other shareholders.



11. **Refusal to register transmission under will - Gajarabai Patny v. Patny Transport (P) Ltd. [1966] 36 Comp. Cas. 745 (AP).** Refusal to register shares bequeathed under the will while registering other shares bequeathed under the same will may be construed as oppression since it involves violation of the conditions of fair play.
12. **Issue of further shares benefiting a section of the shareholders** - Issue of further shares may form the subject-matter of a petition under this section if it can be proved that the idea of issuing further shares was to benefit one group to the detriment of the other - **Piercy v. Mill(s) & Co. [1920] 1 Ch. 77; also see Mrs. Rashmi Seth v. Chemon (India) (P) Ltd. [1992] 9 CLA 83 (CLB).**
13. **Registration of transfers in violation of articles** - Where the company registered transfers without fulfilling the requirement of the articles relating to transfer of shares which resulted in weakening the minority and strengthening the local group functioning in league with the nominees of a foreign group, it was held that there was oppression - **Bhubaneshwar Singh v. Kanthal India Ltd. [1986] 59 Comp. Cas. 46 (Cal.).**
14. **Diversion of business opportunity** - The diversion of a business opportunity from one company to another company controlled by a director of the former and who was a majority shareholder of that company was held to be oppressive because it deprived the minority twenty-five per cent of the profits which was attributable to that opportunity - **London School of Electronics Ltd., In re [1985] BCLC 273."**
15. Acts of directors/company leading to financial crisis of the company are prejudicial to the interests of shareholders and the company, (vide **Shaw Wallace Employees' Federation** case)
16. **Sending notices to a shareholder to a place where he did not reside - Shivnath Rai Bajaj v. NAFABS India (P) Ltd. [2002] 35 SCL 448 (CLB).** This case also held that an NRI shareholder has the locus standi to file the petition against oppression.
17. **Irregular appointment of director on the strength of irregular allotment of shares is an act of oppression - Radhe Shyam Tulsian v. Panchmukhi Investments Ltd. [2002] 35 SCL 849 (CLB). Also see Micromerities Engineers (P) Ltd. v. S. Munusamy [2005] 58 SCL 301 (Mad.)**

Acts held as not oppressive - The following acts have been held as not oppressive:

1. **An unwise, inefficient or careless conduct of a director - Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd, [1981] 51 Comp. Cas. 743 (SC)** - The Supreme Court in this case ruled that "on a true construction of section 397, an unwise, inefficient or careless conduct of a director in the performance of his duties cannot give rise to a claim for relief under that section. The person complaining of oppression must show that he has been constrained to submit to a conduct which lacks in probity, conduct which is unfair to him and which causes prejudice to him in the exercise of his legal and proprietary rights as a shareholder.
2. **Non-holding of the meeting of the directors** - It may affect the rights of the petitioner as a director but his rights as a minority shareholder would not be affected - **Chander Krishan Gupta v. Pannalal Girdhari Lai (P) Ltd. [1984] 55 Comp. Cas. 702 (Delhi).**
3. **Not declaring dividends when company is making losses - Chander Krishan Gupta v. Pannalal Girdhari Lai (P) Ltd. (supra)** - Delhi High Court in this case observed that if the company makes profit and the management for ulterior reasons and motives, primarily with a view to deprive the shareholders of any share of the profits, does not declare dividend, then it may possibly be argued that non-declaration of dividend may amount to an act of oppression. But where the company has been making losses, the question of the company declaring dividends cannot arise.

If the company continues to run in losses and its substratum is wiped off, it may be a good ground for winding-up the company but the non-declaration of dividend, under such circumstances, when the company is not making profit, cannot be a ground for invoking section 397.

4. **Mere filing of a suit for recovery of money from an ex-director - Chenna Basappa Kothambari v. Multi Plast Industries (Karnataka) (P.) Ltd. [1985] 57 Comp. Cas. 541 (Kar.)** - In this case 'M' was a private limited company in which twenty-five per cent shares were held by the petitioner, 'C', and the remaining shares were held by another group and their friends. After the petitioner gave up his directorship in the company, a suit was filed for recovery of rupees eighty thousand from him. The petitioner filed a petition contending that there was oppression and it was just and equitable to wind up the company.

Held that mere filing of a suit against him could not be said to be any oppression to him.
5. **Denial of inspection of books to a shareholder - Maharani Lalita Rajya Lakshmi v. Indian Motor Company (Hazaribagh) Ltd. (supra).**
6. **Lack of details in notice of a meeting - Maharani Lalita Rajya Lakshmi's case (supra)** - In case notice of a meeting is not accompanied by an 'explanatory statement', where necessary under section 173(2), it cannot ipso facto be considered as an act of oppression in conducting the affairs of the company within the meaning of section 397. Breach of section 173(2) can at best make the meeting called invalid.
7. **Non-maintenance of records - Chander Krishan Gupta v. Pannalal Girdhari Lai (P) Ltd. (supra)** - Delhi High Court, in this case, observed as follows :

"The non-maintenance of records cannot amount to acts of oppression being committed on the minority shareholders. If proper records of the company are not maintained, it may mean that the management is not working properly. The wrongful act, if committed, of not maintaining the statutory records at the registered office may attract evil consequences to the directors of the company and may also, in certain circumstances, amount to an act of mismanagement but under no circumstances can it be regarded as an act of oppression."
8. **Drawing of remuneration by a director to which he is not legally entitled-** If a director of a company draws remuneration to which he was not legally entitled or in excess of the remuneration to which he was legally entitled, this might no doubt cause misfeasance proceedings or proceedings for some other kind of relief, but it would not by itself amount to oppression. Nor would the fact that the director was a majority shareholder in the company make any difference, unless he had used his majority voting powers to procure or retain or to stifle proceedings by the company or other shareholders in relation to it - **Jermyn Street Turkish Baths Ltd., In re [1971] 41 Comp. Cas. 999 (CA).**
9. **Negligence and inefficiency in managing the affairs of a company-** Minor acts of mismanagement, e.g., where passengers travelling without ticket on a company's buses were not checked or where the petrol consumption by a transport company was excessive, the Calcutta High Court refused to grant relief under section 397. Negligence and inefficiency, even assuming that these are proved, do not amount to oppression or mismanagement as contemplated by the Act - **Mohta Bros. v. Calcutta Landing and Shipping Co. Ltd [1970] 40 Comp. Cas. 119 (Cal.).**
10. **Where a resolution is passed by the members in a general meeting suspending operation of section 81 (Rights issue) – Shanti Prasad Jain v. Kalinga Tubes Ltd. [1965] 35 Comp. Cas. 35(supra).**
11. **Increasing the voting rights of the shares held by the management** - Where there is nothing against the present management and where it can be said that it would be beneficial to maintain the present management, any attempt to increase the voting rights of the shares held by the present management cannot be construed as an act of oppression - **Rights & Issues Investment Trust Ltd. v. Style Shoes Ltd. [1964] 3 All ER 628.**
12. By prejudicial conduct against the company's interest and also on grounds of waiver, estoppel and acquiescence, the petitioner had disentitled itself from being granted any equitable relief - **VLS Finance Ltd. v. Sunair Hotels Ltd. [2001] 33 SCL 475 (CLB).**



13. In a case where allegation of minority oppressing majority was brought before it, CLB ruled that mere expression of desire to gain control over the company by the minority is not an act of oppression – **Ultrafilter (India) Pvt. Ltd. v. Ultrafilter GmbH**[2002] 38 SCL 573.
14. A preference shareholder cannot allege oppression in matters of allotment of equity shares - **Hillcrest Realty Sdn. Bhd. v. Hotel Queen Road (P) Ltd. Supra.**
15. Where the grievances of petitioners flow from share purchase agreement between them and respondents no application lie before CLB - **M. Trimme Gowda v. SPR Sugars (P) Ltd. [2008] 81 SCL 30 (CLB).**

Meaning of public interest

The concept of public interest was specifically brought in by the Companies (Amendment) Act, 1963. The idea was to enable the Court (now the CLB) to pass an order under section 397 on 'just and equitable ground', even on the basis of an application by one or two members of the company, not holding the requisite number and value of shares. This is possible if the Central Government under section 399(4) allows a member or members to make an application under section 397 despite the lack of shareholding strength.

The expression 'public interest' is not capable of precise description. It has been held to be an elusive abstraction meaning general social welfare or regard for social good and predicating interest of the general public in matters where a regard for the social good is of the first moment. In the words of Frankfurter, J. of the United States Supreme Court, "the idea of public interest is a vague, impalpable, but all controlling consideration". A thing is said to be in public interest where it is or can be made to appear to be contributive to the general welfare rather than to the special privilege of a class, group or individual - **N.R. Murty v. Industrial Development Corporation of Orissa Ltd. [1977] 47 Comp. Cas. 389 (Ori).**

The Supreme Court in **State of Bihar v. Kameshwar Singh AIR 1952 SC 252** has observed that the expression 'public interest' is not capable of a precise definition and has no rigid meaning and is elastic and takes its colours from the statute in which it occurs, the concept varying with the time and state of society and its needs.

Thus, what is public interest today may not be so considered a decade later. It cannot be considered in value but must be decided on the facts and circumstances of each case

Petition to contain all material facts

Petition under section 397 must plead all material facts necessary for granting the relief prayed for. If the facts transpiring on the date of the petition and alleged in the petition are not sufficient to make out a case, facts arising subsequent to the filing of the petition cannot be relied upon. Also, subsequent affidavits are not enough - **Shanti Prasad Jain v. Kalinga Tubes Ltd. [1964] 1 Comp. LJ 117**. The validity of the petition will be judged on the facts alleged therein and existing at the time of its presentation. Thus, where the petitioners were not even able to prove that they were members nor could show any facts which constituted their oppression, the petition was dismissed as being without substance – **T.J. Thomas v. Rev. C.S. Joseph [1988] 1 Comp. LJ 22 (Ker.).**

Further, lack of essential allegation in a petition cannot be made good by leading evidence - **Re. Bengal Luxmi Cotton Mills Ltd. [1965] 1 Comp. LJ 35.**

Besides, the application under section 397 must specifically state the nature of the relief or reliefs sought. It must contain enough to leave no doubt as to what the applicant wants the CLB to do and should not merely seek a general relief that the CLB (now Tribunal - yet to take effect) may deem just and expedient". The Madras High Court in a comprehensive judgment in the case of **S. Seetharaman v. Stick Fast Chemicals (P.) Ltd. [1998] 18 SCL 399** has confirmed all the points made in this Paragraph. Also, the judgment held that relief against reallocation of shares cannot be sought under sections 397 and 398 (as the Companies Act then provided recourse to section 155), and continuous act of

oppression must be present to establish oppression under section 397. Further, it held that the mere fact that a substantial shareholder is excluded from management does not amount to oppression. Also cases like denial of right of inspection or declaration of dividend at a lesser rate, etc., do not constitute oppression as separate reliefs are available.

True scope of section 397

In **Shanti Prasad Jain v. Kalinga Tubes Ltd. (supra)**, the Supreme Court considered four important English cases and quoted the following summary given in Meyer's case which lays down certain important considerations to be kept in view in determining the scope of section 397.

- The oppression of which a petitioner complains must relate to the manner in which the affairs of the company concerned are being conducted; and the conduct complained of must be such as to oppress a minority of the members (including the petitioners) qua shareholders.
- It follows that the oppression complained of must be shown to be brought about by a majority of members exercising as shareholders' predominant voting power in the conduct of the company's affairs.
- Although the facts relied on by the petitioner may appear to furnish grounds for making of a winding up order under the 'just and equitable' rules, those facts must be relevant to disclose also that the making of a winding up order would unfairly prejudice the minority members qua shareholders.
- Although the word 'oppressive' is not defined, it is possible, by way of illustration, to figure a situation in which majority shareholders, by an abuse of their predominant voting power, are 'treating the company and its affairs as if they were their own property' to the prejudice of the minority shareholders and in which just and equitable grounds would exist for the making of a winding up order but in which the 'alternative' remedy provided by this section by way of an appropriate order might well be open to the minority shareholders with a view to bringing to an end the oppressive conduct of the majority.
- The power conferred on the court to grant a remedy in an appropriate case appears to envisage a reasonably wide discretion vested in the court in relation to the order sought by a complainant as the appropriate equitable alternative to a winding up order.
- In proceedings under section 397, it is not legality or illegality of action complained of is of primary importance but whether the act(s) is oppressive is of paramount importance - **K.N. Bhargava v. Track Parts of India Ltd, (supra)**. It is also permissible in petition under sections 397 and 398 to bring further facts and grounds before the final hearing of the petition provided such facts/grounds disclose additional cause of action and the same is arguable – **Jer Rutton Kavasmaneck v. Gharda Chemicals Ltd, [2000] 23 SCL 71 (Bom.)**.

Oppression of majority

It may be noted that remedies against oppression or mismanagement are available not only to the minorities but, in an appropriate case, if the Court is satisfied about the acts of oppression or mismanagement, relief can be granted even if the application is made by a majority, who have been rendered completely ineffective by the wrongful acts of a minority group. In **Sindhri Iron Foundry (P) Ltd., Re. [1964] 34 Comp. Cas. 510 (Cal)**, the High Court observed that sections 397 and 398 nowhere prescribe that the application under the two sections can be made only by a minority group. Nor do they prescribe that a majority group can under no circumstances come to Court for redress, whatever may be the nature and extent of the oppressive acts of the rival group and whatever may be the extent of the injury suffered by the company as a result of the activities of such a group. Justice Mitra further observed that if the Court finds that the company's interest is being seriously prejudiced by the activities of one or the other group of shareholders, that two different registered offices at two different addresses have been set up, that two rival boards are holding meetings, that the company's business,



property and assets have passed into the hands of unauthorised persons who have taken wrongful possession and who claim to be shareholders and directors, that the bank accounts of the company have been practically frozen, there is no reason why the Court should not make appropriate orders to put an end to such matters.

Mere expression of the desire by minority to gain control over the company has been held as not an act of oppression - **Ultrafilter (India) Pvt. Ltd. v. Ultrafilter GmbH case (supra)**. But when majority is denied his legitimate right and is wrongfully reduced to minority, it was held to be an act of oppression and the Calcutta High Court set aside illegal allotment of shares - **Bhagirath Agarwal v. Tara Properties (P.) Ltd. [2002] 39 SCL 943**. Also see **Kobian (P.) Ltd. v. Kobian India (P) Ltd. [2005] 59 SCL 608 (CLB)**.

Limitation

In **Hungerford Investment Trust Ltd. v. Turner Morrison & Co. Ltd. ILR [1972] 1 Cal. 286**, it was held that Article 137 of Limitation Act, 1963, applies to application under sections 397 and 398 and accordingly a petitioner cannot rely upon events (acts of oppression) more than three years prior to the date of the filing of the petition. However, certain authors on the subject hold a different view. Ramaiya, for instance, argues that the Schedule to Limitation Act, 1963 applies to suits and application before a Court and not before a quasi-judicial authority like CLB. Further, it is argued that if the oppression is of a continuing nature, bar of limitation cannot come in the way of admitting the petition.

Sections 397 to 408 confer certain powers on the court (now CLB*) and the Central Government to deal with oppression of the minority or with mismanagement of the affairs of a company in a manner prejudicial to the interests of the company and its members. The provisions of these sections are intended to avoid recourse to the extreme step of winding up a company and at the same time protect the minority shareholders from acts of oppression and mismanagement. Under these sections, the oppressed members of the company may, subject to the conditions laid down in section 399, move the court (now CLB) for the protection of their rights and interests. The court (now CLB) thus approached by the parties is required, in turn, to give notice under section 400 of every such application to the Central Government to make representation to it, if any, for its consideration before it passes the final order in the case.

Instances: A study of the applications made to the courts in respect of which notices were received by the Department revealed common types of mismanagement and oppression against which courts were moved. These were as follows :

- (a) fraudulent transactions;
- (b) grossly inefficient management in disregard of the best interests of companies;
- (c) misappropriation of funds of the company;
- (d) illegality in the conduct of board meetings and general meetings;
- (e) absence of the proper legal authority on the part of directors to carry on the management of companies.

Nature of reliefs - While making these allegations, the parties sought the following general types of reliefs from the courts :

- (a) a direction by the court for the proper conduct of the affairs of the company;
- (b) removal of the existing directors or some of them from the management of the company;
- (c) declaration that the removal of the petitioner(s) from the management of the company was invalid, and that his/their appointments or rights were to remain unaffected;
- (d) appointment of an administrator or receiver during the interim period till final judgment of the court (now CLB);

- (e) revision of the company's accounts and recovery of funds alleged to have been misappropriated by the existing management; and
- (f) an order that the affairs of the company should be investigated - Taxmann's Circulars & Clarifications, 1992 edn., pp. 422-423.

PREVENTION OF MISMANAGEMENT

Application to CLB for relief in cases of mismanagement - Section 398 provides for relief in cases of mismanagement. The section provides that the requisite number of members (as laid down in section 399) of a company may apply to the CLB for appropriate relief on the ground of mismanagement of the company. Similar to the case of oppression, the legal representative of the deceased shareholder acquires right to approach competent court for relief against mismanagement of the company - **Arjun Tukaram Shetaonkar v. Smt. Urmila Vaikunta Desai [2001] 34 SCL 227 (Bom.)**.

Relief by the CLB - The CLB may give relief if it is of opinion—

- (a) that the affairs of the company are being conducted in a manner prejudicial to the public interest or in a manner prejudicial to interests of the company; or
- (b) that by reason of a material change in the management or control of the company, the affairs of the company are likely to be conducted in a manner prejudicial to the public interest or in a manner prejudicial to the interests of the company.

The change in management or control of the company may be due to an alteration in its Board of directors or Manager or in the ownership of the company's shares, or if it has no share capital, in its membership or in any other manner whatsoever. The material change in the management or control does not include a change brought about by, or in the interests of any creditors including debenture holders, or any class of shareholders, of the company.

It would, however, not be correct to say that jurisdiction of CLB is very wide and serious dispute regarding title to shares cannot necessarily be decided by the CLB. Such dispute may be decided by appropriate Civil Court. CLB was held to be not a Civil Court - **Gordon Woodroffe & Co. Ltd., U.K. v. Gordon Woodroffe Ltd. [1999] 20 SCL 429 (Mad.)**. Where principal issues of dispute between shareholders and the company are already before the High Court, the CLB loses its jurisdiction in matters of sections 397 and 398 - **Indowind Energy Ltd. v. ICICI Bank Ltd. (supra)**.

Instance of mismanagement - A very clear illustration of mismanagement contemplated under section 398 appears in **Rajahmundry Electric Corporation v. A. Nageshwara Rao (supra)**

A petition was brought against a company by certain shareholders on the ground of mismanagement by directors. The court found that the vice-chairman grossly mismanaged the affairs of the company and had drawn considerable amounts for his personal purposes, that large amounts were owing to the Government for charges for supply of electricity, that machinery was in a state of disrepair, that the directorate had become greatly attenuated and "a powerful local junta was ruling the roost" and, that the shareholders outside the group of the chairman were powerless to set matters right. This was held to be sufficient evidence of mismanagement. The Court, accordingly, appointed two administrators for the management of the company for a period of six months vesting in them all the powers of the directorate.

It may be noted that expression "the affairs of the company are being conducted in a manner prejudicial to the interest of the company" in section 398 will also take within its ambit the non-conduct of the affairs of the company where such non-conduct results in prejudice being caused to the company. In **Chander Krishan Gupta v. Pannalal Girdhari Lal (P) Ltd. (supra)**, the Delhi High Court observed that "section 398 has two facets. The first is that positive acts are done by the management which result in prejudice being caused to the company. Secondly, section 398 may be attracted even where no action at all is taken by the management and such non-action results in prejudice being caused to the company.....non-conduct may arise for a variety of reasons including serious disputes among the



Board of directors of the company which results in a complete deadlock or stalemate."

In the case cited above, for quite some time the company had been incurring losses. The directors of the company were carrying on other personal businesses. The disputes amongst the directors of the company had resulted in the records of the company not being available. The management of the company had miserably failed in protecting the company's records and this failure resulted in prejudice being caused to the company. Moreover, the constant fight amongst the directors, who were also the shareholders of the company, had an adverse effect on the conduct of the company's business with the result that the company started incurring losses. Held that, it was a fit case where appropriate orders under section 398 should be passed. In **Central Government v. Pentamedia Graphics Ltd.**, the CLB held that violation of statutory provisions constitutes mismanagement and offences being compounded do not stand in the way of invoking CLB jurisdiction under section 408 of the Act-[2006] 70 SCL 13.

Conditions precedent for obtaining relief - Section 398 can be invoked in either of the two circumstances:

1. that the affairs of the company **are** being conducted in a manner which is—
 - (a) prejudicial to public interest; or
 - (b) prejudicial to the interest of the company.
- OR
2. it is likely that the affairs of the company **will be** conducted in a manner—
 - (a) prejudicial to public interest; or
 - (b) prejudicial to the interest of the company.

due to a material change that has taken place in the management or control of the company. Such change may take place due to alteration in the company's Board of directors or Manager or in ownership of its shares or membership or in any other manner whatsoever. (Such change not being a change brought about or in the interests of any creditors including debentureholders or any class of shareholders of the company).

In **Suresh Kumar Sanghi v. Supreme Motors Ltd. [1988] 54 Comp. Cas. 235 (Delhi)**, the Delhi High Court observed that "relief under section 398 can be obtained only if (i) the affairs of the company are being conducted in a manner prejudicial to public interest, (ii) if the affairs are being conducted in a manner prejudicial to the interest of the company, or (iii) if there is material change which has taken place in the management or control of the company in the manner set out in the said section, and that by reason of such change it is likely that the affairs of the company will be conducted in a manner prejudicial to public interest or in a manner prejudicial to the interest of the company." It was further observed that section 398 comes into play only when there is actual mismanagement or apprehension of mismanagement of the affairs of the company.

Who can make the petition (Section 399) - A petition under section 398, like under section 397, may be made—

- (a) In case of a company having share capital –
 - (i) by not less than 100 members or not less than ten percent of the total number of members, whichever is less;
 - or
 - (ii) by any member or members holding not less than ten per cent of the issued share capital of the company.
- (b) In case of a company having no share capital- by not less than twenty per cent of the total number of members;

The Central Government may, however, authorise any member or members of the company to apply even though he/they is/are not otherwise entitled to do so because of deficiency in the number or proportion of members who can make the application.

Matters Before BIFR - When a matter is already before BIFR, a petition under section 398(1)(b) to disturb the present management is to be dismissed. The order held that when there is a material change in control of a company holding substantial proportion of shares in another company, then such a change with reference to other company, has to be treated as a material change within the ambit of the words "in any other manner, whatsoever", appearing in section 398(1)(b) - *Gordon Woodroffe & Co. Ltd. (U.K.) v. Gordon Woodroffe Ltd.* [1998] 17 SCL 343 (CLB - New Delhi). However, the CLB in *Paharpur Cooling Towers Ltd. v. Swadeshi Polytex Ltd.* [2002] 38 SCL 142 allowed the petitioner (happened to hold second largest chunk of shares in the subject company) to revive the company provided a settlement was reached with workers of the company. Simultaneously, petitioner was allowed to purchase shares of the company from NTC.

Petition Undisposed for a long time - Karnataka High Court in *Devraj Dhanram v. Firebricks & Potteries (P) Ltd.* [1999] 22 SCL 263 allowed a new petition to be presented in place of the old one remaining undisposed for almost 9 years with further material arising in the intervening period.

Cessation of Membership of Company after filing Petition u/s 397 and 398 - The petition get dismissed - *Mohd. Badarudheen v. Navarathna Business Developers (P) Ltd.* [2006] 71 SCL 215 (CLB). There was no substitution of the petitioner.

Acts held as mismanagement- The following acts have been held as amounting to mismanagement under section 398:

1. **Where there is serious infighting between directors resulting in serious prejudice being caused to the company** - *Suresh Kumar Sanghi v. Supreme Motors Ltd, (supra)*. In a family centered company if shares are allotted to one group to the exclusion of the other and additional directors are appointed to control the Board, taking advantage of temporary absence of a director belonging to the other group - *Ms. Pushpa Prabhudas Vora v. Vora Exclusive Tools (P) Ltd.* [2000] 24 SCL 111 (CLB).
2. **Where Board of directors is not legal and the illegality is being continued, it will amount to mismanagement, prejudicial to public interest** - *Sishu Ranjan Dutta v. Bholanath Paper House Ltd.* [1988] 53 Comp. Cas. 888 (Cal).
3. **Gross neglect of interest of the company by sale of its only assets and total inattention thereafter to the affairs of the company** - *M. Moorthy v. Drivers and Conductors Bus Service (P) Ltd.* [1991] 71 Comp. Cas. 136 (Mad.).
4. **Diversion of funds of the company for the benefit of majority group** - *Bhaskar Stoneware Pipes (P) Ltd. v. Rajindernath Bhaskar* [1988] 63 Comp. Cas. 184 (Delhi); diversion of public money for unknown/unwanted purposes affecting grossly financial state of the company - (held gross act of mismanagement) *KRS Mani v. Anugraha-Jewellers Ltd. (supra)*.
5. **Where bank account was operated by unauthorised persons** - *Col Kuldip Singh Dhillon v. Paragaon Utility Financiers (P.) Ltd.* [1988] 64 Comp. Cas. 19 (Punj. & Har.). In this case, a certified copy of a resolution had been sent to the bank authorising certain persons to operate the account. No such resolution was found recorded in the minutes book; rather the resolutions passed on the particular date and recorded in the minutes book were different.
6. **Advance of loans without execution of a document which is not repaid and even interest is not realised** - *Col Kuldip Singh Dhillon's case (supra)*.
7. **Where directors take no serious action to recover amounts embezzled** - *Co/. Kuldip Singh Dhillon's case (supra)*.



8. **Continuation in office after expiry of term and infighting among directors.** -Where the managing directors of a company continued in office after their terms had expired, without a meeting being held to re-appoint them prior to making a fresh application to the Central Government under section 269, the continuation in office under these conditions was held to be mismanagement within the purview of this section - **Sishu Ranjan Dutta v. Bhola Math Paper House Ltd. (supra)**. So also infighting among the directors resulting in serious prejudice to the company constitutes mismanagement under section 398 -**Suresh Kumar Sanghiv. Supreme Motors Ltd, (supra)**.
9. **Sale of assets at low price and without compliance with the Act.** - One of the estates of a tea and rubber plantation company was sold by the directors at a low price to another tea plantation company without complying with the requirements of section 293(1) which demands approval by shareholders and without giving adequate notice under section 173 and relevant information, giving delivery of possession before general body meeting and accepting consideration in installment. It was held that all these acts constituted mismanagement of affairs and the sale was set aside.

The Board of directors and the purchasers were held liable for the company's losses and were required to submit an account of the income of the estate from the date of delivery of possession to the date of its actual return to the company - **Malayalam Plantation (India) Ltd., Re [1991] 5 Corpt. LA 361 (Ker.)**.
10. **Collusive sale of assets by lending institutions.** - Where the assets of the borrower company were disposed of by the lending institution to the brother-in-law of the managing director in a collusive sale and the member-directors of the company were not able to pay out the buyer to recover back the assets, the CLB ordered the managing director to take steps to put the company on winding up or to have its name struck off the register. In the meantime the lending institution was instructed not to seek any recovery from the company and to release the directors from their personal guarantees - **Mittal Dal Mills Ltd., Re[1992] 8 Corpt. LA 104 (CLB)**.
11. **Violation of statutory provisions and those of articles.** - Transferring shares without first offering them to the existing members in accordance with their rights under the articles, holding meetings without sending notice to members; issue of shares for a consideration other than cash not represented by corresponding assets and burdening the company with additional rental by shifting the company's office - **Akbarali A. Kalvert v. Konkan Chemicals (P) Ltd. [1994] 3 Comp. LJ 102 : [1994] 15 Corpt. LA 170 (CLB)**.
12. **Erosion of company's substratum.** - Where neither the duly constituted Board of directors nor the petitioner who was allowed a trial to run the company was able to make any headway towards improving the lot of the company and there were also many irregularities in the conduct of affairs which had eroded the substratum of the company, the CLB asked the Central Government to consider taking appropriate action under section 433/439 in case the newly constituted Board of directors also failed in reviving the company within a reasonable time - **AIR Asiatic Ltd., Re [1994] 3 Comp. LJ 294 : [1994] 15 Corpt. LA 189 (CLB) and Thomas George v. KCG Verghese [1994] 3 Comp. LJ 294: [1994] 15 Corpt. LA 189 (CLB)**.
13. **Violation of memorandum.** - **Violation of the conditions of the company's memorandum by those who are in charge of company's management** - **S.M. Ramakrishna Rao v. Bangalore Race Club Ltd. [1970] 40 Comp. Cas. 674 (Mys.)**.
14. Non-existence of names of petitioners in the register of members on the face of existence of valid share certificates, communication in the matter of the AGM to the petitioners and other supporting facts—**Banford Investment Ltd. v. Magadh Spun Pipe Ltd. [1998] 17 SCL 166 (CLB)**.
15. When the respondent managing director does not comply with the terms of consent order and does not appear at hearings, he would be deemed to have abandoned his interest in the company and the petitioner will be entitled to manage and control the company - **Mrs. Pooja Joshi v. Century Gases & Petro Chemicals Ltd. [2004] 50 SCL 556 (CLB - N. Delhi)**

16. When controlling group in a company takes away the company's significant business by incorporating another company without the knowledge of the other group or of the company, amounts to mismanagement of the company concerned- *Vaishnav Shorilal Puri v. Kishore Kundanlal Sippy* [2004] 53SCL 469 (Bom.).
17. When the managing director of a closely held company transferred his shares to his son and no evidence could be produced that the transfer was in accordance with the Articles, the transfer is ordered to be cancelled as it amounted to oppression and mismanagement - *S. Rehana Rao v. Balaji Fabricators (P) Ltd.* [2004] 55 SCL 400 (CLB).

Acts held as not mismanagement

1. Building up of reserves, or non-declaration of dividend especially when it does not result in devaluation of shares - *V.J. Thomas Vettom v. Kuttanad Rubber Co. Ltd.* [1984] 56 Comp. Cas. 284 (Ker.).
2. Merely because company incurs loss, it cannot be said that it is mismanaged - *Chennabasappa Kothambari v. Multiplast Industries (Karnataka) (P.) Ltd.* [1985] 57 Comp. Cas. 541 (Kar.).
3. Removal of Secretary by majority decision of Board of directors unless it is shown that the removal has prejudicially affected the interest of the company or the public interest - *Dr. V. Sebastian v. City Hospital (P) Ltd.* (supra).
4. The mere keeping of the moneys of the company in a Term Deposit is not bad business practice or in any case such mismanagement as would warrant interference under section 398 of the Act.

The single act of letting out the premises of the company is not sufficient to attract this section.

Allegations that properties of the company have been let out at low rents without any proof as to what higher rents were available as also an unsubstantiated allegation that premium amounts were misappropriated were held to be not sufficient in invoking the provisions regarding mismanagement - ***Jaladhar Chakraborty v. Power Tools and Appliances Co. Ltd.* [1994] 79 Comp. Cas. 505 (Cal).**

5. **Arrangement with creditors in company's bona fide interest.** - Where the directors of a company in financial difficulties arrange with the company's creditors that the creditors may become shareholders and directors instead of remaining as creditors, was not an act of mismanagement or oppression so far as the existing shareholders are concerned but done bona fide in the best interests of the company - ***Suresh Chandra Marwaha v. Lauls (P) Ltd.* [1978] 48 Comp. Cas. 110 (DB) (P & H).**
6. **Removal of director and termination of works manager's services.** - Termination of the services of a works manager who held only ten shares was not in itself an act of mismanagement - ***Modern Furnishers (Interior Designers) (P) Ltd., In re* [1985] 58 Comp. Cas. 858 (Cal).** Removal of some of the directors from office which was found to be valid was held to be not a state of mismanagement of the company's affairs - ***Siddaramappa Bapurao Patil v. Ratna Cements (Yadwad) Ltd.* [1991] 70 Comp. Cas. 27 (Kar.).**
7. **Mismanagement cannot be alleged in pre-production stage—***S. Seetharaman v. Stick Fast Chemicals (P) Ltd.* (supra).
8. Mere breach of fiduciary duty resulting in suffering of interest of company or public interest is not a ground for interference by CLB under section 398(1)(b) of the Act; there must be material change in management or control of company - *Gordon Woodroffe & Co. Ltd. v. U.K. Gordon Woodroffe Ltd* (supra).

Removal of existing directors and appointment of new directors cannot be challenged in a petition under section 398. It is only when the new directors misconduct the affairs of the company that it may be said that they had been working to the prejudice of the company - ***RaiSaheb Vishwamitra v. Amar***



Nath Mehrotra 1983 Tax LR 2600 : [1986] 59 Comp. Cas. 854 (All).

Winding up order declined when basic complaint was of mismanagement - The petitioner sought winding up order as just and equitable under section 433(f) of the Act alleging mismanagement of the company as the company did not recover sale proceeds of six flats. The Court declined to pass the order as specific remedy against mismanagement is available under section 398 of the Act. The petitioner has to establish circumstances justifying winding up of the company and show that no alternative remedy is available to him. Petitioner cannot just come to the Court without first exercising his rights as shareholder in the given circumstances - **Kiritbhai R. Patel v. Lavma Constructions & Finance Ltd. [1999] 20 SCL 158 (Guj.)**.

Private agreement for investment and sections 397 and 398 of the Act - The CLB, in **Allianz Securities Ltd. v. Regal Industries Ltd. [2000] 25 SCL 349** has held that disputes arising out of private agreements for investment in shares have to be agitated in civil suit and the same cannot be dealt with in petition under sections 397 and 398 of the Act.

Wrong and imprudent decisions in management - It is one of the settled principles in deciding on petition under sections 397 and 398 that wrong/imprudent decision alone cannot constitute oppression or mismanagement unless the same is motivated one or in breach of fiduciary responsibilities - **Ramaiya Electronics Ltd. v. Gujarat Trans Receivers Ltd. [2002] 35 SCL 704 (CLB)**. The Madras High Court in **KRS Mani v. Anugraha Jewellers Ltd. (supra)** has pronounced that courts should recognise corporate democracy of a company in managing its affairs and should not restrict powers of the Board of directors of the company and should not interfere in day-to-day affairs of the company. This pronouncement, it appears, is not intended for a situation where management of affairs of a company is palpably wrong.

Oppression and mismanagement and family centered companies - A review of cases on oppression and mismanagement reveal that a sizeable proportion of such cases arise in family centred companies and often involve private disputes among the family members bringing complexities in the concerned company's affairs. Some of the points that the Courts and CLB in various decisions ruled are as under:

1. Family arrangement of equality in shares not being a part of articles of association cannot bind the company.
2. Any attempt to block company from complying with directions of the Courts on the basis of shareholding strength is contrary to company's interest.
3. Raising resources by further issue of shares by the group in management is not oppressive to the other group so long the issue is in bona fide need of the company and articles do not prohibit such course of action.
4. Where articles provide that shares in the company are to be allotted equally/ proportionately and that no new member could be inducted without approval of majority of members, equity demands, that in making allotments requirement of articles should be followed and any allotment of shares to outsiders without offering the proportionate shares to those who are entitled thereto is oppression.

[Vide **V.B. Gopalakris Jinan v. New Theatres (P) Ltd. [2001] 30 SCL 197 (CLB)**]

Also see **Mrs. Najma M. Saiyed v. Mehboob Productions (P) Ltd. [2005] 62 SCL 468 (CLB)**. In this case issue was development of the business property of the family held company. Decision of Board of directors to mobilise funds for the benefit of the company was not held oppressive. In fact, the CLB was of the view that the petitioner had oblique motive.

5. Sale of properties owned jointly by two factions of a family and sold by one of the factions, where leave of court was necessary to effect the sale was held to be an act of oppression, when no leave of court was taken - **Bajrang Prasad Man v. Raigarh Jute & Textile Mills Ltd. [2001] 32 SCL 583 (Cal.)**

6. Board of directors, acting in fiduciary capacity, had no right to register irregular transmission of shares. Articles of Association provided for transmission only to holder of succession certificate and there was no evidence to show that the Board in effecting the transmission had regard to the relevant provision of the Articles. The registration of shares of the deceased in favour of one who did not hold the succession certificate was held as an act of oppression and therefore set aside - *A.J. Coelho v. South India Tea and Coffee Estates Ltd.* [2001] 33 SCL 503 (CLB).
7. In a family based company in the nature of quasi-partnership, admission of new members should be with the consent of existing members. Though a number of irregular and improper acts were allegedly committed by respondents to reduce the shareholding of the petitioners from 50% to less than 10% on record and to remove them from management of the company, the CLB ordered that the petitioners should sell their shares to the respondents/company on receipt of fair value in view of the fact that bringing back the parity in shareholding and management would bring deadlock in the company. This order was to safeguard the interest of the company- *S. Ajit Singh v. DSS Enterprises (P) Ltd.* [2001] 34 SCL 547.
8. Directors of a company cannot use their fiduciary powers over the shares of the company for destroying an existing majority. They cannot gain total control of the company by use of improper means. The right to refuse transmission of shares cannot be invoked against the legal heir/successor of the deceased shareholder - *Smt. Shanta Devi Pratap Singh Gaekwad v. Sangramsinh P. Gaekwad* [2002] 37 SCL 339 (Guj.).
9. A party to a decision can never allege mismanagement - A family/private agreement between shareholders in the instant case, as a reference point before CLB, has become redundant in view of the agreement between parties to implement the family settlement - *Prakash Math v. Ashoka Mfg. Co. (P) Ltd.* [2002] 38 SCL 747 (CLB).
10. In a partnership in the guise of a company (a family company), removing a director by dubious means and methods from directorship, siphoning of funds, not serving notice etc. constitute oppression. The CLB allowed compensation for loss of office as a director to the petitioner and directed the company and the respondents to purchase the shares of the petitioner at fair value - *V. Natarajan v. Nilesh Industrial Products (P) Ltd.* [2003] 41 SCL 237 (CLB).
11. Petitioner complaining that a majority group in the family company has been reduced to minority has to establish that all the family members involved have recognized creation and existence of groups in the company. However, any disturbance in shareholding of members disproportionately is an act of oppression - *Mrs. Shyamali Day v. Homco Engg. Works (P) Ltd.* [2003] 41 SCL 223 (CLB); also *Dilip Kumar Chandra v. Chandra & Sons (P) Ltd.* [2003] 45 SCL 408 (CLB - Delhi).
12. The CLB, in *Brij Mohan Bansal v. Bansal Gems (P) Ltd.* [2002] 38 SCL 1 has held that in the absence of cogent evidence from petitioner to support his contention, it is impossible to accept that concerned documents were fabricated/manipulated to oust him from management. Also, it was found unbelievable that petitioner could remain silent for over three years without raising the matter with the respondent.
13. Transfer of shares by certain members of the family in the family owned private limited company in full compliance of the requirements of the Articles of Association is not an act of oppression; also alternative use of land for earning revenue when normal business of the company has been closed is not an act of mismanagement – *Devaraj Dhanram v. Firebricks & Potteries (P) Ltd* [2002] 38 SCL 13 (CLB - Chennai).
14. Lack of mutual confidence between petitioner and respondent was taken into consideration by the CLB which gave option to the petitioner to take over the company after paying to the respondents their investments in share capital and share application money in the company and all other dues to them even though the petitioner might have got relief through order of the CLB to end oppression/mismanagement - *Arun Kejriwal v. A.R. Corrugated Containers (P) Ltd* [2002] 38 SCL 52; in *Chandrakant Kantilal Shah v. National Refinery (P) Ltd* [2004] 51 SCL 387. The CLB,



having regard to unreconcilable state of relations between warring groups in the family company directed sale of shares of the minority group to the majority.

15. When Chartered Accountants failed to find out from records of the company, the correct contribution towards shares of the company made by the petitioner, the CLB took into consideration the total "project cost and total resources recorded for the same and attributed the difference to be the unrecorded contribution of the petitioner and ordered issue of shares to the petitioner, representing the difference - **S. Swamiyappan v. Andipalayam Common Effluent Treatment Plant (P) Ltd.** [2002] 38 SCL 58.

In a petition for oppression and mismanagement a right must exist against a third party respondent - The Allahabad High Court in **Banaras Bank v. Bhagwan Das** AIR 1947 All. 18 had laid down two tests to decide whether a certain person is a necessary party. These tests are—

- (i) there must be a right to relief against such party in respect of the matter in complaint, and
- (ii) it should not be possible to pass an effective decree in the absence of such a party.

Interested third party in proceedings u/ss 397 and 398 - When prima facie any third party is found to be involved in carrying out oppression and mismanagement in the affairs of a company and named in the petition as respondent, his prayer for deleting his name as respondent cannot be granted - **Das Lagerwey Wind Turbines Ltd., In re** [2004] 55 SCL 378 (CLB).

Affairs of a Company include Affairs of its Subsidiary(ies) in Appropriate Cases - Sections 397 and 398 of the Act focus on "affairs of the company" in the context of oppression and mismanagement - where the respondent, primarily being a family based company, is also a dominant member of the family group companies, the expression "affairs of the company" as above would include affairs of its subsidiaries and the chain of subsidiaries where a clear nexus of operational control can be discerned on the respondent; this will be specially so, if further the true character of the shareholding in the various companies in the group is of partnership and the group working is as one single economic unit. If facts and circumstances of a case so warrant, after going into the allegations, the affairs of the subsidiary(ies) would get merged in the affairs of the respondent company. From the above, it should not be construed that without going into the allegation and ascertaining the facts, the subsidiaries can be taken out of the scope of the expression "affairs of the company" or be included in it. Therefore, it is necessary, when the plaint connects up the affairs of the holding company and the subsidiary, the CLB has to go into the grievances and consider the evidence and their relevance to subsidiary. If they are relevant, the affairs of the subsidiary come within the scope of affairs of the holding company - **Shankar Sundaram v. Amalgamations Ltd.** [2002] 38 SCL 777 (Mad.), **Life Insurance Corporation of India v. Hari Das Mitndhra** [1966] 36 Comp. Cas. 371 (All.), **Bajrang Prasad Jalan v. Mahabir Prasad Man** AIR 1999 Cal, 156; **Debonair-Agencies Ltd.** - Company Petition No. 494 of 1989 before the **Calcutta High Court**. However, the affairs of an independent firm do not come within purview of the expression "affairs of a company" - **Sanjeev Joy v. Pereira & Rochi (P) Ltd.** [2002] 39 SCL 176 (CLB). This case also relates to a family based company. As the CLB found affairs of a subsidiary was independent of the holding company, the petition of the petitioner to include the subsidiary also in his original petition under sections 397 and

398 against the holding company was turned down - **P. Govindarajan v. Tiruppur Transports (P) Ltd.** [2004] 55 SCL 453.

Waiver, Estoppel or Acquiescence by a Shareholder Holding 10% or more of Shares in the company - The Madras High Court upheld the rejection of the appeal questioning maintainability of a petition filed against the appellant company on preliminary consideration as according to the appellant company, the respondent was a party to the relevant decisions now being questioned. The Court held that as the basic requisite for making the petition has been met, the petitioner cannot be disentitled from claiming reliefs on merit - **Amalgamations Ltd. v. Shankar Sundaram** [2002] 38 SCL 803 (Mad.).

Interim Prayer - According to CLB the normal principles to be applied for grant of interim relief are - (i) there exists a serious dispute in question to be tried, (ii) court's interference is necessary to protect the parties from injury and (iii) a prima facie case has been established and the balance of convenience is in favour of the petitioner for interim relief.

AMALGAMATION OF TRANSFEROR COMPANY AFTER FILING OF PETITION UNDER SECTIONS 397 AND 398

- The transferee company would step into the shoes of transferor company when the High Court order sanctioning the scheme of amalgamation specifically stated that all legal proceedings pending by or against transferor company should be continued by or against transferee company. This decision also held that maintainability of petition under sections 397 and 398 was to be seen when it was presented and substitution of transferor by transferee was to be allowed when petition was made prior to amalgamation **RFB Latex Ltd. v. Union of India [2005] 63 SCL 539 (Delhi)**

Effect of 'Arbitration clause' in the Articles/Separate Agreement

Merely because there is an article in the Articles of Association of a company to the effect that any dispute between the company on the one hand and its members on the other will be referred to arbitration, the CLB will not stay a petition under section 397 or 398 for relief against oppression or mismanagement in the affairs of the company. The provisions of sections 397 and 398 give exclusive jurisdiction to the CLB and the matters dealt with thereby cannot be referred to arbitration - **O.P. Gupta v. Shiv General Finance (Pvt.) Ltd. [1977] 47 Cmp. Cas. 297 (Delhi)**. However, when a dispute arises out of an agreement to settle the dispute by arbitration and no further development has taken place to novate the agreement on arbitration and in the circumstances of the case it is not improper or incapable of being arbitrated, the matter has to go for arbitration, specially in view of mandatory nature of section 45 of Arbitration and Conciliation Act - **Naveen Kedia v. Chennai Power Generation Ltd. [1998] 17 SCL 327 (CLB)**. The distinguishing point may be the specific agreement as against a general clause in the Articles of Association.

When an agreement for arbitration of dispute subsists and the party has already submitted his statement in response to the proceeding under section 397/398, on the substance of the dispute, he is debarred from invoking the arbitration agreement - **Suresh Kumar Jain v. Hindustan Ferro Industries Ltd. [1998] 17 SCL 444 (CLB)**. Also see **VLS Finance Ltd. v. Sunair Hotels Ltd. [2000] 28 SCL 253 (CLB)**.

The CLB, however, has made a significant distinction between matters to be arbitrated and those that cannot be arbitrated while an arbitration agreement subsists between the parties. According to CLB, matters covered in the petition under section 397/398 when relate to or arise from or is in connection with the arbitration agreement, the same have to be referred to the arbitrator provided arbitration agreement is not null and void or inoperative or incapable of being performed. If all the ingredients of section 8 of the Arbitration Act, 1996 are satisfied, even matters covered by sections 397 and 398 can be referred for arbitration - **Vijay Kumar Chopra v. Hind Samachar Ltd. [2001] 30 SCL 80 CLB**. Where the company itself is not a party to the arbitration agreement [i.e., the agreement is between the individual members (promoters)], then matters related to company affairs finding place in the petition under section 397/398 cannot be referred to arbitrator - **Bhadresh Kantilal Shah v. Aia Magotteaux International [2000] 24 SCL 270**. Also see **Premier Automobiles Ltd. v. Fiat India (P) Ltd. [2004] 56 SCL 59 (CLB)**. However, where the subject-matter of the dispute is such that it can be adjudicated under section 397/98 without reference to arbitration agreement the matter cannot be referred for arbitration even though the same is covered by arbitration agreement - **Sporting Pas time India Ltd. v. Kasturi & Sons Ltd. [2006] 70 SCL 391 (CLB)**.

Jurisdiction of Civil Court in matters of oppression and mismanagement when a petition for oppression and mismanagement is pending before the CLB- The Punjab & Haryana High Court ruled that the Civil Court has no jurisdiction in the above circumstances as its jurisdiction is implicitly barred because the Companies Act itself has provided a complete machinery for redressal of grievances involving oppression and mismanagement - **Anil Gupta v. J.K. Gupta [2002] 38 SCL 112**. In this case majority shareholding group filed the petition alleging oppression and mismanagement against the minority group.



However, the CLB cannot pass any order on the same issue on which an order of the Civil Court was in force - **Dr. V.J.S. Vohra v. Mrs. Hardavm Johl [2002] 37 SCL 784 (CLB).**

Civil proceedings filed before filing petition with CLB- Proceedings before CLB have to be stayed till disposal of civil suit – **Guljarilal Kanoria v. Loptchu Tea Co. Ltd. [2000] 24 SCL 101 (CLB).**

Appeals against the orders of the CLB and variation of the order of CLB

Section 10F allows appeal to a High Court against any order of the CLB under any provision of the Companies Act, ordinarily within 60 days from the date of the communication of the decision or order of the CLB. However, the appeal is restricted only on question of law arising out of the decision or the order. **Allahabad High Court, in Scientific Instruments Co. Ltd. v. Rajendra Prasad Gupta [1999] 19 SCL 451** has held that when the CLB finding on matters of sections 397 and 398 was based on no evidence or on surmise, conjecture and assumption, then the reference under section 10F assumes the presence of question of law. The Court set aside the CLB order and directed hearing of the petition on merits including maintainability of petition afresh, on basis of documentary evidence and materials placed by parties. Any person, not being a direct party, may prefer appeal against CLB's order under section 402, if he is affected by the order – **IDBI Ltd. v. CLB [2007] 80 SCL 138 (Delhi)**. [Section 10FQ introduced by the Companies (Second Amendment) Act, 2002 as consequence of replacing the 'CLB' by the Tribunal' provides for appeal against the order of the Tribunal. Any person aggrieved by the order or decision of the Tribunal may prefer an appeal to the 'National Company Law Appellate Tribunal' (NCLAT) ordinarily within forty-five days of the date of receipt by him of the copy of the order or decision. The appeal is to be made in such form and accompanied by such fee as may be prescribed. However, no appeal can be made in respect of an order or decision of the Tribunal made with consent of the parties. If the NCLAT is satisfied as to the circumstances, it may allow an appellant to file the appeal even after expiry of aforesaid forty-five days. An appeal against the order of the NCLAT shall have to be made to the Supreme Court of India.]

Variation of the order of the CLB passed earlier - In a case where the CLB earlier ordered for appointment of four directors by the Central Government under sections 402 and 408 of the Act, in the Board of a company presumably with a view to create a sense of confidence among creditors, shareholders and public in the working of the company, on a direction by the Supreme Court, an application was subsequently moved before the CLB to vary that order. The CLB, being satisfied that considerable improvement has taken place in the working and affairs of the company, ruled that its earlier order is not required to be implemented. It was observed that the provisions of sections 398 and 408 are curative and/or preventive in nature and not punitive. Therefore, when the very basis for issuance of the earlier order is no more present, it will not be proper to stick to the earlier order. - **All India Shaw Wallace Employees Federation v. Shaw Wallace & Co. Ltd. [2002] 40 SCL 393 (CLB).**

Difference between winding up proceedings and proceedings under sections 397 and 398

Sections 397 and 398 are intended to avoid winding up of a company, if possible, and keep it going while at the same time relieving the minority shareholders from acts of oppression and mismanagement or preventing its affairs from being conducted in a manner prejudicial to public interest. Relief, under sections 397 and 398, is perhaps, in fact, a better alternative to the winding up.

Thus, by the introduction of sections 397 and 398, a shareholder aggrieved by oppression and mismanagement has two alternative remedies. Before that, he had only one remedy, viz., to apply for the winding up under the 'just and equitable' clause of section 433(f).

Between a winding up petition under section 433(f) (i.e., when it is 'just and equitable') and a petition under sections 397 and 398, there are following distinguishable features:

Petition under sections 397 and 398	Petition for winding up under section 433(f)
1. Petition under sections 397 and 398 is to be made to the CLB. 2. Notice to Central Government is necessary under section 400. 3. Share qualification is required for an application vide section 399 unless otherwise allowed by the Central Government. As an alternative, a minimum number of members have been specified for a company having share capital. In respect of a company not having share capital a minimum proportion of membership as valid applicants has been specified. 4. Under section 401, the Central Government may itself apply or it can cause the application to be made by a person authorised by it. 5. Nature of relief is much wider, vide section 402. 6. Remedy is of preventive nature and thus helps the continuity of company.	1. Petition for winding up is to be made to the Court. 2. No such notice is necessary. 3. No minimum share qualification is required. 4. The Central Government cannot apply but the Registrar of Companies can apply under section 439(5). Contributory or any other person can also apply. Even the company itself can apply. 5. Nature of relief is narrower, vide section 433. 6. Winding up results in civil death of the company.

Powers of the CLB [Section 402]

Whereas sections 397 and 398 confer general powers on the CLB to pass necessary orders" to end oppression and mismanagement, section 402 empowers it to grant certain specific reliefs. The reliefs contemplated under section 402 are :

- (a) **The regulation of the conduct of company's affairs in future [Section 402(a)]** - In **M.R. Harmer Ltd. In re [1958] 3 All EQ 689 (CA)**, a father held a majority of votes in the company. By virtue of a weighted shareholding he exercised his control irregularly without regard to the wishes of the Board. The Court ordered that he should be employed as consultant only, and that he should not further interfere in the affairs of the company except in accordance with the decision of the Board. Again, in **Bennet Coleman and Co. v. Union of India [1977] 47 Comp. Cas. 92 (Bom.)**, the Bombay High Court ordered for the incorporation of a new regulation in the articles providing for retirement of the shareholders' directors every year. Further, it held that the regulation was valid even if it was contrary to the provisions of section 255. In **Richardson and Cruddas Ltd., In re [1959] 29 Comp. Cas. 549**, the Calcutta High Court ordered for the appointment of a Board of advisers to assist the special officer already appointed in managing the business of the company, subject to the terms and conditions laid down in the order.

It may be noted that the CLB's power under section 402 in regulating the management of the company can be exercised even during the pendency of petition under section 397/398 - **B.R. Kundra v. Motion Pictures Association [1978] 48 Comp. Cas. 564 (Delhi)**.

However, under section 402 directions only for administration and management of affairs of company can be given; questions relating to debts due to third parties are outside its scope - **T.P. Sokkalal Ram Sait Factory (P) Ltd., In re [1978] 48 Comp. Cas. 503 (Mad.)**.

It may be noted that a committee of management appointed by Court (now CLB) is not board of directors, nor even a special officer or receiver, and its powers are not subject to those limitations which apply to board, special officer and receiver- **Pramod Kumar Mittal v. Andhra Steel Corp. Ltd, [1985] 58 Comp. Cas. 772 (Cal)**.

- (b) **Purchase of the shares or interest of any members of the company by other members thereof or**



by the company [Section 402(b)] - In **Suresh Kumar Sanghi v. Supreme Motors Ltd. (supra)**, the Delhi High Court granted the group in actual control the opportunity to purchase the shares of the other group at a price to be fixed by a judge. Also see **Bajrang Prasad Jalan v. Raigarh Jute & Textile Mills Ltd, (supra)**; **Suresh Arora v. Grevlon Textile Mills (P) Ltd, [2007] 80 SCL 228 (CLB)** and **H.S.D.C. Radharamanam v. M.S.D. Chandra Sekara Raja[2007] 80 SCL 254 (Mad.)**. In this case, though oppression was not proved but to remove the deadlock in the management, the father was asked to sell his shares to his son at an independently obtained value. In this case, father and son were the only shareholders and directors.

Valuation of shares - The overwhelming requirement in valuing shares is that the price should be fair. What is fair will depend upon the facts of the particular case - **Bird Precision Bellows Ltd. (supra)**. There is no general rule as to the date by reference to which the valuation of shares should be made. Date of valuation of shares may be the date of the petition, or a date prior to the petition or the date of the order. Generally, it is the date of the petition that is favoured because it is the date on which the members chose to complain about oppression or mismanagement - **Cumana Ltd., In re [1986] BCLC 430 (CA)**. In appropriate cases, however, fairness may sometimes require that the shares be valued at a date earlier than the petition - **O.C. Transport Services Ltd., In re [1984] BCLC 251; Re, a Company [1983] 1 WLR 927 and London School of Electronics Ltd., In re [1986] Ch. 211. Nourse, J.**, thought that, prima facie, an interest in a going concern ought to be valued at the date of the order for purchase.

Valuation of shares can be directed to be done both on assets basis and on maintainable profits basis so as to enable the court to decide at what price the shares should be offered to the purchasing group. As to what should be the value of the shares to be so offered is to be decided after the receipt of the report of the valuers - **Omni India (P) Ltd. v. Balbir Singh [1989] 2 Comp. LJ 216 (Delhi); Rakhra Sports (P) Ltd. v. Khairatilal Rakhra [1993] 10 CLA 96 (Kar.) (DB)**.

- (c) **Reduction of share capital [Section 402(c)]**-The order of the CLB relating to purchase of its own shares by the company as per section 402(c) may also provide for the consequent reduction of its share capital. However, before granting such reduction, it is not necessary to give notice of the consequent reduction of share capital to the creditors of the company. No such requirement is laid down by the Act. The procedure prescribed for reduction of share capital (including resolution of the shareholders confirming the reduction of capital) in sections 100 to 104 need not be followed in respect of a reduction of share capital effected pursuant to the order under this section - **Cosmosteels (P) Ltd. v. Jairani Das AIR 1978 SC 375**. Nevertheless, before giving directions for purchase of shares of members by the company, the court should keep in view all the relevant facts and circumstances, including the interests of the creditors. Even if the petition is being disposed of on a compromise between the parties, the court should certainly satisfy itself that the direction proposed to be given by it pursuant to the consent terms would not adversely affect or jeopardise the interests of the creditors - **Cosmos tee ls' case (supra)**.
- (d) **Termination, setting aside or modification of any agreement between the company and the managing director/director/manager [Section 402(d)]** -CLB may, in its order, direct the termination, setting aside or modification of any agreement, howsoever arrived at, between the company on the one hand, and any of the following persons, on the other, namely :
- (i) Managing director,
 - (ii) Any other director, and
 - (iii) the Manager,

upon such terms and conditions as may, in the opinion of the CLB, be just and equitable in all the circumstances of the case.

In **Shoe Specialities Ltd. v. Standard Distilleries & Breweries (P) Ltd & Others**, it was held that when a case of oppression is made out, it is within the powers of CLB to end the matter and make such

orders as it thinks fit. While considering to end the matters complained of and when given the power to make any such order as it thinks fit to rectify the same, the CLB is empowered to remove the Board of directors so that the affairs of the company could be set right.

- (e) **Termination, setting aside or modification of any agreement between the company and any third person [Section 402(e)]**-Again, CLB may, in its order, direct the termination, setting aside or modification of any agreement between the company and any third person provided due notice to the party concerned has been given and his consent obtained for the modification.
- (f) **Setting aside of any transfer, delivery of goods, payment, execution or other act relating to property [Section 402(f)]** - The CLB may, in its order, direct the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application under section 397 or 398, which would if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference.

The period of three months should be a clear period of three months between the date of transfer and that of application - **Roshan Lal Aggarwal v. Sheoram [1980] 50 Comp. Cas. 243 (Pal.)**.

- (g) **Any other matter [Section 402(g)]** - Under clause (g), the CLB' is conferred with the residual powers of granting relief in respect of any other matter for which, in its opinion, it is just and equitable that provision should be made.

Thus, the CLB has power to make the order in regard to convening and holding of meetings, filing of proxies or nominations or in regard to any other matter for the purpose of conducting the affairs of a company, which might be contrary to the provisions of the articles of the company or of the Act, e.g., order for reduction of capital - where otherwise procedure in sections 100-104 need not be followed—**Debi Jhora Tea Co. Ltd. v. Barendra Krishna Bhowmick [1980] 50 Comp. Cas. 771 (Cal.) (DB)**.

The residuary provision of clause (g) has, however, to be construed in the light of the object with which this section has been enacted, namely, to give directions regarding internal management of the company. This section, therefore, cannot be utilised for agitating disputes about liabilities like debts due to third parties or for staying tax - liability of the company - **T.P. Sokkalal Ram Salt Factory (P) Ltd., In re (supra)**.

In **Prakash Timbers (P) Ltd. v. Shushma Shingla [1996] 1 Comp. L.J. 133 (All.)**, the issue was whether the CLB, in proceedings under sections 397 and 398 of the Act, has powers to order transfer of property when a transfer of property can only be done by execution of a proper deed of conveyance and registering the same. It was held that sections 397 and 398 read with section 402 empower the CLB* to make such orders as it thinks fit with a view to bring to an end the matters complained of.

Whether the provisions of the Evidence Act and Code of Civil Procedure are applicable to proceedings under sections 397 and 398 - In **Rajinder Kumar Malhotra v. Harbanslal Malhotra & Sons Ltd (CP 57 of 1992 decided on 18-1-1996)**, the issue involved was whether the provisions of the Evidence Act and Code of Civil Procedure are applicable to proceedings under sections 397 and 398 of the Act before the CLB and whether recording of oral evidence and cross-examinations can be pressed for.

As a general principle, the Supreme Court has laid down that the Evidence Act had no application to enquiries conducted by Tribunals, even though they might be judicial in character. The Tribunals should observe rules of natural justice (AIR 1957 SC 882); (1995) 4 SCC 132.

As per section 10E of the Companies Act, the CLB shall be guided by the principles of natural justice and shall act in its discretion. Section 10E(5) has provided for procedure to be followed by the CLB. Section 10E(6) of the Act empowers the CLB to regulate its own procedure through Regulations. However, absence of any provision in the Regulations would not make any difference so long as the procedure meets the test of natural justice; also Regulations cannot override the provisions of the law.

Interim Order by the CLB [Section 403] - Under section 403, the CLB may, pending the making by it of a



final order under section 397 or 398, make any interim order which it thinks fit for regulating the conduct of the company's affairs upon such terms and conditions as appear to it to be just and equitable. The CLB may pass such an order on the application of any party to the proceedings.

As already noted, the CLB has powers to enable the regulation of the company during the pendency of a petition under section 397 or 398 in order to protect the interest of the company during the hearing of the petition and to prevent a complete deadlock in the running of the company - **B.R. Kundra v. Motion Pictures Association (supra)**. Where there is complete lack of confidence between the warring groups resulting in the company's plant and machinery lying idle, interim order may be passed to permit the working of the company but without causing any hardship to either of the groups and without entailing further financial liability on either of the groups - **Anil Kumar v. Bedla Flour Mills & Allied Indus tries (P) Ltd. 1978 Tax LR1663 (Raj.)**.

Similarly, the CLB allowed further issue of shares by the respondent, when proceedings under section 397 were on, as the same was decided by the Board in the interest of the company and petitioner was not excluded from the issue - **Girish Gupta v. Tirupati Roller Flour Mills (P) Ltd [2007] 79 SCL 282**.

An applicant for an interim relief must satisfy the CLB that he would be entitled to a similar or a greater relief if he succeeds in the action. If, on the other hand, the relief cannot be granted in the action itself or in the main petition, an interim relief which is always granted by the CLB in aid of the relief in the action itself should be refused - **Bengal Luxmi Cotton Mills Ltd., In re (supra)**.

The Delhi High Court in **R.F. Wood & Co. Ltd., In re [2002] 39 SCL 378** has stated that the relief sought under section 402 of the Act has to flow from the petition under sections 397 and 398 of the Act.

An interim order made upon the consent of all parties concerned cannot be revoked, recalled or cancelled when it has been acted upon by the parties concerned - **Parvesh Kumar Basil v. Special Officer, New Standard Coal Co. Pvt. Ltd., In re [1964] 2 Comp. LJ184(Cal.)**.

Interlocutory order - An interlocutory order passed by CLB is open to final adjustment if nature of proceedings and the order do not appear as impediment - **Tara Properties Ltd. v. Bhagirathi Agarwala [2004] 52 SCL 158 (Cal.)**

Effect of alteration of Memorandum of association or Articles of association of company by order under section 397/398 [Section 404] - Where an order under section 397 or 398 results in an alteration in the Memorandum or Articles, the company shall not have power to make, without the leave of the CLB, any alteration whatsoever which is inconsistent with the order of the CLB. The alteration made in the Memorandum or the Articles shall within thirty days be filed by the company with the ROC who shall register the same. The order of the CLB will have the same effect as is obtained by following the required procedure for alteration of the Memorandum or the Articles.

If default is made in communicating the alteration to the ROC, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to fifty thousand rupees.

Provision for getting impleaded as a respondent (section 405) - The managing director, any other director or the manager of the company or any other person who has not been included as a respondent in the application under section 397 or 398, may apply to the CLB for such inclusion and if the CLB is satisfied, then such applicant will be added as a respondent in the proceeding. As per the decision of Bombay High Court in **Ravi Kiran Agarwal v. Moolchand Shah [2010J.97 SCL 182]**, the expression 'any other person' in section 405 is not restricted to categories of persons specified in section 402 where relief sought under sections 397 and 398 is liable to affect interest of a third party, an order of impleadment is warranted.

Consequences of termination or modification of certain agreements [Section 407] -Where an order made under section 397 or 398 terminates, sets aside or modifies an agreement between the company and the managing director/director/manager or any other person [as referred to in clause (d) or (e) of section 402], no compensation shall be payable for loss of office or in any other respect resulting therefrom. Further, a person i.e. a managing director or a director or a manager, whose agreement

or office has been terminated by the order of the CLB shall not act for the company for five years thereafter without the leave of the CLB. Any person who knowingly acts as a managing director, or other director, or manager in contravention of this provision and every other director of the company who is knowingly a party to this contravention, shall be punishable with imprisonment up to one year, or with fine up to rupees fifty thousand, or with both.

Powers of the CLB' to prevent change in Board of directors [Section 409] - If the managing director or any director or manager of a company complains to the CLB that as a result of a change in the ownership of shares, a change in the Board of directors is likely to take place and such change would prejudicially affect the affairs of the company, the CLB, may, after being satisfied after such inquiry as it thinks fit, order that no such change in the Board of directors can be made, without its prior approval. The CLB may make an interim order to the effect before making or completing the inquiry. This power of the CLB is an overriding power, and its order, if any, is binding even though may be contrary to any other provision of this Act, memorandum of association, articles of association or any agreement or any decision of the general meeting or of the Board.

CLB in **Ashok Kumar Oswal v. Vardhman Polytext Ltd. [2002] 38 SCL 223** has interpreted the provisions of section 409 as—

- (i) shares in question must be in existence and held by someone - future issue of shares or fresh issue of shares is not within the scope of section 409;
- (ii) change of ownership of shares took place or is taking place only by transfer or transmission;
- (iii) 'a change in Board' means appointment/removal of one or more directors in the Board but does not include any change in designation/power of the existing members of the Board; and
- (iv) legality or otherwise of appointments to the Board is not within the scope of enquiry of the CLB.

Estoppel- After making a petition under sections 397 and 398, the parties arrived at a settlement and the same was placed before the CLB, which in turn, passed a consent order embodying facts and terms of settlement. Eventually, valuation of shares made by a valuer was rejected by both the parties and at that stage the respondent raised question on maintainability of the petition and the same was rejected as with the passing of the consent order the parties have been estopped from contending otherwise than the terms of settlement even though no finality was then there on the valuation of shares - **K.K. Framji v. Consulting Engg. Services (P) Ltd. [2002] 38 SCL 1118 (CLB)**.

Does CLB possess power to review its own order ? - Though CLB has no such power, but it can review its order in case findings and reliefs were based on fabricated/ forged documents - **Smt. Pushpa Katoch v. Mann Maharani Hotels Ltd. [2001] 34 SCL 398 (CLB)** also see **Balaji Fabricators (P) Ltd. v. S. Rehana Rao [2006] 66 SCL 57 (CLB)**. [Section 10FN introduced by the Companies (Second Amendment) Act, 2002 gives the power to review its order to the Tribunal, when it starts functioning.] - Events likely to come immediately after the final hearing and within knowledge of the respondent cannot be allowed to upset the order issued by CLB - **Ashok K. Oswal v. Panchsheel Textiles (P) Ltd, [2002] 38 SCL 241**.

General theme of the power of CLB - CLB is endowed with a number of specific and non-specific powers including the power to use discretion. It has been held in **Cachar Native Jt. Stock Co. Ltd, v. Smt. Namita Gupta** that an authority vested with discretion by law is to exercise such discretion based on records - [2004] 52 SCL 170 (Gau.). In this case allegation of false voting in EOGM was proved on the basis of records.

Private company exempted - Section 409 does not apply to a private company.

Powers of the Central Government to prevent oppression and mismanagement -Section 408 empowers the CLB to direct the appointment of directors by the Central Government on the Board of a company to safeguard the interests of the company or its shareholders or the public interest.

In a petition for fraud and mismanagement, the Central Government sought the authorisation to appoint majority of directors in the Board of the subject company. The CLB found that five directors



of the company have resigned and the managing director is absconding and as such no Board was functioning and allowed the Central Government to appoint five directors on Board of the company - **Secretary to the Government of India v. Leaf in India Ltd.** [2003] 38 SCL 121.

Some more cases on oppression and mismanagement : -

1. Where validity of petitioner's status as wife of the deceased shareholder is under challenge in a civil suit, the company's insistence on receiving of succession certificate for effecting transmission of shares of the deceased, is not oppressive. Claim for rent etc. receivable by the petitioner arising out of contractual rights and obligations between the petitioner and the company does not fall within the ambit of sections 397 and 398 - **Smt. Prameela Ravindran v. Vital Instruments (P) Ltd.** [2003] 45 SCL 46 (CLB - Chennai).
2. The management of the company has passed on to a group and the group holding 16.5% shares in the company, being the group formerly managing the affairs of the company, accuses the present management of mismanagement on various counts while facing charges of mismanagement by the present management group. This matter cannot be adjudicated under section 397/ 398 of the Act. However, the former management group has to be relieved from the liability of personal guarantee given for the company as it is now not in the management and has also a substantially lesser stake in the shares of the company - **M.K. Dhir v. Givo Ltd.** [2003] 45 SCL 55 (CLB - New Delhi).
3. Sale of property agreement entered into by the company before petition under section 397/398 was filed and partly remaining to be executed has to be allowed as the sale is prima facie not below market price - **Vijayawada Share. Brokers Ltd. v. D. Ramkishore** [2003] 45 SCL 1 (CLB - Chennai).
4. When the Articles provided for consensus on important matters amongst almost equal shareholding blocks and one block unilaterally decides on an issue on which despite earlier discussions with other block, consensus was not reached, such block cannot complain of oppression or deadlock. The other block also cannot succeed in its charge of mismanagement against the former block as minutes revealed that the company's loss was due to bad market condition and not mismanagement. In view of lack of trust for each other, it would be appropriate that either block goes out of the company. Since ordering either to go out would be unfair in view of valuable contributions made by both the groups to the company in the past, preferred course was to order both the blocks to value the shares of the company and the block arriving at a higher value being asked to buy the shares held by the other block at that value - **Tenneco Mauritius Ltd v. Bangalore Union Services Ltd.** [2003] 45 SCL 205 (CLB - Chennai).
5. Petitioners alleged oppression and mismanagement by the respondents on account, of non-convening of meetings of the Board and the members, removal of petitioners from directorship, illegal allotment of shares and induction of persons in the Board of directors, siphoning of the company's funds and encumbering company's properties without any benefit to the company and all these were denied by the respondents. It was held that mere production of certificate of posting of notices of the meetings in the absence of any other corroborative evidence shows an effort on the part of respondents to marginalise the petitioners. Therefore, induction of directors could not be held valid. Also, as the respondents could not produce any documentary proof of having brought funds for the allotment of shares made or having utilised any such fund for the company, the allotment of shares made in exclusion of petitioners was oppressive. The order directed for allotment of shares to the petitioners as per their entitlements - **M. M. Subrahmanyam v. Gulf Olefines (P) Ltd.** [2003] 45 SCL 240 (CLB - Chennai). Also see **M.M. Subrahmanyam v. Prasanna Investments (P) Ltd.** [2003] 47 SCL 161 (CLB - Chennai).
6. With a view not to destabilise the control of the plaintiff and defendant on the company and not to upset existing MOU between them and to prevent any third party gaining control over the company the court allowed the purchase of the block of shares (offered to a single party by

UPSIDC), by the plaintiff on condition that 50% of the consideration payable would be on account of the defendant as aforesaid, who was running short of cash, so that their inter se relation is maintained - **K.K. Modi v. K.N. Modi [2003] 45 SCL 509 (Delhi).**

7. The rule against interference by court with internal management of a company is not applicable in cases of infringement of individual membership rights. Since there was no evidence of notice of the meeting being sent to the plaintiffs and the plaintiffs did not attend the meeting, the meeting should be deemed as not having been held and accordingly all the decisions purportedly passed thereat should be treated as null and void - **Dr. Dilip Makhija v. Arun Mittal [2003] 47 SCL 241 (Delhi).**
8. In Maharashtra **Power Development Corpn. Ltd. v. Dhabol Power Company** the Bombay High Court, held - (i) if effects of a single act is burdensome, wrongful and oppressive and of continuing impact, which deprives a member of his membership rights and privileges for all times to come, then a petition under section 397 is maintainable, (ii) a petition by shareholder(s) who are not minority shareholders, while the alleged oppressors are also not majority shareholders is also maintainable, (iii) a shareholder in the status of a shareholder is not entitled to be served with notice for the Board meeting, (iv) since Reg. 75 of Table A formed part of the articles of the company, two continuing directors could validly hold Board meeting for co-option/appointment of one more director to constitute valid quorum for Board meeting to be held in future, (v) in the absence of nomination to the Board by financial institutions, shareholders can appoint directors by majority vote, (vi) the mere fact that the holding company of the appellant would be loser in a different capacity and some other members would be beneficiaries in their concurrent capacity of creditors, cannot bar the Board from proceeding with the arbitration proceedings started by the respondent against such holding company, (vii) exercise of contractual rights against Government cannot be considered as against public interest, (viii) the fact that an arbitration proceeding against the Government or its instrumentality is also not against public interest merely for the fact that an adverse award by the arbitrator may lead to payment from public exchequer. This decision further held that where there was no lack of probity or fair dealing and no violation of proprietary rights of appellants as a shareholder and also the shareholder could not establish that it is just and equitable to wind up the respondent, the petition under section 397 lacks the essential elements required to maintain the petition. The Court added an Obiter Dicta-Even after appointment of a provisional liquidator, the Board of directors has a power to make a reference to BIFR and also the power to propose a scheme of arrangement under sections 391-394 to rehabilitate the company [2003] 48 SCL180. On appeal, a Division Bench of the High Court upheld the judgment and more specially dealt with interpretation of Reg. 75 of Table A and found no violation thereof. Also it clearly stated that at the time of petition filing with CLB, the petitioner was only a shareholder and it had no director on the Board, therefore there was no question of serving it with notice of Board meeting. No case of oppression on shareholders was also established [2004] 52 SCL 224.
9. Non-issue of further shares, to petitioner-applicants, offered by the respondent company, taking a plea that a joint application by several shareholders is not in conformity with provisions of section 41(2) of the Act, was held as an act of oppression as provision of section 41 (2) is inapplicable to issue of shares subsequent to first allotment of shares by the company - **Vijay Kumar Narang v. Prakash Coach Builders (P) Ltd. [2004] 56 SCL 274 (CLB).**
10. Clandestine issue of further shares by the company to reduce the shareholding proportion of petitioner, not acknowledging the petitioner as shareholder and denial of right to the petitioner to nominate directors on the Board of the company were held as acts of oppression. The change of name of the petitioner, though intimated to the company, was not recorded to render the new name of the petitioner under which the petition was made, as a non-shareholder to deprive it of the right to redressal of oppression. The CLB ordered that petitioner could exercise all the rights that the entity could exercise as shareholder in its previous name - **Pearson Education Inc. v. Prentice Hall of India (P) Ltd. [2004] 56 SCL 365.**



11. A petition under section 397 or 398 or 408 must stand on its own footing and it should be complete with all the required details. Except any development arising subsequent to the petition, no other matters/fact can be entertained in deciding on the petition. Commercial misjudgment cannot be treated as oppression/mismanagement. Similarly, fluctuation in share price in the stock market without any evidence of manipulation cannot be so treated - **Central Government v. Kopran Ltd. [2004] 56 SCL 428 (CLB).**
12. CLB in **Gian Gupta v. Siel Ltd. [2004] 56 SCL 560** has held that a petition written in English for which consent support signature of some of the consent givers was in Hindi, is not maintainable as the consents of those who signed in Hindi have to be ignored as it is to be presumed that they did not understand the writings in the Petition. When signatures in Hindi are ignored the number of petitioners along with consent givers fell below 100 and the aggregate shareholding also did not reach 10% of the subscribed share capital.
13. Allegation of non-compliance of the provisions of the Articles of Association that amount to oppression or mismanagement can only be considered by the CLB notwithstanding existence of an Arbitration Agreement between parties, the terms whereof were incorporated in the Articles. - **Gerlesheim GMBH v. Goyal M. Gases (P) Ltd. [2004] 56 SCL 593 (CLB).**
14. When equal participation in day-to-day management of a domestic company exists among the petitioner and the respondent, there cannot arise a case of oppression. What can be there is only deadlock in management and relief can be by letting either party buying off the shares of the other - **MSD Chandrasekhar Raja v. Shree Bhaarithi Cotton Mills (P) Ltd. [2005] 57 SCL 72 (CLB).**
15. On the issue of substitution of one of the original petitioners by another shareholder, it was held that proceeding under section 397/398 is a representative proceeding and can continue even if one of the original petitioners withdraw, provided the petition is on merit. Substitution of one of the original petitioners by another shareholder is permissible even without the support of any enabling provision like section 405 of the Act - **Renuka A. Kattar v. Gees Marine Products (P) Ltd. [2005] 57 SCL 68 (CLB).** This decision has two distinct parts:
 - (i) continuity of the proceedings if petition was valid at the time of making, with or without any withdrawal - substitution syndrome. If the petition can stand on merit, it survives even if one of the petitioners go out;
 - (ii) there can be a substitution of petitioner, provided the substituting person is otherwise eligible to be a petitioner under section 399 of the Act.
16. A company which originally started with three directors, removed one of such directors after another one voluntarily resigned. The directors remaining after resignation mentioned above, had equal shareholdings and they were the only shareholders. Held, it was a case of oppression as in a two directors -two members company no board meeting or AGM can be held without participation of both and it was established that no notice of board meeting was sent to the director who was removed - **Rohit Churaniani v. Disha Research & Marketing Services (P) Ltd. [2005] 57 SCL 353 (CLB).**
17. When letter of resignation from directorship is duly signed by the concerned person and it could not be shown that the signature is not that of the person concerned, then the position that the director has resigned is acceptable, it is necessary for the company to inform the concerned Bench of the CLB when AGM is held during the pendency of the proceedings before CLB. Sending notice of the AGM through UPC when notice was to be sent through Registered A.D. post is not in order - **Ms. Hardeep Kaur v. Thinlac Enterprises (P) Ltd. [2005] 57 SCL 459 (CLB).**
18. Not an oppression - Non-declaration of dividend or giving interest-free loan to sister concerns by itself do not constitute oppression as these are management decisions - **Shankarlal Gilada v. Kapricon Sleepers Works (P) Ltd. [2005] 63 SCL 609 (CLB).**

19. CLB in **Girdhar Gopal Dalmia v. Bateli Tea Co. Ltd, (supra)** has held that (i) mere incurring of losses and/or existence of huge liabilities do not necessarily mean mismanagement; it may, at most reflect in efficient management (ii) actions taken by the group in control of a company to prevent diversion of funds, even if same are in violation of the provisions of the Act, cannot be held to be mismanagement/oppression and (iii) but attempt to stripping of one group of directors of their powers enjoyed by them for a long period is definitely an act of oppression.
20. The CLB held the manipulative issue of shares by the respondent, on whom the petitioner reposed great faith, as an act of oppression. The properties of the company were entirely given by the petitioner, who had to live abroad after setting up the company along with the respondent - **Dr. Mrs. Usha Chopra v. Chopra Hospital (P) Ltd. [2005] 63 SCL 625.**

On appeal, the Delhi High Court upheld the CLB decision as the CLB's decision was based on facts then submitted by parties and on Principle of Preponderance of possibility. There is no ground for interference by the court [2007] 79 SCL 299. Also, the court held that in a situation of fiduciary relationship, the burden of proving that actions by the party enjoying confidence is devoid of fraud and manipulation, rests on that party.

1.11 REVIVAL AND REHABILITATION OF SICK INDUSTRIAL COMPANIES

Definitions (Section 2)

Sick industrial company [Section 2(46AA)]

'Sick industrial company' means an industrial company which has

- (i) the accumulated losses in any financial year equal to 50% or more of its average net worth during 4 years immediately preceding such financial year; or
- (ii) failed to repay its debts within any 3 consecutive quarters on demand made in writing for its repayment by a creditor or creditors of such company.

Industrial company [Section 2(19AA)]

'Industrial company' means a company which owns one or more industrial undertakings.

Industrial undertaking [Section 2(19AB)]

'Industrial undertaking' means any undertaking, pertaining to any industry carried on in one or more factories or units by any company, as defined in clause (aa) of section 3 of the Industries (Development and Regulation) Act, 1951 but does not include a small-scale industrial undertaking as defined in clause (j) of that section.

Net worth [Section 2(29A)]

'Net worth' means the sum total of the paid-up capital and free reserves after deducting the provisions or expenses as may be prescribed.

Explanation. For the purposes of this clause, "free reserves" means all reserves created out of the profits and share premium account but does not include reserves created out of revaluation of assets, write back of depreciation provisions and amalgamation.

Operating agency [Section 2(31AA)]

'Operating agency' means any group of experts consisting of persons having special knowledge of business or industry in which the sick industrial company is engaged and includes public financial institutions, State level institution, scheduled bank or any other person as may be specified as the operating agency by the Tribunal.



Procedure for Revival and Rehabilitation

Reference to Tribunal (Section 424A)

1. Reference by the Board to Tribunal when a company becomes sick [Section 424A(1)]

Where an industrial company, has become a sick industrial company, the Board of directors of such company shall make a reference to the Tribunal and prepare a scheme of its revival and rehabilitation and submit the same to the Tribunal along with an application containing such particulars as may be prescribed for determination of the measures which may be adopted with respect to such company.

Non-applicability to Government companies [First Proviso to Section 424A(1)]. Nothing contained in this sub-section shall apply to a Government company.

Applicability to Government companies in certain cases [Second Proviso to Section 424A(1)]. However, a Government company may, with the prior approval of the Central Government or a State Government, as the case may be, make a reference to the Tribunal in accordance with the provisions of this sub-section and thereafter all the provisions of this Act shall apply to such Government company.

2. Application to be accompanied by a certificate from Auditor [Section 424A(2)]

The application under sub-section (1) shall be accompanied by a certificate from an auditor from a panel of auditors prepared by the Tribunal indicating –

- (a) the reasons of the net worth of such company being 50% or less than 50%; or
- (b) the default in repayment of its debt making such company a sick industrial company, as the case may be.

3. Reference to Tribunal by CG, SG, RBI etc. [Section 424A(3)]

Without prejudice to the provisions of sub-section (1), the Central Government or the Reserve Bank or a State Government or a public financial institution or a State level institution or a scheduled bank may, if it has sufficient reasons to believe that any industrial company has become, for the purposes of this Act, a sick industrial company, make a reference in respect of such company to the Tribunal for determination of the measures which may be adopted with respect to such company.

Conditions for making reference [Proviso to Section 424A(3)]. A reference shall not be made under this sub-section in respect of any industrial company by –

- (a) the Government of any State unless all or any of the industrial undertakings belonging to such company are situated in such State;
- (b) a public financial institution or a State level institution or a scheduled bank unless it has, by reason of any financial assistance or obligation rendered by it, or undertaken by it, with respect to such company, an interest in such company.

4. Time limit for making reference to Tribunal [Section 424A (4)]

A reference under sub-section (1) or sub-section (3) shall be made to the Tribunal within a period of 180 days from the date on which the Board of directors of the company or the Central Government or the Reserve Bank of India or a State Government or a public financial institution or a State level institution or a scheduled bank, as the case may be, come to know, of the relevant facts giving rise to causes of such reference or within 60 days of final adoption of accounts, whichever is earlier.

5. Order of Tribunal [Section 424A (5)]

The Tribunal may, on receipt of a reference under sub-section (1), pass an order as to whether a

company in respect of which a reference has been made has become a sick industrial company and such order shall be final.

Inquiry into working of sick industrial companies (Section 424B)

1. Inquiry by the Tribunal as to whether an industrial company has become sick [Section 424B(1)]

The Tribunal may make such inquiry as it may deem fit for determining whether any industrial company has become a sick industrial company -

- (a) upon receipt of a reference with respect to such company under section 424A; or
- (b) upon information received with respect to such company or upon its own knowledge as to the financial condition of the company.

2. Order by Tribunal to operating agency to inquire into the scheme for revival [Section 424B (2)]

The Tribunal may, if it deems necessary or expedient so to do for the expeditious disposal of an inquiry under sub-section (1), require by order any operating agency to enquire into the scheme for revival and make a report with respect to such matters as may be specified in the order.

3. Time limit for completion of inquiry by operating agency [Section 424B(3)]

The operating agency shall complete its inquiry as expeditiously as possible and submit its report to the Tribunal within 21 days from the date of such order.

Extension of period by the Tribunal [Proviso to Section 424B(3)]. The Tribunal may extend the said period to 40 days for reasons to be recorded in writing for such extension.

4. Time limit for conclusion of inquiry by the Tribunal [Section 424B (4)]

The Tribunal shall conclude its inquiry as expeditiously as possible and pass final orders in the proceedings within 60 days from the commencement of the inquiry.

Extension of period [Proviso to Section 424B(4)]. The Tribunal may extend the said period to 90 days for reasons to be recorded in writing for such extension.

Meaning of 'commencement of inquiry' [Explanation to Section 424B(4)]. For the purposes of this sub-section, an inquiry shall be deemed to have commenced upon the receipt by the Tribunal of any reference or information or upon its own knowledge reduced to writing by the Tribunal.

5. Appointment of special director(s) on the Board [Section 424B (5)]

Where the Tribunal deems it fit to make an inquiry or to cause an inquiry to be made into any industrial company under sub-section (1) or, as the case may be, under sub-section (2), it may appoint one or more persons who possess knowledge, experience and expertise in management and control of the affairs of any other company to be a special director or special directors on the board of such industrial company on such terms and conditions as may be prescribed for safeguarding its financial and other interests or in the public interest.

6. Special director(s) to submit report to the Tribunal [Section 424B(6)]

The special director or special directors appointed under sub-section (5) shall submit a report to the Tribunal within 60 days from the date of appointment of such director or directors, about the state of affairs of the company in respect of which reference has been made under sub-section (1) and such special director or directors shall have all the powers of a director of a company under this Act, necessary for discharge of his or their duties.

7. Issue of directions by the Tribunal to the special director(s) [Section 424B(7)]

The Tribunal may issue such directions to a special director appointed under sub-section (5) as it may deem necessary or expedient for proper discharge of his duties.



8. Overriding effect of the appointment of special director(s) [Section 424B(8)]

The appointment of a special director referred to in sub-section (5) shall be valid and effective notwithstanding anything to the contrary contained in any other provision of this Act or in any other law for the time being in force or in the memorandum and articles of association or any other instrument relating to the industrial company, and any provision regarding share qualification, age limit, number of directorships, removal from office of directors and such like conditions contained in any such law or instrument aforesaid, shall not apply to any special director or directors appointed by the Tribunal.

9. Provisions applicable to special director(s) [Section 424B(9)]

Any special director appointed under sub-section (5), shall -

- (a) hold office during the pleasure of the Tribunal and may be removed or substituted by any person by order of the Tribunal;
- (b) not incur any obligation or liability by reason only of his being a director or for anything done or omitted to be done in good faith in the discharge of his duties as a director or anything in relation thereto;
- (c) not be liable to retirement by rotation and shall not be taken into account for computing the number of directors liable to such retirement;
- (d) not be liable to be prosecuted under any law for anything done or omitted to be done in good faith in the discharge of his duties in relation to the sick industrial company.

Powers of Tribunal to make suitable order on completion of inquiry (Section 424C)

1. Decision by Tribunal [Section 424C(1)]

If after making an inquiry under section 424B, the Tribunal is satisfied that a company has become a sick industrial company, the Tribunal shall, after considering all the relevant facts and circumstances of the case, decide, as soon as may be, by an order in writing, whether it is practicable for the company to make its net worth exceed the accumulated losses or make the repayment of its debts referred to in clause (b) of sub-section (2) of section 424A within a reasonable time.

2. Time given by Tribunal to the company [Section 424C(2)]

If the Tribunal decides under sub-section (1) that it is practicable for a sick industrial company to make its net worth exceed the accumulated losses or pay its debt referred to in that sub-section within a reasonable time, the Tribunal shall, by order in writing and subject to such restrictions or conditions as may be specified in the order, give such time to the company as it may deem fit to make its net worth exceed the accumulated losses or make repayment of the debts.

3. Direction by Tribunal to operating agency to prepare a scheme [Section 424C(3)]

If the Tribunal decides under sub-section (1) that it is not practicable for a sick industrial company to make its net worth exceed the accumulated losses or make the repayment of its debts referred to in clause (b) of sub-section (2) of section 424A, within a reasonable time and that it is necessary or expedient in the public interest to adopt all or any of the measures specified in section 424D in relation to the said company it may, as soon as may be, by order in writing, direct any operating agency-specified in the order to prepare, having regard to such guidelines as may be specified in the order, a scheme providing for such measures in relation to such company.

4. Review of order and passing of fresh order by Tribunal [Section 424C(4)]

The Tribunal may, -

- (a) if any of the restrictions or conditions specified in an order made under sub-section (2) are not complied with by the company concerned, or if the company fails to revive in pursuance of

the said order, review such order on a reference in that behalf from any agency referred to in sub-section (3) of section 424A or on its own motion and pass a fresh order in respect of such company under subsection (3);

- (b) if the operating agency specified in an order made under sub-section (3) makes a submission in that behalf, review such order and modify the order in such manner as it may deem appropriate.

Preparation and sanction of schemes (Section 424D)

1. Time limit for preparation of scheme by the operating agency [Section 424D(1)]

Where an order is made under sub-section (3) of section 424C in relation to any sick industrial company, the operating agency specified in the order shall prepare as expeditiously as possible and ordinarily within a period of 60 days from the date of such order, having regard to the guidelines framed by the Reserve Bank of India in this behalf, a scheme with respect to such company providing for any one or more of the following measures, namely:

- (a) the financial reconstruction of such industrial company;
- (b) the proper management of such industrial company by change in, or takeover of, the management of such industrial company;
- (c) the amalgamation of-
 - (i) such industrial company with any other company; or
 - (ii) any other company with such industrial company (hereafter in this section, in the case of sub-clause (i), the other company, and in the case of sub-clause (ii), such industrial company, referred to as "transferee-company");
- (d) the sale or lease of a part or whole of any industrial undertaking of such industrial company;
- (e) the rationalisation of managerial personnel, supervisory staff and workmen in accordance with law;
- (f) such other preventive ameliorative and remedial measures as may be appropriate;
- (g) repayment of debt;
- (h) such incidental, consequential or supplemental measures as may be necessary or expedient in connection with or for the purposes of the measures specified in clauses (a) to (g).

However, the Tribunal may extend the said period of 60 days to 90 days for reasons to be recorded in writing for such extension.

2. Measures covered by the scheme [Section 424D(2)]

The scheme referred to in sub-section (i) may provide for any one or more of the following, namely:

- (a) the constitution, name and registered office, the capital, assets, powers, rights, interests, authorities and privileges, duties and obligations of the sick industrial company or, as the case may be, of the transferee company;
- (b) the transfer to the transferee company of the business, properties, assets and liabilities of the sick industrial company on such terms and conditions as may be specified in the scheme;
- (c) any change in the Board of directors, or the appointment of a new Board of directors, of the sick industrial company and the authority by whom, the manner in which and the other terms and conditions on which, such change or appointment shall be made and in the case of appointment of a new Board of directors or of any director, the period for which such appointment shall be made;



- (d) the alteration of the memorandum or articles of association of the sick industrial company or, as the case may be, of the transferee company for the purpose of altering the capital structure thereof, or for such other purposes as may be necessary to give effect to the reconstruction or amalgamation;
- (e) the continuation by or against the sick industrial company or, as the case may be, the transferee company of any action or other legal proceeding pending against the sick industrial company immediately before the date of the order made under sub-section (3) of section 424C;
- (f) the reduction of the interest or rights which the shareholders have in the sick industrial company to such extent as the Tribunal considers necessary in the interests of the reconstruction, revival or rehabilitation or repayment of debts of such sick industrial company or for the maintenance of the business of such industrial company;
- (g) the allotment to the shareholders of the sick industrial company, of shares in such company or, as the case may be, in the transferee company and where any shareholder claims payment in cash and not allotment of shares, or where it is not possible to allot shares to any shareholder, the payment of cash to those shareholders in full satisfaction of their claims -
 - (i) in respect of their interest in shares in the sick industrial company before its reconstruction or amalgamation; or
 - (ii) where such interest has been reduced under clause (f) in respect of their interest in shares as so reduced; .
- (h) any other terms and conditions for the reconstruction or amalgamation of the sick industrial company;
- (i) sale of the industrial undertaking of the sick industrial company free from all encumbrances and all liabilities of the company or other such encumbrances and liabilities as may be specified, to any person, including a co-operative society formed by the employees of such undertaking and fixing of reserve price for such sale;
- (j) lease of the industrial undertaking of the sick industrial company to any person, including a co-operative society formed by the employees of such undertaking;
- (k) method of sale of assets of the industrial undertaking of the sick industrial company such as by public auction or by inviting tenders or in any other manner as may be specified and for the manner of publicity therefor;
- (l) issue of the shares in the sick industrial company at the face value or at the intrinsic value which may be at discount value or such other value as may be specified to any industrial company or any person including the executives and employees of such sick industrial company;
- (m) such incidental, consequential and supplemental matters as may be necessary to secure that the reconstruction or amalgamation or other measures mentioned in the scheme are fully and effectively carried out.

3. Examination of the scheme by the Tribunal and forwarding of scheme to concerned parties [Section 424D(3)]

- (a) The scheme prepared by the operating agency shall be examined by the Tribunal and a copy of the scheme with modification, if any, made by the Tribunal shall be sent, in draft, to the sick industrial company and the operating agency and in the case of amalgamation, also to any other company concerned, and the Tribunal may publish or cause to be published the draft scheme in brief in such daily newspapers as the Tribunal may consider necessary, for suggestions and objections, if any, within such period as the Tribunal may specify.
- (b) The complete draft scheme shall be kept at the place where registered office of the company is situated or at such places as mentioned in the advertisement.

- (c) The Tribunal may make such modifications, if any, in the draft scheme as it may consider necessary in the light of the suggestions and objections received from the sick industrial company and the operating agency and also from the transferee company and any other company concerned in the amalgamation and from any shareholder or any creditors or employees of such companies.

If the scheme relates to amalgamation, the said scheme shall be laid before the company other than the sick industrial company in the general meeting for the approval of the scheme by its shareholders and no such scheme shall be proceeded with unless it has been approved, with or without modification, by a special resolution passed by the shareholders of the transferee company.

4. Sanctioning of the scheme by the Tribunal [Section 424D(4)]

The scheme may thereafter be sanctioned, within 60 days by the Tribunal (hereinafter referred to as the sanctioned scheme) and shall come into force on such date as the Tribunal may specify in this behalf. However, the Tribunal may extend the said period of 60 days to 90 days for reasons to be recorded in writing for such extension. Different dates may be specified for different provisions of the scheme.

5. Powers of Tribunal to review and modify the scheme and order for preparation of fresh scheme [Section 424D(5)]

The Tribunal may, on the recommendations of the operating agency or otherwise, review any sanctioned scheme and make such modifications as it may deem fit or may by order in writing direct any operating agency specified in the order, having regard to such guidelines including the guidelines framed by the Reserve Bank of India in this behalf in order to prepare a fresh scheme providing for such measures as the operating agency may consider necessary.

6. Provisions applicable to the fresh scheme [Section 424D(6)]

When a fresh scheme is prepared under sub-section (5), the provisions of sub-sections (3) and (4) shall apply in relation thereto as they apply to in relation to a scheme prepared under sub-section (1).

7. Transfer of property and liabilities as per the sanctioned scheme [Section 424D(7)]

Where a sanctioned scheme provides for the transfer of any property or liability of the sick industrial company in favour of any other company or person or where such scheme provides for the transfer of any property or liability of any other company or person in favour of the sick industrial company, then, by virtue of, and to the extent provided in, the scheme, on and from the date of coming into operation of the sanctioned scheme or any provision thereof, the property shall be transferred to, and vest in, and the liability shall become the liability of, such other company or person or, as the case may be, the sick industrial company.

8. Sanctioned scheme to be conclusive evidence [Section 424D(8)]

The sanction accorded by the Tribunal under sub-section (4) shall be conclusive evidence that all the requirements of this scheme relating to the reconstruction or amalgamation, or any other measure specified therein have been complied with and a copy of the sanctioned scheme certified in writing by an officer of the Tribunal to be a true copy thereof, shall, in all legal proceedings (whether in appeal or otherwise), be admitted as evidence.

9. Filing of sanctioned scheme with the Registrar [Section 424D(9)]

A copy of the sanctioned scheme referred to in sub-section (8) shall be filed with the Registrar within the prescribed time by the company in respect of which such scheme relates.

10. Binding effect of the sanctioned scheme [Section 424D(10)]

On and from the date of the coming into operation of the sanctioned scheme or any provision



thereof, the scheme or such provision shall be binding on the sick industrial company and the transferee company or, as the case may be, the other company and also on the shareholders, creditors and guarantors and employees of the said companies.

11. Preparation of scheme by the creditors of sick industrial company [Section 424D(11)]

The creditors of a sick industrial company may also prepare a scheme for revival or rehabilitation of such sick industrial company and submit the same to the Tribunal for its sanction. However, no scheme shall be submitted by the creditors to the Tribunal unless such scheme has been approved by at least 3/4th in value of creditors of the sick industrial company.

12. Provisions applicable to the scheme prepared by the creditors [Section 424D(12)]

All the provisions relating to the preparation of scheme by the operating agency and sanction of such scheme by the Tribunal shall, as far as may be, apply to the scheme referred to in sub-section (11).

13. Binding effect of scheme prepared by creditors and sanctioned by the Tribunal [Section 424D(13)]

The scheme referred to in sub-section (11) if sanctioned by the Tribunal shall be binding on all the creditors and on other concerned.

14. Removal of difficulties by the Tribunal [Section 424D(14)]

If any difficulty arises in giving effect to the provisions of the sanctioned scheme, the Tribunal may, on the recommendation of the operating agency or otherwise, by order, do anything, not inconsistent with such provisions, which appears to it to be necessary or expedient for the purpose of removing the difficulty.

15. Order of Tribunal to operating agency to implement the sanctioned scheme [Section 424D(15)]

The Tribunal may, if it deems necessary or expedient so to do, by order in writing, direct any operating agency specified in the order to implement a sanctioned scheme with such terms and conditions and in relation to the sick industrial company as may be specified in the order,

16. Manner of distribution of sale proceeds in case of transfer of v/hole of the undertaking [Section 424D(16)]

Where the whole of the undertaking of the sick industrial company is sold under a sanctioned scheme, the Tribunal may distribute the sale proceeds to the parties entitled thereto in accordance with the provisions of section 529A and other provisions of this Act.

17. Monitoring of implementation of scheme [Section 424D(17)]

The Tribunal may monitor periodically the implementation of the sanctioned scheme.

Rehabilitation by giving financial assistance (Section 424E)

1. Financial assistance by Government, banks, institutions and other authorities [Section 424E(1)]

Where the scheme relates to preventive, ameliorative, remedial and other measures with respect to the sick industrial company, the scheme may provide for financial assistance by way of loans, advances or guarantees or reliefs or concessions or sacrifices from the Central Government, a State Government, any scheduled bank or other bank, a public financial institution or State level institution or any institution or other authority (any Government, bank, institution or other authority required by a scheme to provide for such financial assistance being hereafter in this section referred to as the person required by the scheme to provide financial assistance) to the sick industrial company.

2. Circulation of the scheme for obtaining consent [Section 424E(2)]

Every scheme referred to in sub-section (1) shall be circulated to every person required by the scheme to provide financial assistance for his consent within a period of 60 days from the date of such circulation or within such further period, not exceeding 60 days, as may be allowed by the Tribunal, and if no consent is received within such period or further period, it shall be deemed that consent has been given.

3. Sanctioning of the scheme where consents obtained [Section 424E(3)]

Where in respect of any scheme the consent referred to in sub-section (2) is given by every person required by the scheme to provide financial assistance, the Tribunal may, as soon as may be, sanction the scheme and on and from the date of such sanction the scheme shall be binding on all concerned.

4. Designating a financial institution or bank for fixing responsibility for disbursements [Section 424E(4)]

On the sanction of the scheme under sub-section (3), the financial institutions and the banks required to provide financial assistance, shall designate by mutual agreement a financial institution and a bank from amongst themselves which shall be responsible to disburse financial assistance by way of loans or advances or guarantees or reliefs or concessions or sacrifices agreed to be provided or granted under the scheme on behalf of all financial institutions and banks concerned.

5. Designated financial institution or bank to proceed forthwith to release the financial assistance [Section 424E(5)]

The financial institution and the bank designated under sub-section (4) shall forthwith proceed to, release the financial assistance to the sick industrial company in fulfillment of the requirement in this regard.

6. Discretionary power of Tribunal where consents not obtained [Section 424E(6)]

Where in respect of any scheme consent under sub-section (2) is not given by any person required by the scheme to provide financial assistance, the Tribunal may adopt such other measures, including the winding up of the sick industrial company, as it may deem fit.

Arrangement for continuing operations, etc., during inquiry (Section 424F)

Application to Tribunal by the company or others concerned before completion of inquiry [Section 424F(1)]

At any time before completion of the inquiry under section 424B, the sick industrial company or the Central Government or the Reserve Bank of India or a State Government or a public financial institution or a State level institution or a scheduled bank or any other institution, bank or authority providing or intending to provide any financial assistance by way of loans or advances or guarantees or reliefs, or concessions to such industrial company may make an application to the Tribunal :-

- (a) agreeing to an arrangement for continuing the operations of the sick industrial company; or
- (b) suggesting a scheme for the financial reconstruction of the sick industrial company.

Orders of Tribunal [Section 424F(2)]

The Tribunal may, within 60 days of the receipt of the application under sub-section (1), pass such orders thereon as it may deem fit.

Winding up of sick industrial company (Section 424G)

1. Conditions for order of winding up of the sick industrial company [Section 424G(1)]

Where the Tribunal, after making inquiry under section 424B and after consideration of all the



relevant facts and circumstances and after giving an opportunity of being heard to all concerned parties, is of the opinion that the sick industrial company is not likely to make its net worth exceed the accumulated losses within a reasonable time while meeting all its financial obligations and that the company as a result thereof is not likely to become viable in future and that it is just and equitable that the company should be wound up, it may record its findings and order winding up of the company.

2. Appointment of any officer of the operating agency as the liquidator [Section 424G(2)]

For the purpose of winding up of the sick industrial company, the Tribunal may appoint any officer of the operating agency, if the operating agency gives its consent, as the liquidator of such industrial company and the officer so appointed shall for the purpose of the winding-up of such sick industrial company be deemed to be, and have all the powers of, the official liquidator under this Act.

3. Sale of assets by the Tribunal and distribution of sale proceeds [Section 424G(3)]

Notwithstanding anything contained in sub-section (2), the Tribunal may cause to be sold the assets of the sick industrial company in such manner as it may deem fit and pass orders for distribution in accordance with the provisions of section 529A, and other provisions of this Act.

4. Time limit for conclusion of winding up [Section 424G(4)]

Without prejudice to the other provisions contained in this Act, the winding up of a company shall, as far as may be concluded within 1 year from the date of the order made under sub-section (1).

Operating agency to prepare complete inventory, etc. (Section 424H)

As per section 424H, where for the proper discharge of the functions of the Tribunal under this Part, the circumstances so require, the Tribunal may, through any operating agency, cause to be prepared –

- (a) with respect to a company a complete inventory of -
 - (i) all assets and liabilities of whatever nature;
 - (ii) all books of account, registers, maps, plans, records, documents of title or ownership of property and all other documents of whatever nature relating thereto;
- (b) a list of shareholders and a list of creditors showing separately in the list of creditors, the secured creditors and unsecured creditors;
- (c) a valuation report in respect of the shares and assets in order to arrive at the reserve price for the sale of a part or whole of the industrial undertaking of the company or for fixation of the lease rent or share exchange ratio;
- (d) an estimate of reserve price, lease rent or share exchange ratio;
- (e) proforma accounts, where no up-to-date audited accounts are available.

Direction not to dispose of assets (Section 424I)

As per section 424I, the Tribunal may, if it is of opinion, that any direction is necessary in the interest of the sick industrial company or creditors or shareholders or in the public interest, by order, direct such company not to dispose of, except with the prior approval of the Tribunal, any of its assets during the period of inquiry under section 424B or during the period of preparation or consideration of the scheme under section 424C.

Power of Tribunal to call for periodic information (Section 424J)

As per section 424J, on receipt of reference under section 424A, the Tribunal may call for any periodic information from the company as to the steps taken by the company to make its net worth exceed the

accumulated losses or to make repayment of its debts referred to in that section, as the case may be, and the company shall furnish such information.

Misfeasance proceedings (Section 424K)

1. Orders of Tribunal against any person liable for misfeasance, breach of trust etc. [Section 424K(1)]

If, in the course of scrutiny or implementation of any scheme or proposal, it appears to the Tribunal that any person who has taken part in the promotion, formation or management of the sick industrial company or its undertaking, including any past or present director, manager or officer or employee of the sick industrial company -

- (a) has misapplied or retained, or become liable or accountable for, any money or property of the sick industrial company; or
- (b) has been guilty of any misfeasance, malfeasance or non-feasance or breach of trust in relation to the sick industrial company.

The Tribunal may, by order, direct him to repay or restore the money or property or any part thereof, with or without interest, as it thinks just, or to contribute such sum to the assets of the sick industrial company or the other person, entitled thereto by way of compensation in respect of the misapplication, retainer, misfeasance or breach of trust as the Tribunal thinks just, and also report the matter to the Central Government for any other action which that Government may deem fit.

2. Order of Tribunal not to provide financial assistance to certain entities [Section 424K(2)]

If the Tribunal is satisfied on the basis of the information and evidence in its possession with respect to any person who is or was a director or an officer or other employee of the sick industrial company, that such person by himself or alongwith, others had diverted the funds or other property of such company for any purpose other than a bona fide purpose of the company or had managed the affairs of the company in a manner highly detrimental to the interests of the company, the Tribunal shall by order, direct the public financial institutions, scheduled banks and State level institutions not to provide, during a period of 10 years from the date of the order, any financial assistance to such person or any firm of which such person is a partner or any company or other body corporate of which such person is a director (by whatever name called).

3. Tribunal to give opportunity of being heard [Section 424K(3)]

No order shall be made by the Tribunal under this section against any person unless such person has been given an opportunity for making his submissions.

4. Provisions to be in addition to criminal liability [Section 424K(4)]

This section shall apply notwithstanding that the matter is one for which the person may be criminally liable.

Penalty for certain offences (Section 424L)

1. Period of imprisonment and amount of fine [Section 424L(1)]

Whoever violates provisions of this Part or any scheme, or any order, of the Tribunal or the Appellate Tribunal or makes a false statement or gives false evidence to the Tribunal or the Appellate Tribunal, and attempts to tamper the records of reference or appeal filed under this Act, shall be punishable with simple imprisonment for a term which may extend to 3 years or shall be liable to fine not exceeding Rs. 10 lakh.

2. Cognizance of offences [Section 424L(2)]

No court shall take cognizance of any offence under sub-section (1) except on a complaint in writing of an officer of the Tribunal or the Appellate Tribunal or any officer of the Central Government



authorised by it or any officer of an operating agency as may be authorised in this behalf by the Tribunal or the Appellate Tribunal, as the case may be.

Levy and collection of cess on turnover or gross receipts of companies (Sections 441A and 441B)

1. Rate of levy of cess [Section 441A (1)]

There shall be levied and collected, for the purposes of rehabilitation or revival or protection of assets of the sick industrial company, a levy by way of cess at such rate not less than 0.005% and not more than 0.1% on the value of annual turnover of every company or its annual gross receipt, whichever is more as the Central Government may, from time to time, specify by notification in the Official Gazette.

2. Time period for payment of cess [Section 441A(2)]

Every company shall pay to the Central Government the cess referred to in sub-section (1) within 3 months from the close of every financial year.

3. Furnishing of details relating to turnover, gross receipts and cess paid by the companies [Section 441A(3)]

Every company shall furnish, in such form as may be prescribed, to the Central Government and the Tribunal the details of its turnover and gross receipts with payment of cess under sub-section (1).

4. Cess to be paid in the manner prescribed by the Rules [Section 441A(4)]

The Central Government may, by rules made in this behalf, specify the manner in which the cess shall be paid under sub-section (2).

Note: Crediting proceeds of cess to Consolidated Fund of India (Section 441B)

The proceeds of the cess levied and collected under section 441A shall first be credited to the Consolidated Fund of India and the Central Government may if Parliament by appropriation made by law in this behalf so provides, pay to the Tribunal, from time to time, out of such proceeds (after deducting the cost of collection), such sums of money as it may think fit for being utilised for the purposes of the Fund.

Rehabilitation Fund (Sections 441C, 441D and 441E)

1. Purpose of the Fund [Section 441C(1)]

There shall be formed for the purposes of rehabilitation or revival or protection of assets of a sick industrial company, a Fund to be called the Rehabilitation and Revival Fund.

2. Credits to the Fund [Section 441C(2)]

There shall be credited to the Fund -

- (a) all amounts paid under section 441B;
- (b) any amount given as grants by the Central Government for the purposes of this Fund;
- (c) any amount given to the Fund from any other source;
- (d) any income from investment of the amount in the Fund;
- (e) amount refunded by the company under section 441G.

3. Utilisation of the Fund (Section 441D)

The Fund shall be applied by the Tribunal for the purpose of –

- (a) making interim payment of workmen's dues pending the revival or rehabilitation of the sick industrial company; or

- (b) payment of workmen's dues due to the workmen, referred to in sub-section (3) of section 529, of the sick industrial company; or
 - (c) protection of assets of sick industrial company; or
 - (d) revival or rehabilitation of sick industrial company,
- which in the opinion of the Tribunal are necessary or expedient for the said purposes.

Power to call for information (Section 441E)

The Central Government or Tribunal may require any company to furnish for the purposes of rehabilitation or revival or protection of assets of sick industrial companies, such statistical and other information in such form and within such period as may be prescribed.

Penalty for non-payment of Cess (Section 441F)

1. Manner of recovery of cess by the Tribunal [Section 441F(1)]

If any cess payable by a company under section 441A is not paid in accordance with the provisions of that section, it shall be deemed to be in arrears and the same shall be recovered by the Tribunal in such manner as may be prescribed.

2. Penalty for non-payment of Cess [Section 441F(2)]

The Tribunal may, after such inquiry as it deems fit, impose on the company, which is in arrears under sub-section (1), a penalty not exceeding 10 times the amount in arrears.

However, before imposing such penalty, such company shall be given a reasonable opportunity of being heard, and if, after such hearing, the Tribunal is satisfied that the default was for any good and sufficient reason, no penalty shall be imposed under this sub-section.

Refund of fund in certain cases (Section 441G)

1. Recovery of amount from the company after it is revived or rehabilitated [Section 441G(1)] Where the fund has been applied by the Tribunal for any of the purposes specified in clauses (a) to (d) of section 441D, such amount of fund shall be recovered from the company after its revival or rehabilitation or out of sale proceeds of its assets after discharging the statutory liabilities and payment of dues to creditors.

2. Manner of recovery of the amount [Section 441G(2)]

The amount referred to in sub-section (1) shall be recovered in the manner as the Tribunal may direct.

1.12. ISSUES RELATED TO WINDING UP AND DISSOLUTION

Meaning of winding up/liquidation

- Winding up or liquidation is the process of bringing to an end the life of a company. However, the company is not dissolved immediately at the commencement of winding up. Its corporate status and powers continue. Thus, winding up precedes dissolution.
- Winding up is a process by which the management of a company's affairs is taken out of its directors' hands, its assets are realised by a liquidator, and its debts are paid out of the proceeds of realisation and any balance remaining is returned to its members. At the end of the winding up, the company will have no assets or liabilities, and will therefore be simply a formal step for it to be dissolved, that is, for its legal personality as a corporation to be brought to an end.

Dissolution

Dissolution means bringing to an end the legal personality of a company. A company is created by



law (i.e., incorporation of a company) and similarly the life of a company can be ended only by due process of law (i.e., dissolution). The dissolution of a company may be achieved by any of the following processes:

- (a) A scheme of reconstruction of a company or amalgamation of two or more companies requires the approval of Court. The Court while sanctioning the scheme may also provide for the dissolution, without winding up of the company (Section 394).
- (b) The registrar, after following the prescribed procedure, may strike off the name of a defunct company (i.e., a company which is not carrying on any business) from the register of companies (Section 560).
- (c) Through winding up process.

Insolvency and winding up - a comparison

- Only an individual can be adjudged an insolvent. A company cannot be adjudged an insolvent even if it is unable to pay its debts (However, it is common to use the expression 'insolvent company' where a company is unable to pay its debts).
- A person can be adjudged an insolvent only when he is unable to pay his debts or liabilities. A company may be wound up even if it is financially sound, e.g. voluntary winding up.
- In insolvency proceedings, the assets of a person are vested with official assignee/ receiver. In winding up, the property remains vested in the company, but the administration is taken over by the liquidator.
- After completion of insolvency proceedings, the insolvent is discharged from all his debts and he becomes a legal person. However, after completion of winding up, the company is dissolved.

Winding up and dissolution - a comparison

- Winding up always precedes dissolution.
- In winding up, the assets are realised and the liabilities are paid, but the corporate status of the company continues. Dissolution brings an end to the company's existence as a legal entity.
- The liquidator can be appointed either by the Court (i.e., in winding up by the Court) or members (i.e., in members' voluntary winding up). However, the order of dissolution can be passed by the Court only.
- The liquidator can represent the company in winding up proceedings. Once the order of dissolution is passed, the liquidator cannot represent the company.
- Creditors can prove their debts in the winding up proceedings but not after an order of dissolution has been made.
- Any person may proceed against a company which is being wound up. But, no proceedings can be started against a company which has been dissolved (unless the order of dissolution is set aside by the Court).
- Winding up proceedings may be started without the intervention of the Court. However, an order of Court is essential for dissolution of the company.

Modes of winding up (Section 425)

A company registered under the Companies Act, 1956 may be wound up in any of the following modes:

1. Compulsory winding up
2. Voluntary winding up

- (a) Members' voluntary winding up
- (b) Creditors' voluntary winding up

3. Winding up subject to supervision of Court*

*Provisions relating to Winding up subject to supervision of Court has been omitted by the Companies (Second amendment Act) 2002- yet to take effect.

Compulsory winding up

Grounds for compulsory winding up (Section 433)

Winding up of a company under an order of the Court is known as compulsory winding up. As per section 433, the Court may order the winding up of a company, if a petition is filed with the Court. Section 433 of the Act reads as under:

A company may be wound up by the Court :-

- (a) if the company has, by special resolution, resolved that the company be wound up by the Court;
- (b) if default is made in delivering the statutory report to the registrar or in holding the statutory meeting;
- (c) if the company does not commence its business within a year from its incorporation, or suspends its business for a whole year;
- (d) if the number of members is reduced, in the case of a public company, below seven, and in the case of a private company, below two;
- (e) if the company is unable to pay its debts;
- (f) if the Court is of opinion that it is just and equitable that the company should be wound up;
- (g) if the company has made a default in filing with the Registrar its balance sheet and profit and loss account or annual return for any five consecutive financial years;
- (h) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;
- (i) if the Tribunal is of the opinion that the Company should be wound up under the circumstances specified in section 424G:

Provided that the Tribunal shall make an order for winding up of a company under clause (h) on application made by the Central Government or a State Government.

Note: Clauses (g), (h) and (i) have been added to section 433 by the Companies (Second Amendment) Act, 2002 - yet to get effect; hence the word 'Tribunal' in (i) above stand for the word 'Court' in unamended section.

Ground No. a. Special resolution passed by the company

The members of the company may, by passing a special resolution, resolve that the company be wound up by the Court. Winding up under this clause is not common because whenever the members wish to wind up the company, they prefer voluntary winding up which is cheaper and speedier than the compulsory winding up. Also, under members' voluntary winding up, the liquidator is appointed by the members and therefore the control over the winding up proceedings rests with the members, and the interference of the Court is the least.

Ground No. b. Default in filing statutory report or holding statutory meeting

As per section 165, every public company having share capital shall hold a statutory meeting and file a



statutory report with the registrar. If the company fails to comply with section 165, the Court may order the winding up of the company.

- An application on this ground can be made only on the expiration of 14 days from the last day on which statutory meeting ought to have been held.
- The Court may instead of making a winding up order, direct that the statutory report shall be delivered or that the statutory meeting shall be held. The Court may order the costs to be paid by any persons who are responsible for the default [Section 443(3)].

Ground No. c. Non-commencement of business or suspension of business

If a company does not commence business within 1 year from its incorporation or suspends its business for 1 year, the Court may order the company to be wound up. Petition on this ground may be made by the Registrar, the company, the contributory or the creditor.

- Where a company having many businesses, discontinues one of them, it cannot be said to have suspended its business. For invoking section 433(c), it must be shown that the entire business of the company has been suspended [Paramjit Lal Badhwar v Prem Spg. & Wvg. Mills Ltd. (1986) 60 Comp Cas 420].
- If the delay for non-commencement of business is sufficiently explained and it is shown that the company intends to carry on its business, an order for winding up will not be made [Malabar Iron and Steel Works Ltd. v ROC (1963) 33 Comp Cas 886 (Ker)]. But where no satisfactory explanation is given, although the company has assets and no debts, an order for winding up will be made [Re, Tumacacori Mining Co. (1874) 143 Ch. 417].
- Where suspension of business is alleged, the Court will decide whether the company has abandoned the object for which it was established. If the majority of the shareholders do not want it, winding up order will not be made [Re, Middlesbrough Assembly Rooms Co. (1880) 14 Ch. D. 104].

Ground No.d. Reduction in number of members below minimum

If the numbers of members fall below the statutory minimum, i.e., seven in case of a public company and two in case of a private company, the company may be ordered to be wound up.

Ground No.e. Company unable to pay its debts

If the company is unable to pay its debts, the Court may order the company to be wound up.

As per section 434, a company shall be deemed to be unable to pay its debts in the following circumstances:

- 1. Neglect to pay a debt exceeding ₹ 500 [₹ 1 lakh – Companies (Second Amendment) Act, 2002- Yet to take effect].** Where the company neglects to pay or compound or secure the debt exceeding ₹ 500 within 3 weeks from the date of demand by any of its creditors.
 - The creditor must make the demand by serving a notice, by registered post or otherwise.
 - The notice must be served at the registered office of the company.
 - The notice must be signed by the creditor or his agent or legal adviser duly authorized in this behalf.
 - It is immaterial whether the amount is payable to the creditor originally or some other creditor has assigned the debt in the favour of such creditor.
- 2. Failure to satisfy Court decree etc.** When the company fails to satisfy a Court decree in favour of a creditor, whether in whole or in part.
 - Unsatisfied execution of a decree, however small, will constitute inability to pay debts.
 - Inability to satisfy a decree of a foreign Court shall also constitute inability to pay debts.

3. Satisfaction of the Court. When it is proved to the satisfaction of the Court* that the company is unable to pay its debts.

- The Court* shall also take into account the contingent and prospective liabilities of the company.
- The expression 'unable to pay its debts' is to be taken in the commercial sense of being unable to meet the current demands though the company may be otherwise solvent [Tripura Administration v Tripura State bank Ltd. AIR 1959]. The test is whether the Court is satisfied that the existing and probable assets would be insufficient to meet the existing liabilities [Re, European Life Assurance Society (1869) LR Eq.122].

***Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect.**

Observations made under section 434.

- (a) Where in spite of repeated demands by a creditor, the company neglects to pay the debt, it is prima facie evidence of its inability to pay [Re, Gold Hill Mine's (1883) 23 Ch. D 210].
- (b) Where a debt is bona fide disputed by the company and the Court is satisfied with the company's defence, there is no 'neglect to pay' and therefore a winding up order will not be made [Piara Singh (S) v S.H.R Properties Pvt. Ltd. (1993) 10 CLA 83]. Bona fide dispute implies the existence of a substantial ground for the dispute raised. In other words, where there is scope for honest differences of opinion and disputes in respect of the claim made, the Court will not entertain a winding up petition [Bhabesh Chandra Guha Roy v Bissesarlal Sharma, 1973 Tax LR 2331 (Cal)]. The Court may, however, at its discretion direct the company to furnish security.
- (c) The Court may, in its discretion, refuse to pass a winding up order and may grant some time to the company to satisfy the debt [Re, Ansew Drums Co. Ltd. (1968) 38 Comp Cas 287 (Bom)].

Ground No.f. Just and equitable to wind up the company

When the Court* is of the opinion that it is just and equitable that the company be wound up, it may order the winding up of the company.

- Winding up on this ground is in the nature of a remedy of the last resort and is allowed when other remedies are not efficacious enough to protect the general interests of the company and its claimants.
- The petitioner must convince the Court* that -
 - (a) there are just and equitable grounds for winding up the company; and
 - (b) there is no alternative remedy open to him [Re, Atul Drug House Ltd. (1971) 41 Comp Cas 352].
- Where a petition is presented on the ground that it is just and equitable that the company should be wound up, the Court* has the discretion to dismiss it, if –
 - an alternate remedy is available; or
 - the petitioner is acting unreasonably in asking for a winding up order [Section 443(2)].
- The Court* shall take into account not only the interests of the shareholders and creditors but also public interest and interest of employees.
- The words 'just and equitable' are not to be read *ejusdem generis* with the grounds mentioned under section 433(a) to (e) [Davis & Co. Ltd. v Brunswick (Australia) Ltd. AIR 1936 PC 114].

***Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect.**



Examples on just and equitable ground. The Court may order the winding up of a company in the following cases:

1. **Loss of substratum.** The substratum of the company may be said to have gone where the main purpose for which the company was formed becomes impossible, i.e., permanently impracticable. No general rule can be laid down as to the nature of circumstances in which it can be said that the substratum of the company has gone, and each case has to be decided on its own facts. Winding up order was passed in the following cases:
 - Where it was established that the company was incorporated for a particular purpose which could no longer be achieved.
 - Where it was impossible to carry on the business of the company except at a loss, i.e., there was no reasonable hope of trading at a profit.

[Seth Mohan Lal v. Grain Chambers Ltd., AIR 1968 S.C..772]

2. **Deadlock in management.** If there is total deadlock and there is no other practical remedy, the Court would have little option but to order the winding up. **[Re. Yenidje Tobacco (1916) 2 Ch. 426]**
3. **Fraudulent or illegal business.** Where the company was formed to carry on a fraudulent or illegal business or the business of the company becomes illegal by change in law.
4. **Company is a bubble.** Where the company is a mere bubble and does not carry on any business and does not have any property. **[Re London and County Coal Co.(1867) L.R. 3 Eq.365]**
5. **Recommendation by BIFR.** Where the Board for Industrial and Financial Reconstruction (BIFR) recommends the winding up of a company.

Commencement of compulsory winding up (Section 441)

- (a) In case of a winding up by the Court, the winding up shall be deemed to have commenced at the time of presentation of the petition for the winding up. Thus, where a petition is made to the Court and the Court orders the winding up, the order relates back to the date of the presentation of the petition. If no order for winding up is made and the winding up petition is dismissed, the date of presentation of petition has no relevance.
- (b) Where a company is being wound up voluntarily, an application may be made to the Court seeking an order of compulsory winding up. After considering the application, the Court may order the compulsory winding up if it is satisfied that the voluntary winding up cannot be continued with due regard to the interests of the creditors or contributories or both (Section 440). In this case, the winding up shall be deemed to have commenced when the resolution for voluntary winding up was passed.

Note: The power of the Court to order winding up is discretionary

The use of the word 'may' in the opening part of section 433 implies that the circumstances mentioned under section 433(a) to (f) give to the Court a discretionary power to order the winding up of a company, i.e., the Court is not under an obligation to order the winding up of a company even if the conditions mentioned under any of the clauses of section 433 are fulfilled. The Court may not order the winding up if it is opposed to the interest of the company or public interest.

Winding up by the Court - A discretionary power

The Court has discretionary powers to order winding up under section 433(a) to (f). The Court may not order the winding up if it is opposed to the interest of the company or public interest. In **Tata Iron and Steel Co. v. Micro Forge (India) Ltd. 2000 CLC 1669**, a petition was filed against the company about which the Court found that its profitability, turnover, reserves, surpluses and soundness were beyond question. The petition was quashed by the Court. The Court also prepared chronicles of the point that emerged from the case law developments, which are reproduced hereunder:

1. The remedy under section 433 is not a matter of right. Merely because one of the circumstances enumerated in section 433 exist, the Court is not bound to order winding up of the company. Inability to pay debts in all cases, *ipso facto*, could not be construed as an appropriate case for winding up.
2. Even if the debt is proved and even if the inability to pay the debt is also- shown, it is not a launching pad, in all cases, for successful winding up order. Inability may arise for variety of reasons and the Court is obliged to consider whether inability is the outcome of any deliberate or designed action or temporary shock of economy and market. In a given case, it may happen that a party may become unable to pay its debts for a while, but that by itself is not a criterion for exercise of the power, *ipso facto*.
3. It is necessary for the Court to consider the financial status, strength and substratum of the company, in the overall context. If there is temporary cash crisis despite high sales and heavy turnover, it would not be proper to wind up the company for mere inability of the company to pay its debts. The Court is also obliged to consider that it would be in the interest of justice to give the company some time to come out of the momentary financial crisis or any other temporary difficulty as winding up is a measure of last resort. . .
4. If the company is an ongoing concern having regular business and employment of employees, the Court cannot remain oblivious to this aspect. The effect of winding up would be of putting an end to the business or an industry or an entrepreneurship and, in turn, resulting in loss of employment to several employees and loss of production and effect on the larger interest of the society. The Court would take into consideration the entire status and position of the company in the market.
5. If the company has shown considerable growth in a reasonable span and is a growth oriented enterprise, even a case of temporary inability to pay debts would not be sufficient to wind up the company.
6. Though, ordinarily, an unpaid creditor may aspire for an order of winding up, the rule is not inflexible but a matter of discretion of the Court. Section 433 is also indicative of the fact that even if one or more grounds mentioned in section 433 exist, it is not obligatory for the Court to make an order of winding up. The Court has discretionary power. The Court must in each case exercise its discretion in deciding whether in the circumstances of the case, it would be in the interest of justice to wind up the company. It is a well known rule of prudence that even in a case where indebtedness to the petitioning person is undisputed, the Court does not pass an order for winding up where it is satisfied that it would not be in the larger interest of justice to wind up the company.
7. It is also well settled that a winding up order shall not be made on a creditors petition, if it would not benefit him or the company's creditors in general.
8. The element of public policy has to be taken into account before determining the winding up issue.
9. Winding up is the last thing the Court would do and not the first thing to do having regard to its impact and consequences. Winding up of a company would ensue -
 - (a) closing down of a company which is engaged in production or manufacture or which provides some services;
 - (b) it would throw oat or employment numerous persons and result in gross hardship to the members of families of the employees;
 - (c) loss of revenue to the State by way of collection of taxes which otherwise should have been collected, on account of customs, excise duties, sales tax, income-tax, etc.;
 - (d) scarcity of goods and diminishing of employment opportunities.



Therefore, it is not correct to say that the existence of any of the circumstances for compulsory winding up of the company as enumerated under section 433 binds the Court to order the winding up of the company.

Petition for compulsory winding up (Section 439)

Under section 439, the petition for winding up of a company may be presented by any of the following persons:

1. the company; or
2. any creditor or creditors, including any contingent or prospective creditor or creditors; or
3. a contributory or contributories; or
4. any combination of creditors, company or contributories acting jointly or separately; or
5. the Registrar; or
6. any person authorized by the Central Government, as per section 243 (in consequence of investigation under section 237 of the Act);
7. the official liquidator in a voluntary winding up. [Section 440].
8. in a case falling under clause (h) of section 433 by the Central Government or a State Government. (Would become applicable when Companies (Second Amendment) Act, 2002 comes to effect.)

1. Company

The company may file a petition for its winding up, when the members of the company have so resolved by passing special resolution.

2. Creditors

A creditor can file a petition if the company is unable to pay its debts. The petition shall not be valid if the claim of the creditor has become time barred under the Limitation Act. The following persons shall also be deemed to be the creditors for this purpose;

(a) A prospective or contingent creditor.

However, a prospective or contingent creditor shall obtain the leave of the Court before making the petition. Such leave shall not be granted -

- unless, in the opinion of the Court, there is a prima facie case for winding up the company; and
- until such security for costs has been given as the Court thinks reasonable.

(b) A secured creditor.

(c) The holder of any debentures (including debenture stock), whether or not any trustee or trustees have been appointed.

(d) The trustee for the holders of debentures.

3. Contributory

The term contributory means every person liable to contribute to the assets of a company in the event of its being wound up and includes the holder of fully paid shares. A contributory may file a winding up petition in the following cases:

- (a) He can present the petition on the ground that the number of members has fallen below the statutory limit.
- (b) He can present the petition on any other ground if -

- he is an original allottee of shares; or
- he has held his shares for at least 6 months during the 18 months immediately preceding the commencement of winding up; or
- the shares have been devolved on him through the death of a member.

Rights of certain persons as a contributory:

Holder of forfeited shares. A holder of forfeited shares, being a contributory, has a right to apply for winding up of the company provided he has held the shares for 6 months during the 18 months preceding the commencement of winding up [**Re, Mumtaz Bank Ltd. (1932) 2 Comp Cas 350**].

Legal representative. The legal representative of a shareholder is a contributory for the purpose of filing a petition for winding up of the company [**Re, Bayswater Trading Co. Ltd. (1970) 1 All ER 608**].

Surviving shareholder in case of joint holders. In case of joint shareholders, the legal representatives of a joint holder cannot maintain a petition for winding up because this right falls upon the other joint holder [**Ram Govind Misra v. Allahabad Theatres P. Ltd. (1989) 66 Comp Cas 358**].

4. Joint petition.

Any combination of the company, the creditors and the contributories can present a petition for winding up.

5. The Registrar

The registrar may file the petition under any of the following grounds:

- (a) If a default is made in filing the statutory report or holding a statutory meeting.
- (b) If the company does not commence business within 1 year or suspends its business for 1 year.
- (c) If the numbers of members fall below the statutory minimum.
- (d) If the company is unable to pay its debts.
- (e) If the Court is of the opinion that it is just and equitable to wind up the company.
- (f) There has arisen a default contemplated under section 433(g) [in filing of Balance Sheet and Profit and Loss Account or Annual Return – yet to become applicable].

Restrictions on power of the registrar to make petition.

- (a) The registrar shall not make the petition unless he has obtained the previous approval of the Central Government. The Central Government shall not accord its approval, unless the company has first been afforded an opportunity of making a representation.
- (b) The registrar shall not make the, petition on the ground that the company is unable to pay its debts unless he is satisfied that the company is unable to pay its debts as disclosed from -
 - (i) the financial condition of company, as disclosed from the balance sheet of the company; or
 - (ii) the report of a special auditor appointed under section 233A; or
 - (iii) the report of an inspector appointed to investigate the affairs of the company under section 235 or 237.

6. The Central Government

Section 237(b) empowers the Central Government to order investigation into the affairs of a



company if, in the opinion of the Company Law Board, any of the following circumstances exist:

- (a) That the business of the company is being conducted -
 - with intent to defraud its creditors, members or any other persons; or
 - for a fraudulent or unlawful purpose; or
 - in a manner oppressive of any of its members.
- (b) That the company was formed for any fraudulent or unlawful purpose.
- (c) That the persons concerned in the formation or management of the company have been guilty of fraud, misfeasance or other misconduct.

After considering the inspector's report, if the Central Government is satisfied that any of the above circumstances exist and it is expedient to wind up the company, it may cause a petition to be presented to the Court for winding up the company on just and equitable ground (Section 243). It is for the Court to decide whether to wind up the company or not, but the Court will give Special weight to the views of the Central Government.

7. Petition by Official Liquidator (Section 440)

- (1) Where a company is being wound up voluntarily, a petition for its winding up by the Court* may be presented by-
 - (a) any person authorised to do so under section 439; or
 - (b) the Official Liquidator.
- (2) The court* shall not make a winding up order on a petition presented to it under sub-section (1), unless it is satisfied that the voluntary winding up cannot be continued with due regard to the interests of the creditors or contributories or both.

[*Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect.]

Statement of affairs to be filed on winding up of a company [Sec.439A]

Section 439A (Yet to take effect) introduced by the Companies (Second Amendment) Act, 2002 requires-

- (1) Every company shall file with the Tribunal a statement of its affairs along with the petition for winding up.
- (2) Where a company opposes a petition for its winding up, it shall file with the Tribunal a statement of its affairs.
- (3) The statement of affairs referred to in sub-section (1) or sub-section (2) shall be accompanied by-
 - (a) The last known addresses of all directors and company, secretary of such company;
 - (b) The details of location of assets of the company and their value;
 - (c) The details of all debtors and creditors with their complete addresses;
 - (d) The details of workmen and their employees and any amount outstanding to them;
 - (e) Such other details as the Tribunal may direct.

Jurisdiction of Court to order winding up (Section 10 and 435 to 438)*

The provisions relating to jurisdiction of the Court to wind up a company may be explained as follows:

1. Jurisdiction of Court

As per section 10, with respect to any matter relating to a company, the Court having jurisdiction means the High Court having jurisdiction in relation to a place at which the registered office of the company is situated. However, for the purpose of winding up of a company, such jurisdiction may be conferred on any District Court subordinate to that High Court in relation to companies having a paid up capital of less than ₹ 1 lakh. In other words, the Court having jurisdiction to wind up a company means -

- (a) the High Court having jurisdiction in relation to the place at which the registered office of the company is situated; or
- (b) any District Court subordinate to such High Court (However, the District Court shall not have any jurisdiction to wind up a company which has a paid up capital of ₹ 1 lakh or more).

2. Transfer of proceedings

- (a) Transfer of winding up proceedings to District Court. As per section 435, where a High Court makes an order for winding up a company, it may direct that all subsequent proceedings shall be held in -
 - (i) a District Court subordinate to that High Court; or
 - (ii) another High Court or District Court subordinate to that other High Court (after obtaining the consent of that other High Court).
- (b) Withdrawal and transfer of winding up from one District Court to another. As per section 436, during the continuance of winding up proceedings, the High Court may,
 - (i) withdraw the case and proceed with the winding up itself; or
 - (ii) transfer the case to any other District Court, whereupon the winding up shall proceed in that District Court.

3. Proceedings commenced in wrong Court

Where the proceedings for winding up of a company are started in a District Court, the High Court may direct that such District Court shall retain and continue with such proceedings, although it may not be the Court in which the proceedings ought to have been commenced (Section 437).

Note: 1.

- (a) Meaning of 'Court'. The High Court or the District Court as defined under section 10 is referred to as the 'Court' or the 'Company Court'.
- (b) Meaning of 'registered office'. For the purpose of section 10, 'registered office' means the place which has longest been the registered office of the company during the 6 months immediately preceding the presentation of the petition for winding up.

2. High Court may any time pass orders under sections 435,436 and 437

The High Court shall have jurisdiction to pass orders under sections 435,436 and 437 at any time and at any stage. Further, it may pass such orders whether or not an application in this behalf has been made by any of the parties to the proceedings (Section 438).

[*Section 435 to 438 Omitted by the Companies (Second amendment) act, 2002 (w.e.f. a date yet to be notified)]

Powers of the Court

Powers of the Court* in the winding up proceedings of the company can be classified as follows:

- (A) Powers of the Court* before making winding up order
- (B) Powers of the Court* after making winding up order



(A) Powers of the Court* before making winding up order

1. Stay of suits or proceedings (Section 442)

At any time after the presentation of a winding up petition and before a winding up order has been made, the company, or any creditor or contributory, may apply to the Court* for stay of suits or proceedings against the company. The application shall be made as follows:

- (a) Where any suit or proceeding is pending in the Supreme Court or in any High Court, application shall be made to the Supreme Court or the High Court, as the case may be.
- (b) Where any suit or proceeding is pending in any other Court, application shall be made to the Court having jurisdiction to wind up the company.

Discretion of the Court. The Court may stay or restrain the suit or proceedings against the company on such terms as it thinks fit.

[Note:Section 442 has been omitted Vide Companies (Second Amendment) Act, 2002, but not yet notified.]

2. Powers of Court to decide the petition (Section 443)

On hearing a winding up petition, the Court may:

- (a) dismiss it, with or without costs;
- (b) adjourn the hearing conditionally or unconditionally;
- (c) make any interim order as it thinks fit;
- (d) make an order for winding up the company with or without costs; or
- (e) any other order that it thinks fit;

3. Power to order winding up even if the company has no assets (Section 443)

Where the circumstances justify the making of a winding up order, the Court shall not refuse to make a winding up order on the ground only that -

- (a) the company has no assets; or
- (b) no assets will be available after paying the mortgages.

As per Companies (Second amendment) Act, 2002, Section 443 shall be substituted by-

Section 443.Power of Tribunal on hearing petition-

(1) On hearing a winding up petition, the Tribunal may:

- (a) dismiss it, with or without costs;
- (b) adjourn the hearing conditionally or unconditionally;
- (c) make any interim order as it thinks fit;
- (d) make an order for winding up the company with or without costs; or any other order that it thinks fit;

Provided that the Tribunal shall not refuse to make a winding up order on the ground only that the assets of the company have been mortgaged to an amount equal to or in excess of those assets, or that the company has no assets,

(2) Where the petition is presented on the ground that it is just and equitable that the company should be wound up, the Tribunal may refuse to make an order of winding up, if it is of the opinion that some other remedy is available to the petitioners and that they are acting unreasonably in

seeking to have the company wound up instead of pursuing that other remedy.

- (3) Where the petition is presented on the ground of default in delivering the statutory report to the Registrar, or in holding the statutory meeting, the Tribunal may-
- (a) instead of making a winding up order, direct that the statutory report shall be delivered or that a meeting shall be held; and
 - (b) order the costs to be paid by any persons who, in the opinion of the Tribunal, are responsible for the default.

(B) Powers of the Court after making winding up order

After making a winding up order, the Court may exercise the following powers:

1. Power of Court to stay winding up (Section 466)

- (a) **When can application be made?** The application can be made to the Court at any time after a winding up order has been made. .
- (b) **Who can make the application?** The application may be made by the Official Liquidator or any creditor or contributory. The applicant shall contend that all proceedings in relation to the winding up ought to be stayed. .
- (c) **Satisfaction of Court necessary.** The Court may require the Official Liquidator to furnish to the Court a report with respect to any facts or matters which are in his opinion relevant to the application. After considering the report of the Official Liquidator, if the Court is satisfied that all proceedings in relation to the winding up ought to be stayed, the Court may make an order staying the proceedings, either altogether or for a limited time, on such terms and conditions as the Court thinks fit.

As per Companies (Second amendment) Act, 2002, Section 466 shall be substituted by-

466. Power of tribunal to stay winding up.-

- (1) The Tribunal may at any time after making a winding up order, on the application either of the Official Liquidator or of any creditor or contributory, and on proof to the satisfaction of the Tribunal that all proceedings in relation to the winding up ought to be stayed, make an order staying the proceedings, either altogether or for a limited time, on such terms and conditions as the Tribunal thinks fit.
- (2) On any application under this section, the Tribunal may, before making an order, require the Official Liquidator to furnish to the Tribunal a report with respect to any facts or matters which are in his opinion relevant to the application.
- (3) A copy of every order made under this section shall forthwith be forwarded by the company, or otherwise as may be prescribed, to the Registrar, who shall make a minute of the order in his books relating to the company.

2. Settlement of list of contributories and application of assets (Section 467)

- (a) After making a winding up order, the Court* shall settle a list of contributories. It shall distinguish between those who are contributories in their own right and those who are contributories as being representatives of, or liable for the others' debts.
- (b) Where it appears to the Court* that it will not be necessary to make calls or adjust the rights of contributories, it may dispense with the settlement of list of contributories.
- (c) The Court* shall have the power to rectify the register of members.
- (d) The Court* shall cause the assets of the company to be collected and applied in discharge of its liabilities.



3. Delivery of property to liquidator (Section 468)

The Court* may require any contributory, trustee, receiver, banker, agent, officer or other employee of the company, to pay, deliver, surrender or transfer to the liquidator, any money, property or books and papers in his custody or under his control to which the company is *prima facie* entitled.

4. Set off (Section 469)

Where, apart from his liability as a shareholder, any other money is due from a contributory to the company, the court* may order him to pay the same.

5. Power of Court to make calls (Section 470)

- (a) The Court may make calls on all or any of the contributories. The liquidator has no power to make calls without the leave of the Court.
- (b) No set off can be claimed against the calls made by the Court or the liquidator.
- (c) In making a call, the Court may take into consideration the probability that some of the contributories may partly or wholly, fail to pay the call. Therefore, the Court may make the calls for such amount as may leave a surplus after everything is paid.
- (d) The Court shall adjust the rights of the contributories among themselves and distribute any surplus among the persons entitled thereto (Section 475).

As per Companies (Second amendment) Act, 2002, Section 470 shall be substituted by-

470. Power of Tribunal to make calls-

- (1) The Tribunal may, at any time after making winding up order, and either before or after it has ascertained the sufficiency of the assets of the company,-
 - (a) make calls on all or any of the contributories for the time being on the list of the contributories, to the extent of their liability, for payment of any money which the Tribunal considers necessary to satisfy the debts and liabilities of the company, and the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributories among themselves; and
 - (b) make an order for payment of any calls so made.
- (2) In making a call, the Tribunal may take into consideration the probability that some of the contributories may, partly or wholly, fail to pay the call.

6. Power to exclude creditors not proving in time (Section 474)

The Court* may fix a time within which the creditors shall prove their debts or claims. If within the time fixed by the Court*, a creditor does not prove his debt he will be excluded from the benefit of any distribution made before those debts or claims are proved.

7. Power to order costs (Section 476)

The Court* may, in the event of the assets being insufficient to satisfy the liabilities, make an order for the payment out of the assets, of the costs, charges and expenses incurred in the winding up, in such order of priority inter se as the Court* thinks just.

8. Power to summon persons suspected of having property of company, etc. (Section 477)

- (a) The Court* may summon -
 - any officer of the company; or
 - any person known or suspected to have in his possession any property or books or papers of the company; or

- any person known or suspected to be indebted to the company; or
 - any person whom the Court* deems capable of giving information concerning the promotion, formation, trade, dealings, property, books or papers, or affairs of the company.
- (b) The Court* may examine any officer or person so summoned on oath.
- (c) The Court* may require him to produce any books and papers in his custody relating to the company.
- (d) If, on his examination, he admits that he is indebted to the company, the Court* may order him to pay the amount. If he admits that some property of the company is in his possession, the Court* may order him to deliver the property.
- (e) If he fails to appear before the Court* without any valid reason, the Court* may cause him to be apprehended and brought before the Court* for examination.

9. Power to order public examination of promoters, directors, etc. (Section 478)

If the Official Liquidator states in his further report that any fraud has been committed in the promotion or formation of the company or in relation to the company, the Court* shall have the power to direct that any person charged with the fraud shall be publicly examined by the Court* under section 478.

10. Power to arrest absconding contributory (Section 479)

Where evidence is produced before the Court* that there is probable cause for believing that a contributory is about to leave India or abscond or conceal any of his property for the purpose of evading payment of calls or of avoiding examination respecting the affairs of the company, the Court* may cause the contributory to be arrested. The Court* may also order the seizure of his books and papers and movable property.

11. Dissolution of company (Section 481)

The Court* may make the order of dissolution in the following cases:

- (a) Where the affairs of a company have been completely wound up.
- (b) Where the Court* is of the opinion that the following two conditions have been satisfied:
- (i) the liquidator cannot proceed with the winding up of a company -
 - ✓ for want of funds and assets; or
 - ✓ for any reason whatsoever.
 - (ii) it is just and reasonable in the circumstances of the case that an order of dissolution of the company should be made.

12. Power of the Court* to declare the dissolution void (Section 559)

Where a company has been dissolved, it may be revived by the Court* by declaring the dissolution void. The effect of an order under section 559 is that it makes the dissolution void ab initio and all consequences resulting from the dissolution are avoided, including proceedings taken during the interval between the date of dissolution and the date of the order [Morris v. Harris 1927 AC 252].

[* Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect.]

Consequences of winding up order (Sections 444 to 447)

The consequences of a winding up order are as follows:

1. Communication of winding up Order (Section 444)

Where the Court makes an order for the winding up of a company, the Court shall forthwith cause



intimation thereof to be sent to the Official Liquidator and the registrar. This will enable the Official Liquidator to take into his possession the books, accounts and assets of the company.

Substitution of Section 444 as per Companies (Second Amendment) Act, 2002, w.e.f.-yet to come in force.

444. Order for winding up to be communicated to Official Liquidator and Registrar.

Where the Tribunal makes an order for the winding up of the company, the Tribunal, shall within a period not exceeding two weeks from the date of passing of the order, cause intimation thereof to be sent to the Official Liquidator and the Registrar.

2. Copy of winding up order to be filed with Registrar (Section 445)

- (1) The petitioner and the company must also file with the Registrar within 30 days a certified copy of the order.
- (2) The Registrar should then make a minute of the order in his books relating to the company and notify in the Official Gazette that such an order has been made.
- (3) The order for winding up is deemed to be a notice of discharge to the officers and employees of the company except when the business of the company is continued for the beneficial winding up of the company.

3. Stay of suits or proceedings (Section 446)

- (1) When a winding up order has been made or the Official Liquidator has been appointed as provisional liquidator, no suit or other legal proceeding shall be commenced, or if pending at the date of the winding up order, shall be proceeded with, against the company, except by leave of the court* and subject to such terms as the court* may impose.
- (2) The court which is winding up the company** shall, notwithstanding anything contained in any other law for the time being in force, have jurisdiction to entertain, or dispose of -
 - (a) any suit or proceeding by or against the company ;
 - (b) any claim made by or against the company (including claims by or against any of its branches in India) ;
 - (c) any application made under section 391 by or in respect of the company ;
 - (d) any question of priorities or any other question whatsoever, whether of law or fact, which may relate to or arise in course of the winding up of the company ;

whether such suit or proceeding has been instituted, or is instituted, or such claim or question has arisen or arises or such application has been made or is made before or after the order for the winding up of the company, or before or after the commencement of the Companies (Amendment) Act, 1960.

*** (3) Any suit or proceeding by or against the company which is pending in any Court other than that in which the winding up of the company is proceeding may, notwithstanding anything contained in any other law for the time being in force, be transferred to and disposed of by that Court.

- (4) Nothing in sub-section (1) or sub-section (3) shall apply to any proceeding pending in appeal before the Supreme Court or a high Court.

[* Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect.

****The Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect.**

*****Sub-section (3)-Omitted by the Companies (Second Amendment) Act, 2002- Yet to take effect.]**

4. Effect of winding up order (Section 447)

An order for winding up a company shall operate in favour of all the creditors and of all the contributories of the company as if it had been made out on the joint petition of a creditor and of a contributory. Accordingly, where the directors received some money from a creditor by fraudulent trading, and the liquidator recovered such money, it was held that the money formed part of the general assets of the company; it did not become payable to the creditor **[Re, W.C. Leitch Bros. (No. 2), (1993) 148 LT 108]**.

The Liquidator (Sections 448 to 453)

5. Official Liquidator to be liquidator (Section 449)

On a winding up order being made, the Official Liquidator shall become the liquidator of the company.

Appointment of Official Liquidator (Sec.448)

- (1) For the purposes of this Act, so far as it relates to the winding up of companies by the Court, -
 - (a) there shall be attached to each High Court, an Official Liquidator appointed by the Central Government, who shall be a whole-time officer, unless the Central Government considers that there will not be sufficient work for a whole-time officer in which case a part-time officer may be appointed ; and
 - (b) the Official Receiver attached to a District Court for insolvency purposes, or if there is no such Official Receiver, then, such person as the Central Government may, by notification in the Official Gazette appoint for the purpose, shall be the Official Liquidator attached to the District Court.
- (1A) The Central Government may appoint one or more Deputy or Assistant Official Liquidators to assist the Official Liquidator in the discharge of his functions.
- (2) All references to the "Official Liquidator" in this Act shall be construed as references to the Official Liquidator referred to in clause (a) or clause (b), as the case may be, of sub-section (1) and as including references to Deputy or Assistant Official Liquidators appointed under sub-section (1A).'

Section 448 substituted by the Companies (Second Amendment) Act, 2002 (w.e.f. a date yet to be notified)

Sec. 448. Appointment of Official Liquidator

- (1) For the purposes of this Act, so far as it relates to the winding up of a company by the Tribunal, there shall be an Official Liquidator who -
 - (a) may be appointed from a panel of professional firms of chartered accountants, advocates, company secretaries, costs and works accountants or firms having a combination of these professions, which the Central Government shall constitute for the Tribunal ; or
 - (b) may be a body corporate consisting of such professionals as may be approved by the Central Government from time to time ; or
 - (c) may be a whole-time or a part-time officer appointed by the Central Government :

Provided that, before appointing the Official Liquidator, the Tribunal may give due regard to the views or opinion of the secured creditors and workmen.
- (2) The terms and conditions for the appointment of the Official Liquidator and the remuneration payable to him shall be -
 - (a) approved by the Tribunal for those appointed under clauses (a) and (b) of sub-section (1),



subject to a maximum remuneration of five per cent of the value of debt recovered and realisation of sale of assets ;

(b) approved by the Central Government for those appointed under clause (c) of sub-section (1) in accordance with the rules made by it in this behalf.

(3) Where the Official Liquidator is an officer appointed by the Central Government under clause (c) of sub-section (1), the Central Government may also appoint, if considered necessary, one or more Deputy Official Liquidators or Assistant Official Liquidators to assist the Official Liquidator in the discharge of his functions, and the terms and conditions for the appointment of such Official Liquidators and the remuneration payable to them shall also be in accordance with the rules made by the Central Government.

(4) All references to the "Official Liquidator" in this Act shall be construed as reference to the Official Liquidator specified in sub-section (1), or to the Deputy Official Liquidator or Assistant Official Liquidator referred to in subsection (3), as the case may be.

(5) The amount of the remuneration payable shall -

(a) form part of the winding up order made by the Tribunal ;

(b) be treated as first charge on the realisation of the assets and be paid to the Official Liquidator or to the Central Government, as the case may be.

(6) The Official Liquidator shall conduct proceedings in the winding up of a company and perform such duties in reference thereto as the Tribunal may specify in this behalf :

Provided that the Tribunal may -

(a) transfer the work assigned from one Official Liquidator to another Official Liquidator for the reasons to be recorded in writing ;

(b) remove the Official Liquidator on sufficient cause being shown ;

(c) proceed against the Official Liquidator for professional misconduct.

Sec. 449. Official liquidator to be Liquidator

On a winding up order being made in respect of a company, the Official Liquidator shall, by virtue of his office, become the liquidator of the company.

The provisional liquidator (Section 450)

(a) Object of appointment. The provisional liquidator is appointed in special circumstances in order to protect the assets of the company pending the hearing or disposal of the winding up petition. As such, where there is a danger to the assets of the company, the Court may appoint a provisional liquidator in order to protect the interests of the creditors and safeguard the properties of the company.

(b) Official Liquidator to be provisional liquidator. After receiving the winding up petition and before the making of a winding up order, the Court may appoint the Official Liquidator as a provisional liquidator.

(c) Opportunity to make representations. Before appointing a provisional liquidator, the Court shall give notice to the company and give a reasonable opportunity to it to make its representations. However, the Court may dispense with the notice for any special reasons to be recorded in writing.

(d) Same powers as that of liquidator. The provisional liquidator shall have the same powers as that of a liquidator. However, the Court may limit and restrict his powers at the time of his appointment or thereafter.

- (e) Provisional liquidator to be liquidator. On a winding up order being made, the provisional liquidator shall automatically become the liquidator of the company.
- (f) Appointment of provisional liquidator is a drastic measure.- The Court will not take a drastic step like the appointment of a provisional liquidator unless the company is shown to be insolvent or unless the petition is presented by the company itself or the petition is unopposed [Virendra Singh v. Nandlal Bhandari & Sons Pvt. Ltd. (1979) 49 Comp Cas 532]. The appointment of a provisional liquidator will be made only when the Court is satisfied that such an order is absolutely necessary. Where the company opposes the appointment of a provisional liquidator, the Court will not appoint a provisional liquidator because the appointment would in effect put a stop to the business of the company, and if afterwards the Court refuses to make the winding up order, it would paralyze the affairs of the company.

General Provisions as to liquidator (Section 451)

- (1) The liquidator shall conduct the proceedings in winding up the company and perform such duties in reference thereto as the court* may impose.
- (2) Where the Official Liquidator** becomes or acts as liquidator, there shall be paid to the Central Government such fees as may be prescribed, out of the assets of the company (when Tribunal starts functioning, fee will be payable to the Central Government only when an officer of the Central Government is appointed as the Official Liquidator)
- (3) The acts of a liquidator shall be valid, notwithstanding any defect that may afterwards be discovered in his appointment or qualification :

Provided that nothing in this sub-section shall be deemed to give validity to acts done by a liquidator after his appointment has been shown to be invalid.

[*To be substituted by "Tribunal" as per Companies (Second Amendment) Act, 2002 (w.e.f. a date yet to be notified)]

****To be substituted by "Official Liquidator referred to in clause (c) of sub-section (1) of section 448" as per Companies (Second Amendment) Act, 2002 (w.e.f. a date yet to be notified)]**

Sec. 452. Style, etc., of Liquidator

A liquidator shall be described by the style of "The Official Liquidator" of the particular company in respect of which he acts, and not by his individual name.

Sec. 453. Receiver not to be Appointed of Assets with Liquidator

A receiver shall not be appointed of assets in the hands of a liquidator except by, or with the leave of, the court.*

[* Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect.]

Duties of the Liquidator

A liquidator is an agent employed for the purpose of winding up of the company. In some respects he is a trustee, but he is not a trustee for each individual creditor. His principal duties are to take possession of assets, to make out the requisite lists of contributories and of creditors, to have disputed cases adjudicated upon, to realise the assets subject to the control of the Court in certain matters and to apply the proceeds in payment of the company's debts and liabilities in due course of administration, and having done that, to divide the surplus amongst the contributories and to adjust their rights [Discount Bank of India Ltd. (in Liquidation) v Tirloki Nath, (1952) 54 Punj LR 335].

The duties of the liquidator in compulsory winding up are explained as follows:

1. Conduct of Minding up proceedings (Section 451)

The liquidator must conduct equitably and impartially all the proceedings in winding up the



company according to the provisions of the law, and must perform such duties as the Court may impose.

2. Not to make secret profit

The liquidator occupies a fiduciary position and he must not make any secret profit [Silkstone and Haigh Moor Coal Co. v Edey (1900) 1 Ch. 167].

3. Preliminary report (Section 455)

(a) Time limit for submission. The Official Liquidator shall submit a preliminary report to the Court as soon as he receives the statement of affairs from the persons who were the directors of the company at the time of winding up. In any case, the preliminary report shall be submitted within 6 months of the winding up order. The time limit may be extended by the Court.

(b) Contents. The report shall contain the following particulars:

- (i) The amount of issued capital, subscribed capital and paid up capital.
- (ii) The estimated amount of assets giving separately the particulars of -
 - ❖ cash and negotiable securities;
 - ❖ debts due from contributories;
 - ❖ debts due to the company and securities, if any available in respect thereof;
 - ❖ movable and immovable properties belonging to the company; and
 - ❖ unpaid calls.
- (iii) The estimated amount of liabilities,
- (iv) If the company has failed, the causes of such failure.,-
- (v) Whether, in his opinion, further inquiry is desirables to any matter relating to the promotion, formation, or failure of the company, or the conduct of the business.

4. Further report (Section 455)

The Official Liquidator may make a further report to the Court. However, the Official Liquidator is not bound to submit such further report; it is discretionary.

(a) Contents. Such report may contain the following particulars:

- (i) Particulars regarding the promotion and formation of the company.
- (ii) Whether, in his opinion, any fraud has been committed by any person in the promotion or formation of the company,
- (iii) Whether, in his opinion, any fraud has been committed by any officer of the company since its formation.
- (iv) Any other matters which, in his opinion, it is desirable to bring to the notice of the Court.

(b) Public examination. If the Official Liquidator states in his further report that any fraud has been committed in the promotion or formation of the company or in relation to the company, the Court shall have the power to direct that any person charged with the fraud shall be publicly examined by the Court under section 478.

5. Custody of company's property (Sections 456)

Where a winding up order has been made, the liquidator shall take into his custody all the

properties, effects and actionable claims to which the company is entitled. Following points must be noted in this regard:

- (a) **Property of the company vests in company itself.** The properties and effects of the company do not vest in the liquidator or in the Court. They remain the properties of the company. The Court has the custody of the same and the liquidator is the custodian thereof.
- (b) **Taking possession of the properties of the company.** For the purpose of taking into custody the properties of the company, the liquidator may request the Chief Presidency Magistrate or the District Magistrate for assistance and such assistance shall be provided. For this purpose, such steps may be taken and such force may be used as is necessary in the given circumstances.

6. Maintenance of books (Section 461)

- (1) The liquidator shall keep, in the manner prescribed, proper books in which he shall cause entries or minutes to be made of proceedings at meetings and of such other matters as may be prescribed.
- (2) Any creditor or contributory may, subject to the control of the court*, inspect any such books, personally or by his agent.

[* Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect.]

7. Presentation of accounts by the liquidator (Section 462)

The liquidator has to maintain an account of the proceedings of the winding up. Following points need consideration:

- (a) **Submission to Court.** So long as a liquidator is in office, he shall present to the Court an account of his receipts and payments, at least twice a year. He shall furnish the Court with such vouchers and information as the Court may require. The Court may require the production of any books or accounts kept by the liquidator.
- (b) **Form of accounts.** The account shall be in the prescribed form, shall be made in duplicate, and shall be verified by a declaration in the prescribed form.
- (c) **Audit through Court.** The Court shall cause the accounts to be audited in such manner as it thinks fit.
- (d) **Filing of copies of audited accounts.** One copy of the audited accounts shall be filed and kept by the Court. The second copy of the audited accounts shall be filed with the registrar.
- (e) **Inspection.** The copies filed with the Court and the registrar shall be open to the inspection of any creditor, contributory or any other interested person.
- (f) **Copies to be sent to creditors and contributories.** A printed copy of the audited accounts shall be sent by the liquidator to every creditor and to every contributory. Instead of the complete accounts, a summary of accounts may be sent. However, the Court may, in its discretion dispense with sending of accounts or summary thereof, e.g., where the assets of the company are not sufficient to meet all the liabilities.
- (g) **Applicability to Government Company in liquidation.** In case of a government company, the liquidator shall send a copy of the accounts to –
 - (i) the Central Government, if the Central Government is a member of the Government company; or
 - (ii) the State Government, if any State Government is a member of the Government company; or
 - (iii) the Central Government and any State Government, if both the Governments are members of the Government company.



8. Calling Meeting (Section 464)

Within 2 months from the date of the direction of the court, the liquidator must call a meeting of the creditors for determining the persons who are to be members of the Committee of Inspection, if such committee is to be appointed. Within 14 days of the meeting of the creditors the liquidator must call a meeting of the contributories to consider the decision of the creditors.

9. Money to be kept in bank account (Section 553)

He must keep all sums received by him, on behalf of the company into some scheduled bank, unless the court otherwise allows deposit in a non-scheduled bank.

The duties of the liquidator in voluntary winding up are explained as follows:

- a) To satisfy himself that the resolution appointing him was validly passed.
- b) To send a notice of his appointment to the Registrar. (Section 516)
- c) To take possession of company's assets and to see that they are intact.
- d) To prepare a list of debts and claims.
- e) To settle the list of contributories fixed for the purpose.
- f) To dispose of the assets of the company to the best advantage and collect, as far as practicable, all outstanding debts due to the company. Subject to preferential payments, the assets of the company shall be applied in satisfaction of its liabilities *pari passu* and, subject to such application, shall unless the Articles otherwise provide, be distributed among members according to their rights and interests in the company. (Section 511)
- g) To apply the proceeds of realization in the prescribed manner.
- h) To convene the general meetings of the company at the end of every year, during liquidation and present the annual accounts thereat. (Section 508)
- i) To file return at the end of the first year and then every six months during the continuation of the winding-up.
- j) At the end of winding-up, to call general meeting and lay before it the account of the winding-up and within one week of this meeting file a return with the Registrar (Section 509)

Powers of the liquidator (Section 457)

The powers of the Official Liquidator may be discussed as follows:

A. Powers exercisable with the sanction of the Court*

The liquidator can exercise the following powers with the sanction of the Court*:

- (a) to institute or defend any legal proceedings on behalf of the company;
- (b) to carry on the business of the company so far as may be necessary for the beneficial winding up of the company;
- (c) to sell the immovable and movable property and actionable claims of the company by public auction or private contract, with power to transfer the whole thereof to any person or body corporate; or to sell or to sell the same in parcels;
- (ca)* to sell whole of the undertaking as a going concern;
- (d) to raise money on the security of the assets of the company;
- (e) to do all such other things as may be necessary for winding up of the affairs of the company and distributing its assets;

- (f)** to appoint an advocate, attorney or pleader entitled to appear before the court to assist him in the performance of his duties [Section 459];
- (g) to compromise calls, debts and other present or potential pecuniary liabilities with contributories or debtors and take any security in discharge of any such claim and give a complete discharge thereof [Section 546];
- (h) to pay any class of creditors in full [Section 546]

The court* may, by order, provide that the liquidator may exercise any of the above powers without the sanction or intervention of the court. However, it shall still be subject to control by the court [Section 458].

***Applicable when Tribunal starts functioning.**

****One or more chartered accountants or company secretaries or cost accountants or legal practitioners entitled to appear before the Tribunal under section 10GD of the Act when Tribunal starts functioning.**

B. Powers exercisable without the sanction of the Court [Section 457(2)]

The liquidator does not require any sanction of the Court* for exercising any of the following powers:

- (i) To do all acts and to execute all documents on behalf of the company and use the company's seal.
- (ia) To inspect the records and returns of the company on the files of the registrar without payment of any fee.
- (ii) To prove, rank and claim in the insolvency of any contributory, and to receive dividends in the insolvency.
- (iii) To draw, accept, make and endorse any bill of exchange, hundi or promissory note on behalf of the company.
- (iv) To take out letters of administration to any deceased contributory, and to do any other act necessary for obtaining payment of any money due from a contributory or his estate.
- (v) To appoint an agent to do any business which he is unable to do himself.

The Companies (Second Amendment) Act, 2002 has added sub-sections (2A) to (2G) to Section 457. The provisions are as under:

(2A) The liquidator shall -

- (a) appoint security guards to protect the property of the company taken into his custody and to make out an inventory of the assets in consultation with secured creditors after giving them notice ;
- (b) appoint, as the case may be, valuer, chartered surveyors or chartered accountant to assess the value the company's assets within fifteen days after taking into custody of property, assets referred to in sub-clause (a) and effects or actionable claims subject to such terms and conditions as may be specified by the Tribunal ;
- (c) give an advertisement, inviting bids for sale of the assets of the company, within fifteen days from the date of receiving valuation report from the valuer, chartered surveyors or chartered accountants referred to in clause (b), as the case may be.

(2B) The liquidator shall, immediately after the order for winding up or appointing the liquidator as provisional Liquidator is made, issue a notice requiring any of the persons mentioned in sub-section (2) of section 454, to submit and verify a statement of the affairs of the company and such notice shall be served by the liquidator.



(2C) The liquidator may apply to the Tribunal for an order directing any person who, in his opinion, is competent to furnish a statement of the affairs under sections 439A and 454 and such person shall for the said purpose be served a notice by the liquidator in the manner as may be prescribed.

(2D) The liquidator may, from time to time, call any person for recording any statement for the purpose of investigating the affairs of the company which is being wound up and it shall be the duty of every such person to attend to the liquidator at such time and place as the liquidator may appoint and give the liquidator all information which he may require and answer all such questions relating to winding up of company as may be put to him by the liquidator.

(2E) Every bidder shall, in response to advertisement referred to in clause (c) of sub-section (2A), deposit, his offer in the manner as may be prescribed, with liquidator or provisional liquidator, as the case may be, within forty-five days from the date of the advertisement and the liquidator or provisional liquidator shall permit inspection of property and assets in respect of which bids were invited :

Provided that such bid may be withdrawn within three days before the last day of closing of the bid :

Provided further that the inspection of property shall be open for not more than five days before closing of the bid.

(2F) The advertisement inviting bids shall contain the following details, namely :-

- (a) name, address of registered office of the company and its branch offices, factories and plants and the place where assets of the company are kept and available for sale ;
- (b) last date for submitting bids which shall not exceed ninety days from the date of advertisement ;
- (c) time during which the premises of the company shall remain open for inspection ;
- (d) the last date for withdrawing the bid ;
- (e) financial guarantee which shall not be less than one-half of the value of the bid;
- (f) validity period of the bids ;
- (g) place and date of opening of the bids in public ;
- (h) reserve price and earnest money to be deposited along with the bid;
- (i) any other terms and conditions of sale which may be prescribed.

(2G) The liquidator appointed shall -

- (a) maintain a separate bank account for each company under his charge for depositing the sale proceeds of the assets and recovery of debts of each company ;
- (b) maintain proper books of account in respect of all receipts and payments made by him in respect of each company and submit half yearly return of receipts and payments to the Tribunal.

Control of Court* over the powers of the liquidator

All the powers of the liquidator (whether exercisable with or without the sanction of the Court*) shall be exercised subject to the control of the Court*. Any creditor or contributory may apply to the Court* with respect to the exercise or proposed exercise of any of the powers of the liquidator.

[* Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect]

Power of liquidator to disclaim onerous property (Section 535)

The provisions of section 535 are explained as follows:

1. Meaning of onerous property

The word 'onerous' means burdensome or something involving heavy obligations. In the real

sense, onerous property means a property which has ceased to be an asset and has become a liability. Some examples of onerous property are as follows:

- (a) Land of any tenure, burdened with onerous covenants.
- (b) Unprofitable contracts, properties which are not saleable because of obligations attached to it.
- (c) Partly paid shares of an unsuccessful company, e.g., where the company may be liable as a contributory.

2. Requirements of a valid disclaimer

- (a) Signed. The disclaimer shall be in writing and signed by the liquidator.
- (b) Sanction of the Court*. No disclaimer can be made except with the leave of the Court*. The Court* may impose certain terms and conditions while granting leave. The Court* may make such other order as it thinks just. The Court* has an absolute discretion to grant or refuse the permission to disclaim the onerous property.
- (c) Time limit for disclaimer. The liquidator may disclaim any onerous property within 12 months from the date of commencement of winding up. But, where any onerous property has not come to the knowledge of the liquidator within 1 month after the commencement of the winding up, the power of disclaiming the property may be exercised at any time within 12 months after he has become aware thereof. Also, the Court* has the power to extend such period.
- (d) Notice to the interested parties. Before granting the sanction, the Court* may require that notices be given to persons interested. The Court* may impose such terms as it thinks fit.
- (e) Notice to interested party within 28 days of his application. Where any party interested in a property makes an application to the liquidator requiring him to decide whether he will or will not disclaim the property concerned, the liquidator shall within 28 days of the receipt of such application, give notice to the applicant of his intention to disclaim the property. The period of 28 days may be extended by the Court*. If the liquidator fails to disclaim the contract within the said periods of 28 days or extended period, he shall be deemed to have accepted the contract.

3. Effect of disclaimer

- (a) **On the Company.** All the rights and liabilities of the company in respect of the property disclaimed shall cease to operate, i.e., the company shall be relieved of all its liabilities in respect of such property.
- (b) **On the other person.** Any person may apply to the Court* for damages for non-performance of the contract. The Court* may make an order rescinding the contract on such terms as to payment of damages for the non-performance of the contract as it thinks fit. If the Court* awards damages to such person, he shall be deemed to be a creditor of the company and may prove the amount of damages as a debt in the winding up.

Section 535 has been enacted with the object that the liquidator be given a power to prevent a loss to the company by getting rid of the onerous properties. The liquidator may disclaim any onerous property in spite of the fact that he had taken possession of the property or had exercised any right of ownership of the property.

[* Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect]



Consequences where no document is filed by the liquidator

The High Court at Mumbai appointed the Official Liquidator as the liquidator of Imprudent Engineering Co. Ltd. Some of the creditors have brought to the notice of the liquidator that though the company is in liquidation for the past several years, nothing worthwhile has been done to speed up the winding up and no documents have been filed to indicate the progress of liquidation. Examine in this connection the nature and periodicity of returns required to be filed by the liquidator in terms of the provisions contained in the Companies Act.

The liquidator has to maintain an account of the proceedings of the winding up. As per section 462, the liquidator shall comply with the following provisions:

- (a) So long as the liquidator is in office, he shall present to the Court an account of his receipts and payments, at least twice a year. He shall furnish the Court with such vouchers and information as the Court may require. The Court may require the production of any books or accounts kept by the liquidator.
- (b) The Court shall cause the account to be audited in such manner as it thinks fit.
- (c) The account shall be in the prescribed form, shall be made in duplicate, and shall be verified by a declaration in the prescribed form. One copy of the account shall be kept by the Court and the other shall be filed with the registrar!
- (d) The copies filed with the Court and the registrar shall be open to the inspection of any creditor, contributory or any other interested person.
- (e) A printed copy of the audited accounts shall be sent by the liquidator to every creditor and to every contributory. Instead of the complete account, a summary of the account may be sent. However, the Court may dispense with sending of account or summary thereof, e.g., where the assets of the company are not sufficient to meet all the liabilities.
- (f) In case of a Government company, the liquidator shall send a copy of the accounts to the Central Government and/or the State Government, as the case may be.

As per section 551, the liquidator shall submit to the Court information relating to pending liquidation. The liquidator shall comply with the following provisions:

- (a) Where the winding up proceedings continue for more than 1 year, the liquidator shall file a statement with respect to the proceedings of winding up.
- (b) The statement shall be duly audited by a person who is qualified to act as an auditor of the company.
- (c) The statement shall be filed within 2 months of the end of the first year and thereafter until the winding up is concluded, at intervals of not exceeding 1 year.
- (d) The statement is to be filed with the Court. A copy shall also be filed with the registrar.

In the given case, no documents have been filed by the liquidator. Therefore, the liquidator has made a default in compliance with the provisions of sections 462 and 551. For default of section 551, the liquidator shall be punishable with fine which may extend to ₹ 5,000 per day during which the failure continues. Since no penalty has been provided for contravention of section 462, the residuary penalty section 629A gets attracted and consequently the liquidator shall be punishable with fine which may extend to ₹ 5,000 and a further fine of ₹ 5,000 per day in case of continuing contravention.

Committee of inspection under compulsory winding up (Sections 464 and 465)

Sec. 464. Appointment and Composition of Committee of Inspection

- (1) (a) The court* may, at the time of making an order for the winding up of a company or at any time thereafter, direct that there shall be appointed a committee of inspection to act with the liquidator.

- (b) Where a direction is given by the court* as aforesaid, the liquidator shall, within two months from the date of such direction, convene a meeting of the creditors of the company (as ascertained from its books and documents) for the purpose of determining who are to be members of the committee.
- (2) The liquidator shall, within fourteen days from the date of the creditors' meeting or such further time as the court* in its discretion may grant for the purpose ; convene a meeting of the contributories to consider the decision of the creditors' meeting with respect to the membership of the committee ; and it shall be open to the meeting of the contributories to accept the decision of the creditors' meeting with or without modifications or to reject it.
- (3) Except in the case where the meeting of the contributories accepts the decision of the creditors' meeting in its entirety, it shall be the duty of the liquidator to apply to the court* for directions as to what the composition of the committee shall be, and who shall be members thereof.

Sec. 465. Constitution and Proceedings of Committee of Inspection

- (1) A committee of inspection appointed in pursuance of section 464 shall consist of not more than twelve members, being creditors and contributories of the company or persons holding general or special powers of attorney from creditors or contributories, in such proportions as may be agreed on by the meetings of creditors and contributories, or in case of difference of opinion between the meetings, as may be determined by the court*.
- (2) The committee of inspection shall have the right to inspect the accounts of the liquidator at all reasonable times.
- (3) The committee shall meet at such times as it may from time to time appoint, and the liquidator or any member of the committee may also call a meeting of the committee as and when he thinks necessary.
- (4) The quorum for a meeting of the committee shall be one-third of the total number of the members, or two, whichever is higher.
- (5) The committee may act by a majority of its members present at a meeting, but shall not act unless a quorum is present.
- (6) A member of the committee may resign by notice in writing signed by him and delivered to the liquidator.
- (7) If a member of the committee is adjudged an insolvent, or compounds or arranges with his creditors, or is absent from five consecutive meetings of the committee without the leave of those members who, together with himself, represent the creditors or contributories, as the case may be, his office shall become vacant.
- (8) A member of the committee may be removed at a meeting of creditors if he represents creditors, or at a meeting of contributories if he represents contributories, by an ordinary resolution of which seven days' notice has been given, stating the object of the meeting.
- (9) On a vacancy occurring in the committee, the liquidator shall forthwith summon a meeting of creditors or of contributories, as the case may require, to fill the vacancy ; and the meeting may, by resolution, re-appoint the same, or appoint another, creditor or contributory to fill the vacancy :
Provided that if the liquidator, having regard to the position in the winding up, is of the opinion that it is unnecessary for the vacancy to be filled, he may apply to the court* and the court* may make an order that the vacancy shall not be filled, or shall not be filled except in such circumstances as may be specified in the order.
- (10) The continuing members of the committee, if not less than two, may act notwithstanding any vacancy in the committee.



[* Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect]

Statement of affairs to be made to the Liquidator (Section 454)

The provisions of section 454 in this regard are explained as follows:

1. Submission of statement of affairs

A statement of affairs shall be made out and submitted to the Official Liquidator where -

- (a) the Court* has made a winding up order; or
- (b) the Court* has appointed the Official Liquidator as a provisional liquidator.

2. Contents of statement of affairs

The statement of affairs shall contain the following particulars:

- (a) the assets of the company, stating separately the cash balance in hand and at the bank, and the negotiable securities.
- (b) its debts and liabilities.
- (c) the names, residences and occupations of its creditors, stating separately the amount of secured and unsecured debts; and in the case of secured debts, detailed particulars of the securities given.
- (d) the debts due to the company and the names, residences and occupations of the persons from whom they are due and the amount likely to be realised on account thereof.
- (e) such further or other information as may be prescribed, or as the Official Liquidator may require.

3. Verification of the statement

The statement of affairs shall be submitted and verified by one or more persons who were directors, managers, secretary or other chief officer of the company as on the relevant date. Also, the Official Liquidator may require that the said verification be given by any of the following persons:

- (a) A person who is or has been an officer of the company.
- (b) A person who has taken part in the formation of the company at any time within preceding 1 year.
- (c) A person who is in the employment of the company, or had been in the employment of the company within the preceding 1 year, and is in the opinion of the Official Liquidator, capable of giving the information required.

4. Time limit for filing the statement

The statement of affairs shall be submitted within 21 days of the “relevant date”. However, the Court* or the Official Liquidator has the power to extend the time up to 3 months.

‘Relevant date’ means –

- (a) in a case where a provisional liquidator is appointed, the date of his appointment; and
- (b) in a case where no provisional liquidator is appointed, the date of the winding up order.

5. Inspection or copy of the statement

A creditor or contributory of the company shall be entitled to inspect, or obtain a copy or extract of the statement of affairs.

6. Cost of preparing the statement

A person preparing the statement of affairs and affidavit shall be entitled to recover the costs and

expenses incurred in such preparation. Such payment shall be made by the Official Liquidator or the provisional liquidator. An appeal shall lie to the Court* against determination of such costs.

[* Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect]

Dissolution and revival of a company (Sections 481 and 559)

The provisions relating to dissolution of a company and revival of a dissolved company are contained in sections 481 and 559 respectively. These provisions are “explained in the following paragraphs:

1. Dissolution of a company (Section 481)

- (a) Grounds for dissolution. Only the Court* has the power to order the dissolution of a company. The Court may make the order of dissolution in the following cases:
 - (i) Where the affairs of a company have been completely wound up.
 - (ii) Where the Court* is of the opinion that the following two conditions have been satisfied:
 - the liquidator cannot proceed with the winding up of a company –
 - for want of funds and assets; or
 - for any reason whatsoever.
 - it is just and reasonable in the circumstances of the case that an order of dissolution of the company should be made.
- (b) Effective date of dissolution. The company shall be dissolved from the date of the order of the Court*.
- (c) Filing of order with registrar. Within 30 days from the date of order of the Court*, a copy of the order shall be filed by the liquidator with the registrar.

2. Revival of a dissolved company (Section 559)

- (a) Order of the Court*. Where a company has been dissolved, it may be revived by the Court* by declaring the dissolution void. The effect of an order under section 559 is that it makes the dissolution void ab initio and all consequences resulting from the dissolution are avoided, including proceedings taken during the interval between the date of dissolution and the date of declaration of dissolution as void [Morris v Harris 1927 AC 252].
- (b) Who can make the application? Following persons are eligible to make an application to the Court*:
 - (i) Liquidator of the company.
 - (ii) Any other interested person. Following persons have been held to be interested:
 - Any creditor of the company.
 - Any contributory of the company.
 - The Income Tax Officer who makes a final assessment after dissolution of the company.
 - An unpaid landlord.
- (c) Time limit. Section 559(1) of the Act reads as under:

“Where a company has been dissolved, whether in ‘pursuance of this Part or of section 394 or otherwise, the Court* may at any time within two years of the date of the dissolution, on application by the liquidator of the company or by any other person who appears to the Court* to be interested, make an order, upon such terms as the Court* thinks fit, declaring the dissolution to have been void; and



thereupon such proceedings may be taken as might have been taken if the company had not been dissolved."

Two different views have been expressed while interpreting section 559. According to One view, the application shall be made within 2 years from the date of dissolution of the company, although the order of the Court* may be passed even after the expiry of two years [Re, Scad Ltd. (1941) 2 All ER 466; Income Tax Officer v Vemulapalli & Sons Private Ltd., (1967) 37 Comp Cas 686 (AP)]. However, a conflicting view has been expressed according to which the order under section 559 must be passed within 2 years from the date of order of dissolution [ITO, Ernakulam .v Mambad Timber and Estates Ltd. (1973) 43 Comp Cas 332]. The former view appears to be more in consonance with justice and common sense.

- (d) Filing a copy of order with the registrar. Where the Court* makes an order declaring the dissolution void, the applicant shall file a copy of the order with the registrar within 30 days of the making of order. The Court* may extend the time limit for filing the said copy.
- (e) Discretionary power of the Court*. The Court* has wide discretion under this section and it shall consider each case on its own merits. Following points need consideration:
 - (i) Where the applicant alleged and proved fraud in the winding up proceedings, the Court* declared the dissolution void [Barrett v African Products Ltd. AIR 1928 PC. 2(51)].
 - (ii) Where the assets were realised by the liquidator after the company was dissolved, the Court* passed an order declaring the dissolution void [Henderson's Nigel Co. 105 LT 370].
 - (iii) The mere fact that misfeasance proceedings had been started did not itself amount to a ground for declaring the dissolution void [Lewis and Smart (1954) 1 WLR 755].

[* Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect]

Voluntary winding up (Sections 484 to 487)

The provisions relating to voluntary winding up are explained in the following paragraphs:

1. Meaning of voluntary winding up

Winding up by the Court is a time consuming process and involves compliance of various legal requirements. However, voluntary winding up is a rather simplified process.

Voluntary winding up means winding up at the instance of the members of the company, without any interference by the Court. In other words, the decision to wind up the company is taken by the members of the company, without approaching the Court.

2. Grounds for voluntary winding up (Section 484)

A company may be wound up voluntarily under any of the following circumstances:

- 1. If the company in general meeting passes an ordinary resolution for voluntary winding up (i) where the period fixed by the Articles for the duration of the company has expired, or (ii) the event has occurred on which under the Articles the company is to be dissolved.
- 2. If the company resolves by special resolution that it shall be wound up voluntarily..

3. Advertisement of resolution (Section 485)

Within 14 days of the passing of the resolution for voluntary winding up, a notice of the resolution shall be advertised in -

- (a) the Official Gazette; and
- (b) one newspaper circulating in the district where the registered office of the company is situated.

4. Commencement of voluntary winding up (Section 486)

The voluntary winding up shall be deemed to have commenced when the resolution (ordinary or special, as the case may be) for voluntary winding up was passed.

5. Effect on the status of the company (Section 487)

On passing a resolution for voluntary winding up, the company shall cease to carry on its business, except so far as may be required for the beneficial winding up of the business. But, the corporate status and powers of the company shall continue until it is dissolved.

6. Duty of liquidator to give notice to income tax officer

The liquidator appointed to conduct the voluntary winding up shall give notice of his appointment to the income tax officer. Such notice shall be given within 30 days of his appointment. Thereafter, within 3 months, the income tax officer shall intimate the liquidator the estimated amount to meet the tax liability. The liquidator is required to set aside the amount to meet the tax liability.

7. Kinds of Voluntary winding up

- (a) Members' voluntary winding up
- (b) Creditors voluntary winding up

Generally speaking, where a company is solvent, i.e., it is able to pay its debts in full, the voluntary winding up takes the form of members' voluntary winding up. As opposed to it, where a company is unable to pay its debts, it is called as creditors' voluntary winding up.

Members' voluntary winding up - Declaration of solvency (Section 488)

Where the company is solvent, a 'declaration of solvency' is made by the directors and consequently, winding up proceedings remain in the control of the members of the company. The provisions relating to 'declaration of solvency' are explained as follows:

1. Requirements of a valid declaration of solvency

To be effective, the declaration of solvency must fulfill the following conditions:

- (a) Made by whom? It shall be made by a majority of the directors or all the directors if there are only 2 directors.
- (b) Verification. It shall be verified by an affidavit.
- (c) No inability to pay debts. The declaration must specify, that the directors have made a full enquiry into the affairs of the company. The declaration shall further state -
 - (i) that the company has no debts; or
 - (ii) the period not exceeding 3 years, within which, in the opinion of directors, the company will be able to pay its debts in full.
- (d) Date of declaration of solvency. It shall be made within 5 weeks immediately preceding the date of passing of the resolution for voluntary winding up.
- (e) Filing with the registrar. It shall be registered with the registrar before the date of passing of the resolution for voluntary winding up.
- (f) Auditor's report. The declaration shall be accompanied by a copy of the auditor's report on the profit and loss account and balance sheet of the company. The report shall also contain a statement of assets and liabilities of the company as on the latest practicable date immediately before the date of the declaration of solvency. The report on the profit and loss account and balance sheet shall relate to a period -



- (i) commencing from the date upto which the last profit and loss account was prepared; and
- (ii) ending with the latest practicable date immediately before the making of the declaration of solvency.

2. Proceedings void if declaration is not valid

Where the declaration of solvency is not made in accordance with the law, the resolution for winding up and all subsequent proceedings will be null and void [Shri Raja Mohan Manucha v. Lakshminath Saigal (1963)33CompCas719].

3. Penalty for wrong declaration

Any director of a company making a declaration of solvency without having reasonable grounds for the opinion that the company will be able to pay its debts in full within the period specified in the declaration, shall be punishable with imprisonment for a term which may extend to 6 months, or with fine which may extend to ₹ 50,000, or with both. If the debts of the company are not paid or provided for in full within the period specified in the declaration, it shall be presumed, until the contrary is shown, that the director did not have reasonable grounds for his opinion.

The declaration of solvency shall be made only by way of passing a resolution at a Board meeting. Thus, it is not permitted to pass a resolution, by circulation.

Members' voluntary winding up - Provisions applicable (Sections 490 to 498)

The provisions relating to the members' voluntary winding up are explained as follows:

1. Appointment of liquidators (Section 490)

The members of the company shall appoint one or more liquidators by passing a resolution in the general meeting. Following points need to be noted:

- ❖ The meeting shall also fix the remuneration of the liquidator.
- ❖ If no remuneration is fixed, the liquidator shall not take charge of his office.
- ❖ Remuneration once fixed cannot be increased, even with the sanction of the Court*.

Body corporate not to be appointed as liquidator. A body corporate shall not be qualified for appointment as liquidator of a company in a voluntary winding up (Section 513). Notice by liquidator of his appointment. The liquidator shall, within 30 days after his appointment publish in the Official Gazette and deliver to the registrar for registration a notice of his appointment (Section 516).

2. Cessation of powers of the Board (Section 491)

On the appointment of a liquidator, all the powers of the Board of directors and of the managing or wholetime director or manager shall come to an end. But they will be required to give notice to the registrar of the appointment of the liquidator. Exception. The powers of the Board of directors, managing director and manager shall not cease if -

- (a) the company in general meeting has sanctioned the continuance of their powers; or
- (b) the liquidator has sanctioned the continuance of their powers.

3. Vacancy in the office of liquidator (Section 492)

If a vacancy occurs by death, resignation or otherwise in the office of a liquidator appointed by the company, a general meeting of the company may be convened by any contributory or by the continuing liquidator, if any, to fill the vacancy.

4. Notice of appointment of liquidator to be given to registrar (Section 493)

The company must give notice to the ROC regarding the appointment of liquidator within ten days of his appointment. In case of default, the company and every officer of the company (including liquidator) who is in default, shall be punishable with fine which may extend to rupees one thousand for every day during which the default continues.

5. Power of liquidator to accept shares, etc. as consideration of sale of property of the company (Section 494)

The liquidator may accept shares, policies or like interests in consideration of the sale of the company's undertaking to another company, with an object to distribute the same amongst the members of transferor company, provided:

- (a) a special resolution is passed by the company to that effect; and
- (b) he purchases the interest of any dissenting member at a price to be determined by agreement or by arbitration.

The money to the dissenting members should be paid before the company is dissolved and should be raised in such manner as may be determined by special resolution.

6. Notice to income tax officer

The liquidator shall give notice of his appointment to the income tax officer. Such notice shall be given within 30 days of his appointment. Thereafter, within 3 months, the income tax officer shall intimate the liquidator the estimated amount to meet the tax liability. The liquidator is required to set aside the amount to meet the tax liability.

7. Duty of liquidator to call creditors' meeting in case of insolvency (Sections 495)

If, at any time, the liquidator is of the opinion that the company will not be able to pay its debts in full within the period specified in the declaration of solvency or the period specified in the declaration of solvency has expired without the debts having been paid in full, he shall forthwith summon a meeting of the creditors. The liquidator shall lay before the meeting a statement of assets and liabilities of the company. If he fails to comply with the above requirements, he shall be punishable with fine which may extend to rupees five thousand. The liquidator shall thereafter proceed as if it was a creditor's voluntary winding up.

8. Duty of liquidator to call general meeting at the end of each year (Section 496)

In case winding up proceedings continue for more than 1 year, the liquidator must:

- (a) call a general meeting of the company at the end of the first year from the commencement of winding up and at the end succeeding year, or as soon thereafter as may be convenient within three months from the end of the year or such longer period as the Central Government may allow;
- (b) lay before the meeting an account of his acts and dealing and of the conduct of the winding up during the preceding year.

Any failure of the liquidator in respect of (a) and (b) above will make him punishable with fine upto rupees one thousand in respect of each failure.

9. Final meeting and dissolution (Section 497)

- (a) Final account. As soon as the affairs of a company are fully wound up, the liquidator shall prepare an account of the winding up, showing how the winding up has been conducted and the property of the company has been disposed of.
- (b) Final meeting. As soon as the affairs of a company are fully wound up, the liquidator shall call a general meeting of the company. At the meeting, the liquidator shall lay the account



of the proceedings of winding up and give any explanations, if required. The meeting shall be called by advertisement. The advertisement shall specify the time, place and object of the meeting. The advertisement shall be published not less than 1 month before the meeting in the Official Gazette, and also in some newspapers circulating in the district where the registered office of the company is situated.

- (c) Filing. Within 1 week of conclusion of the general meeting, the liquidator shall send to the registrar and the Official Liquidator appointed u/s 448(1)(c) i.e., the government officer category of the official liquidator (when the Tribunal starts functioning) each a copy of the final account. The liquidator shall also make a return to the registrar and the Official Liquidator stating the dates of holding the general meeting.
- (d) Position if no quorum is present at the meeting. If a quorum is not present at the meeting the liquidator shall, in lieu of the return, make a return that the meeting was duly called and that no quorum was present thereat.
- (e) Registration by the registrar. On receiving the account and the return, the registrar shall forthwith register them.
- (f) Scrutiny by Official Liquidator. On receiving the account and the return, the Official Liquidator shall make a scrutiny of the books and papers of the company. All the officers of the company shall give the Official Liquidator all reasonable facilities to make such scrutiny. Following position may emerge from the report of the Official Liquidator:
 - (i) Dissolution. If the Official Liquidator makes a report to the Court that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest, then, from the date of the submission of such report the company shall be deemed to have been dissolved.
 - (ii) Further investigation. If the Official Liquidator makes a report to the Court that the affairs of the company have been conducted in a manner prejudicial to the interests of its members or to public interest, the Court shall by order direct the Official Liquidator to make a further investigation of the affairs of the company. For this purpose, the Court shall invest him with all such powers as it may deem fit.
 - (iii) Result of further investigation. On the receipt of the report of the Official Liquidator on such further investigation the Court may either make an order that the company shall stand dissolved with effect from the date to be specified by the Court therein or make such other order as the circumstances of the case brought out in the report permit.

If the liquidator fails in sending the copy of the accounts or the return as mentioned, he is punishable with fine upto rupees five hundred for everyday during which the default continues. In case of failure of the liquidator to call the general meeting, he is liable to the punishment by way of fine upto rupees five thousand.

Creditors' voluntary winding up - Provisions applicable (Sections 500 to 509)

Where a company is insolvent, the declaration of solvency is not made by the directors and therefore the voluntary winding up is called as creditors' voluntary winding up. In creditors' voluntary winding up, the dominant control over the winding up proceedings remain in the control of the creditors of the company. Following provisions are applicable to creditors' voluntary winding up:

1. Meetings of members and creditors (Section 500)

Separate meetings. A company may be wound up voluntarily by passing a resolution (ordinary or special, as the case may be) in a general meeting (Section 484). In a case where no declaration of solvency has been made and filed as required by the Act, by the directors, the company shall call two separate meetings, one of members and the other of creditors. The meeting of the creditors shall be called -

- on a day on which the meeting of members is held; or
- on a day next following the meeting of members.

Notice. The notice to the creditors shall be sent by post at the same time when notice is sent to the members. The notice of the meeting of the creditors shall be advertised once in the Official Gazette and once in two newspapers circulating in the district where the registered office or principal place of business of the company is situated.

A director to preside at the meeting of creditors. One of the directors shall preside at the meeting of the creditors. It shall be the duty of the director appointed to preside at the meeting of creditors, to attend the meeting and preside thereat.

Laying of a statement of company's affairs at the meeting. The Board of directors of the company shall lay before the creditor's meeting –

- (a) a full statement of the position of the company's affairs; and
- (b) a list of the creditors of the company and the estimated amount of their claims.

2. Notice to the registrar (Section 501)

Notice of a resolution passed at the creditors' meeting shall be given by the company to the registrar within 10 days of the passing thereof.

3. Appointment of liquidator (Section 502)

The provisions relating to appointment of liquidator in case of creditor's voluntary winding up are as under:

- (a) The members may nominate a person to be the liquidator for the purpose of winding up of the company.
- (b) The creditors' meeting held thereafter will consider the nomination made by the members. The creditors' meeting may nominate a different person to be a liquidator.
- (c) If no person is nominated by the members, creditors' nominee shall be the liquidator. If no person is nominated by the creditors, the members' nominee shall be the liquidator.
- (d) If the creditors and members nominate different persons to be a liquidator, the person nominated by the creditors shall be the liquidator.
- (e) Any director, member or creditor of the company may, within 7 days of nomination by the creditors, make an application to the Court for an order that:
 - (i) the nominee of the members shall be the liquidator instead of the nominee of the creditors; or
 - (ii) the nominee of the members shall be the liquidator jointly with the nominee of the creditors; or
 - (iii) the Official Liquidator be appointed as the liquidator instead of the nominee of the creditors; or
 - (iv) some other person be appointed as the liquidator instead of the nominee of the creditors.

Body corporate not to be appointed as liquidator. A body corporate shall not be qualified for appointment as liquidator of a company in a voluntary winding up (Section 513).

Notice by liquidator of his appointment. The liquidator shall, within 30 days of his appointment, publish in the Official Gazette and deliver to the registrar for registration a notice of his appointment (Section 516).



4. Appointment of committee of inspection (Section 503)

The creditors may, at any time, appoint a committee of inspection consisting of not more than 5 persons. If such committee is appointed, the company may, either at the meeting at which the winding up resolution is passed, or at a later meeting, appoint not more than five persons to serve on the committee. Thus, the strength of a committee of inspection is restricted to ten.

5. Fixing of liquidators' remuneration (Section 504)

The remuneration of the liquidator shall be fixed by -

- (a) the committee of inspection; or
- (b) the creditors, if there is no committee of inspection; or
- (c) the Court*, if the remuneration is not fixed by the committee of inspection or the creditors.

No increase in remuneration. The remuneration of liquidator shall not be increased in any circumstances. Even the Court* cannot sanction an increase in remuneration of the liquidator.

6. Cessation of powers of the Board (Section 505)

On the appointment of a liquidator, all the powers of the Board of directors shall come to an end except in so far as -

- the committee of inspection has sanctioned the continuance of their powers; or
- the creditors have sanctioned the continuance of their powers, where there is no committee of inspection.

7. Power to fill vacancy in office of liquidator (Section 506)

If a vacancy occurs in the office of a liquidator, it shall be filled by the creditors in general meeting. The committee of inspection, if any, cannot fill the vacancy. However, where the liquidator was appointed by the Court* or at the direction of the Court*, then such vacancy shall be filled only by the Court*.

8. Power of liquidator to accept shares, policies etc. as consideration of sale of property (Section 507)

Section 494 as discussed under members' voluntary winding up will have application to creditors' voluntary winding up also but only subject to the permission to exercise such power is granted either by the committee of inspection or the court.

9. Notice to Income Tax Officer

The liquidator shall give notice of his appointment to the income tax officer. Such notice shall be given within 30 days of his appointment. Thereafter, within 3 months, the income tax officer shall intimate the liquidator the estimated amount to meet the tax liability. The liquidator is required to set aside the amount to meet the tax liability.

10. Duty of liquidator to call annual meetings (Section 508)

- (a) Meetings of members and creditors to be held. Where the winding up proceedings continue for more than 1 year, the liquidator shall call a general meeting of the company and a meeting of the creditors.
- (b) Time limit for holding the meeting. The meetings shall be held within 3 months of the end of the first year. Also in every subsequent year, such meetings shall be held within 3 months of the end of the year until the winding up is concluded.

- (c) Status of proceedings of winding up. At the meetings, the liquidator shall place an account of his acts and dealings and of the conduct of the winding up during the preceding year, together with a statement in the prescribed form and containing the prescribed particulars with respect to the proceedings of the liquidation.

11. Final meeting and dissolution (Section 509)

- (a) Final account. As soon as the affairs of a company are fully wound up, the liquidator shall prepare an account of the winding up, showing how the winding up has been conducted and the property of the company has been disposed of.
- (b) Final meeting. As soon as the affairs of a company are fully wound up, the liquidator shall call a meeting of the members and a separate meeting of the creditors. At each such meeting, the liquidator shall lay an account of the proceedings of winding up and give any explanations, if required. Each such meeting shall be called by an advertisement. The advertisement shall specify the time, place and object of the meeting. The advertisement shall be published not less than 1 month before the meeting in the Official Gazette, and also in some newspapers circulating in the district where the registered office of the company is situated.
- (c) Filing. Within 1 week of conclusion of the creditors' meeting, the liquidator shall send to the registrar and the Official Liquidator a copy of the Final account. The liquidator shall also make a return to the registrar and the Official Liquidator stating the dates of holding the members' and creditors' meetings.
- (d) Position if no quorum is present at the meeting. If quorum is not present in either of the meetings, the liquidator shall, in lieu of the return, make a return that the meeting was duly called and that no quorum was present thereat.
- (e) Duty of the registrar. On receiving the account and the return, the registrar shall forthwith register them.
- (f) Scrutiny by Official Liquidator. On receiving the account and the return, the Official Liquidator shall make a scrutiny of the books and papers of the company. All the officers of the company shall give the Official Liquidator all reasonable facilities to make such scrutiny. Following position may emerge from the report of the Official Liquidator:
 - (i) **Dissolution.** If the Official Liquidator makes a report to the Court that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest, then, from the date of the submission of the report to the Court the company shall be deemed to be dissolved.
 - (ii) **Further investigation.** If the Official Liquidator makes a report to the Court that the affairs of the company have been conducted in a manner prejudicial to the interests of its members or to public interest, the Court shall, by order, direct the Official Liquidator to make a further investigation of the affairs of the company and for that purpose shall invest him with all such powers as the Court may deem fit.
 - (iii) **Report of further investigation.** On the receipt of the report of the Official Liquidator on such further investigation, the Court may either make an order that the company shall stand dissolved with effect from the date to be specified by the Court therein or make such other order as the circumstances of the case brought out in the report permit.

The provisions of sections 508 and 509 (as applicable to creditors' voluntary winding up) correspond to ' the provisions of sections 496 and 497 respectively (as applicable to members' voluntary winding up), except that sections 508 and 509 require the liquidator to call a separate meeting of creditors in addition to the meeting of members.

[* Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect]



Committee of inspection under creditors' voluntary winding up (Section 503)

The provisions in respect of committee of inspection in creditors' voluntary winding up are explained as follows:

1. Appointment of committee of inspection by creditors

The creditors may, at any time, appoint a committee of inspection consisting of not more than 5 persons.

2. Appointment of members of the committee

Where the creditors appoint a committee of inspection, the members of the company at a general meeting may appoint the members of the committee of inspection, not exceeding 5 in number.

3. Objection by creditors

The creditors may object to the persons appointed by the members of the company. Also, they may nominate the persons of their choice to be the members of the committee.

4. Intervention by Court

Where the members of the company nominate the members of the committee, but the creditors object to such nomination, the matter will be referred to the Court. The nominees of the members of the company shall not act as members of the committee, unless the Court otherwise directs. The Court has the power to direct that-

- ❖ the members' nominee shall be taken in the committee; and
- ❖ any other person shall also act in the committee instead of the nominees of the creditors.

5. Other applicable provisions

Following provisions of section 465 shall also apply to a committee of inspection appointed in a creditors' voluntary winding up (In the case of compulsory winding up, these provisions apply when a committee of inspection is appointed by the Court):

- (a) Meetings of the committee.** The committee shall meet at such times as it may from time to time appoint. Also, the liquidator or any member of the committee may call a meeting of the committee as and when he thinks necessary.
- (b) Decision by majority.** The committee shall act by a majority of its members present at the meeting.
- (c) Quorum for a meeting.** The quorum for a meeting of the committee shall be one-third of the total number of members or two members, whichever is higher. The committee shall not act unless a quorum is present.
- (d) Right of inspection of accounts.** The committee of inspection shall have the right to inspect the accounts of the liquidator at all reasonable times.
- (e) Cessation of membership.** A person shall cease to be a member of the committee in the following cases:
 - (i) **Resignation.** Where a member of the committee resigns by giving a notice in writing, signed by him, and delivers it to the liquidator.
 - (ii) **Insolvency or compounding.** Where a member of the committee is adjudged an insolvent, or compounds or arranges with his creditors.
 - (iii) **Absence from 5 consecutive meetings.** Where a members absents himself from five consecutive meetings of the committee without the leave of other members.
 - (iv) **Removal.** A member of the committee may be removed at a meeting of creditors if he

represents creditors, or at a meeting of contributories if he represents contributories. For this purpose, an ordinary resolution shall be passed of which 7 days' notice has to be given, stating the object of the meeting.

(f) Filling of vacancies

- (i) On a vacancy occurring in the committee, the liquidator shall call a meeting of the creditors/ contributories for the purpose of filling the vacancy. The meeting may, reappoint the same person or any other person in his place,
- (ii) Where the liquidator is of the opinion that it is unnecessary to fill the vacancy, he may apply to the Court that vacancy need not be filled. In such a case, the liquidator shall act in accordance with the directions of the Court,
- (iii) The continuing members of the committee, if not less than two, may act notwithstanding any vacancy in the committee.

Distinction between members' voluntary winding up & creditors' voluntary winding up

1. Only a solvent company can take the advantage of members' voluntary winding up. Creditors' voluntary winding up is resorted to by insolvent companies.
2. Declaration of solvency must be filed if the company intends to take the advantage of members' voluntary winding up. However, no declaration of solvency can be filed in case of creditors' voluntary winding up.
3. Members' voluntary winding up requires the calling of a meeting of members only. Creditors' voluntary winding up requires the calling of separate meetings of members and creditors.
4. In members' voluntary winding up, the dominant control over the proceedings of the winding up remains with the members. However, in creditors' voluntary winding up, the dominant control over the winding up proceedings lies with the creditors.
5. In members' voluntary winding up, the liquidator is appointed by the members of the company. In creditors' voluntary winding up, the liquidator is nominated by the members as well as the creditors. If the members and creditors nominate two different persons as a liquidator, the nominee of the creditor is appointed as a liquidator. However, an application may be made to the Court seeking an order that the nominee of the members be appointed as the liquidator.
6. The remuneration of liquidator is fixed by the members in case of members' voluntary winding up. But, in case of creditors' voluntary winding up, the remuneration of liquidator is fixed by the committee of inspection (if any) or the creditors.
7. There is no provision for appointment of a committee of inspection in case of members' voluntary winding up. But, the creditors have the option to appoint a committee of inspection in case of creditors' voluntary winding up.

Winding up subject to supervision of Court (Sections 522 to 527)*

The provisions relating to order of winding up subject to supervision of the Court may be explained as follows:

At any time after a company has passed a resolution for voluntary winding up, the court may make an order that the voluntary winding up should continue subject to the supervision of the court [Section 522]. Application for each supervision may be made by a creditor, or a contributory, or the company, or the liquidator.

Such an order is passed by the court where:

1. the resolution for winding up was obtained by fraud, or
2. the rules relating to winding up order are not being observed, or



3. the liquidator is prejudicial or is negligent in collecting the assets.

The court, in such a case, gets the same powers as it has in the case of compulsory winding up under order of the court. The court may also appoint an additional liquidator or liquidators, It may also remove any liquidator and fill any vacancy occasioned by the removal or by death or by resignation [Section 524]. A liquidator so appointed shall have the same powers, be subject to the same obligations and in all respects stand in the same position as if he had been appointed in accordance with the provisions of the Act relating to the appointment of liquidator in voluntary winding up, subject, however, to any restrictions the court may impose [Section 525].

Effect of supervision order [Section 526] – Unless the court imposes restrictions on the exercise of any powers by the liquidator, he will have all the powers conferred on a liquidator in voluntary winding up [Section 526(1)]. The court will also have as wide powers as in compulsory winding up. The court may stay suits or legal proceedings. It can make or enforce calls and all other orders necessary for beneficial winding up of the company [Section 526(2)].

Powers of court to order compulsory winding up [Section 527] – The court may pass an order for compulsory winding up superseding the order of winding up under its supervision. The court may then appoint a person who is the liquidator, either provisionally or permanently to be liquidator in winding up by the court in addition to and subject to the control of Official Liquidator.

[*When Companies (Second Amendment) Act, 2002 becomes operational, “winding up under supervision of the court” will not be there.]

Important provisions applicable in case of every mode of winding up (i.e., Compulsory and Voluntary winding ups including Members and Creditors Voluntary winding up.)

Order of payment of liabilities (Sections 529 A and 530)

Overriding preferential payments (Section 529A)

The purpose of section 529A is to protect the rights of workmen so that they are not deprived of their legitimate claims in the event of winding up of a company. As per section 529A, following debts shall be paid in priority to all other debts -

(a) Workmen's dues.

(b) Debts due to secured creditors to the extent such debts rank pari passu with workmen's dues.

These debts shall be paid in full unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

For the purposes of sections 529A and section 530 -

(a) 'Workmen' means the employees of the company, being 'workmen' within the meaning of the Industrial Disputes Act, 1947.

(b) 'Workmen's dues' means the aggregate of the following sums due from the company to its workmen:

- (i) All wages, salaries and commission earned including any compensation payable to any workman under any of the provisions of the Industrial Disputes Act, 1947.
- (ii) All accrued holiday remuneration becoming payable to any workman before or by the effect of the winding up order.
- (iii) Any compensation, due under the Workmen's Compensation Act, 1923 on account of the death or disablement of any employee of the company. However, no amount shall become payable if the company is being wound up voluntarily merely for the purposes of reconstruction or amalgamation with another company.

- (iv) All sums due to any workman from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the workmen, maintained by the company.
- (c) 'Workmen's portion', in relation to the security of any secured creditor of a company, means the amount which bears to the value of the security the same proportion as the amount of the workmen's dues bears to the aggregate of-
 - the amount of workmen's dues; and
 - the amounts of the debts due to the secured creditors.

e.g.-The realisable value of the security of a secured creditor of a company is ₹ 1,00,000. The total amount of the workmen's dues is ₹ 2,00,000. The amount of the debts due from the company to its secured creditors is ₹ 3,00,000. The aggregate of the amount of workmen's dues and of the amounts of debts due to secured creditors is ₹ 5,00,000. The workmen's portion of the security is, therefore, two-fifth of the value of the security, i.e., ₹ 40,000.

Preferential payments (Section 530)

Section 530(1) specifies that the following unsecured debts shall be paid in priority to other unsecured debts. These are as under:

- (a) **Revenues, taxes, cesses and rates.** All revenues, taxes, cesses and rates due from the company to the Central or a State Government or to a local authority at the relevant date. The amount should have become due and payable within 12 months before the relevant date.
- (b) **Wages and salaries of employees.** All wages and salaries (including wages payable for time or piece work and salary earned wholly or in part by way of commission) of any employee, due for a period not exceeding 4 months within 12 months before the relevant date. However, in case of each employee, the amount shall not exceed such sum as may be notified by the Central Government in the Official Gazette. The sum notified is ₹ 20,000 for the time being [Notification No. GSR 80(E), dated 17.2.1997].
- (c) **Holiday remuneration of employees.** All accrued holiday remuneration becoming payable to any employee before, or by the effect of, the winding up order.
- (d) **Contributions payable as employers.** All amounts due, in respect of contributions payable by the company as an employer under any law for the time being in force. The amount should have become payable within 12 months before the relevant date. No such contribution shall be payable if the company is being wound up voluntarily merely for the purposes of reconstruction or amalgamation with another company.
- (e) **Compensation to employees.** Any compensation due under the Workmen's Compensation Act, 1923 on account of the death or disablement of any employee of the company. However, no amount shall become payable if the company is being wound up voluntarily merely for the purposes of reconstruction or amalgamation with another company.
- (f) **Sums due from various funds.** All sums due to any employee from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the employees, maintained by the company.
- (g) **Investigation expenses.** The expenses of any investigation held in pursuance of section 235 or 237, in so far as they are payable by the company.

Relevant date. The expression 'relevant date' may be understood as follows:

(a) In case of compulsory winding up.

- (i) In a case where provisional liquidator is appointed, 'relevant date' means the date of appointment of provisional liquidator,



- (ii) In a case where no provisional liquidator is appointed, 'relevant date' means the date of winding up order.

(b) In case of voluntary winding up. 'Relevant date' means the date of passing the resolution for voluntary winding up of the company.

Subrogation. Where a person makes payment on account of preferential payments on behalf of the company, he is entitled to claim priority in respect of that amount. For example, where a bank provides an overdraft for payment of wages, the bank shall be entitled to claim priority in respect of the sum actually advanced.

Payment of preferential debts. The preferential debts as mentioned under section 530(1) shall -

- (a) rank equally among themselves and be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions;
- (b) be discharged forthwith so far as the assets are sufficient to meet them.

Priority of preferential debts. The preferential debts shall -

- have priority over the claims of holders of debentures under any floating charge created by the company.
- have no priority over costs and expenses of the winding up.

1. Distribution of property of the company (Section 511)

Subject to the provisions of this Act as to preferential payments, the assets of a company shall be applied in satisfaction of its liabilities *pari passu*.

2. Payment of liabilities - Order of priority

- (a) Overriding preferential payments under section 529A (i.e., workers' dues and debts due to secured creditors).
- (b) Costs and expenses of winding up.
- (c) Preferential payments under section 530.
- (d) Creditors secured by a floating charge.
- (e) Unsecured creditors.

3. Overriding effect of section 529A

The provisions of section 529A shall apply notwithstanding anything contained in any other provision of the Companies Act or any other law for the time being in force.

Fraudulent preference (Section 531)

Fraudulent preference means giving an improper benefit or favourable treatment to some, of the creditors. The object of avoidance of fraudulent preference is to grant protection to the creditors of the company.

Meaning and essentials of fraudulent preference

A transaction shall be deemed to be a fraudulent preference and consequently invalid if all the following conditions are satisfied:

- (a) The transaction relates to transfer of property, delivery of goods, payment of money or other act relating to the property of the company.
- (b) It took place within 6 months before the commencement of the winding up of the company.
- (c) It was an entirely voluntary act and not made under any pressure.

(d) The dominant motive was to give a creditor a preference over other creditors.

Meaning of 'commencement of winding up',

- In case of a winding up by or subject to the supervision of the Court*, the winding up shall be deemed to commence at the time of presentation of the petition for the winding up.
- In case of a voluntary winding up, the winding up shall be deemed to have commenced when the resolution for voluntary winding up was passed.

Involuntary acts do not amount to fraudulent preference. Payments made under pressure shall not be treated as fraudulent preference.

- Payments made to a creditor solely with a view to avoid civil or criminal proceedings do not amount to fraudulent preference [Re, Blackpool Motorcar Co. Ltd. (1901) 1 Ch. 77].
- Payments made by the directors under pressure and to keep good relations with the creditor do not amount to fraudulent preference.

Purpose must be to give preference to a creditor.

- Any transaction would amount to a fraudulent preference only if the dominant motive behind the transaction is to give a creditor some preference over the other creditors. It is not enough to show that preference was given to a particular creditor, it must also be shown that it was done with a view to give him the favoured treatment.
- If the dominant motive of the transaction is tainted with an element of dishonesty, it amounts to fraudulent preference.
- Fraudulent preference cannot be inferred by mere suspicion. The fraud must be clearly alleged, proved and established and there should be a legal evidence [M. Kushler Ltd. (1943) 2 All ER 22].
- There is no fraudulent preference when a debtor's dominant intention is to benefit himself rather than to confer an advantage on his creditor. Thus, where a company created a legal mortgage in favour of a bank in the hope that by keeping good faith with the bank it could get further advance from the bank which could be utilised to revive the company, the mortgage was held not to be a fraudulent preference even though the mortgage was created after it was fairly clear that the company had become insolvent [Re, RLE. Holdings Ltd, (1967) 3 All ER 553].

Examples of fraudulent preference

- A director of a company had given guarantee for certain overdrafts granted to the company on the agreement that the company would give him security over the assets whenever called upon by him to do so. The agreement was not registered. The director later received a debenture charging the assets of the company. Within a month thereafter, the company passed a resolution for voluntary winding up. Held, the charge created on the assets of the company was a fraudulent preference and was void [Re, Jackson & Bassford Ltd. (1906) 2 Ch 467].
- A shareholder advanced money to the company on the condition that the company would execute formal mortgages in his favour whenever asked by him. When the company became unable to pay its debts, mortgages were executed by the company in his favour. Two months later, the company went into voluntary liquidation. Held, the mortgages created in favour of the shareholder amounted to a fraudulent preference and were therefore void [Re, Eric Holmes (Property) Ltd. (1965) 2 All ER 333].

Transfers for benefit of all creditors to be void (Section 532)

Any transfer or assignment by a company of all its property to trustees for the benefit of all its creditors shall be void.



Liabilities and rights of fraudulently preferred persons (Section 533)

Where a transaction is declared as a fraudulent preference, any person who is fraudulently preferred shall have the same rights and liabilities as if he had undertaken to be personally liable as surety for the debt, to the extent of the mortgage or charge on the property or the value of his interest, whichever is less.

Where the company gives a fraudulent preference to a creditor so as to benefit a person who has stood as a guarantor or surety for payment of that creditor, following consequences shall follow:

- The creditor shall be liable to refund to the liquidator the amount paid by the company.
- The creditor shall be entitled to claim such amount from the surety or guarantor.
- The winding up Court* shall be empowered to order that the surety or guarantor shall make the payment to the creditor.

Voluntary transfer to be invalid (Section 531A)

Any transfer of property or delivery of goods made by a company shall be void against the liquidator if it is made within a period of 1 year before the commencement of winding up of the company.

Exceptions

Following transactions shall remain valid even if made: within a period of 1 year before the commencement of winding up:

- (a) Any transfer of property or delivery of goods made in the ordinary course of business.
- (b) Any transfer of property or delivery of goods made in favour of a purchaser or encumbrancer in good faith and for valuable consideration.

Meaning of commencement of winding up:

- In case of a winding up by or subject to the supervision of the Court*, the winding up shall be deemed to commence at the time of presentation of the petition for the winding up.
- In case of a voluntary winding up, the winding up shall be deemed to have commenced when the resolution for voluntary winding up was passed.

Floating charge to be invalid in certain cases (Section 534)

Section 534 prevents an insolvent company from creating a floating charge on its undertaking to secure past debts or for moneys which do not come into the hands of the company.

A floating charge created by the company within 12 months preceding the commencement of its winding up shall be invalid.

Exceptions

- (a) A floating charge shall not be invalid where it is proved that the company was solvent immediately after the creation of the charge.
- (b) Abating charge shall be valid upto the amount of any cash paid to the company (whether at the time of creation of charge or thereafter) as a consideration for the charge. Also, interest shall be allowed on that amount at the rate of 5% per annum or such other rate as may be notified by the Central Government in the Official Gazette.

The words 'as a consideration for the charge' means that the money was paid in consideration of the fact that charge is created. In other words, it will be treated as if the cash has been paid to the company in the following cases:

- Where the cash is paid to the company simultaneously with creation of the charge.

- Where the cash is paid a few days before the charge is created provided it was paid hi reliance upon the promise to create the-charge.
- Where the cash is paid to the company subsequent to the creation of charge provided the cash would not have been paid to the company had the company not given the security (by way of creation of floating charge).

1. Effect of section 534

Unless' a floating charge is covered in the two exceptions, it is invalid. However, the debt is not affected. But, it becomes an unsecured debt.

2. Debt secured by floating charge already paid-Consequences

Where the debt secured by the floating charge has already been paid by the company before winding up commenced, the sum paid cannot be recovered by the liquidator under section 534 [Re, Parkes Garage (Swadlincote) (1929) 1 Ch 139]. However, if the transaction falls under any other section (e.g., section 531), the liquidator may proceed under that section.

Disclaimer of onerous property (Section 535)

When a company court has jurisdiction to entertain and dispose of a suit or any claim by or against the company in liquidation, claim for eviction and enforcement of right to re-enter leased property in terms of lease deed would be clearly within jurisdiction of such court. A disclaimer ought to be ordered by court only if it is essentially in interest of the company being wound up and if retention of such property is required to effectively carry out winding up proceedings; otherwise no disclaimer would be ordered – In Re, Board of trustees for the Port of Kolkata [2003] 44 SCL 81 (Gau.)

Avoidance of transfers, etc. after commencement of winding-up (Section 536)

Section 536 declares that all transfers of shares in the company and any alteration in the status of the members of the company, made after the commencement of winding-up, shall be void. However, such transfers/alterations shall not be adversely affected where the same are made with the sanction of the liquidator(in case of voluntary winding-up) or the court(in case of winding-up by or subject to supervision of the court.)

Avoidance of certain attachments (Section 537)

In case of winding-up by or subject to the supervision of the court*, section 537 declares that the following shall be void:

- (a) any attachment, distress or execution put in force, without leave of the court, against the estate or effects of the company, after the commencement of the winding-up; or
- (b) any sale held, without leave of the court, of any of the properties or effects of the company after such commencement.

As per Companies (Second Amendment) Act, 2002 substitution of new section for section 537

537.Avoidance of certain attachments, executions, etc., in winding up by.-

- (1) Where any company is being wound up by the Tribunal:
 - (a) any attachment, distress or execution put in force, without leave of the Tribunal against the estate or effects of the company, after the commencement of the winding up; or
 - (b) any sale held, without leave of the Tribunal of any of the properties or effects of the company after such commencement,

Shall be void.

- (2) Nothing in this section applies to any proceedings for the recovery of any tax or impost or any dues payable to the Government.



[*The word 'court' has been substituted by the word 'Tribunal' as per Companies (Second Amendment) Act, 2002, yet to come in force.]

Sec.539. Penalty for Falsification of Books

If with intent to defraud or deceive any person, any officer or contributory of a company which is being wound up -

- (a) destroys, mutilates, alters, falsifies or secrets, or is privy to the destruction, mutilation, alteration, falsification or secreting of, any books, papers or securities ; or
- (b) makes, or is privy to the making of, any false or fraudulent entry in any register, books of account or document belonging to the company ; he shall be punishable with imprisonment for a term which may extend to seven years, and shall also be liable to fine.

Sec. 540. Penalty for Frauds by Officers

If any person, being at the time of the commission of the alleged offence an officer of a company which is subsequently ordered to be wound up by the **1**[Tribunal] or which subsequently passes a resolution for voluntary winding up, -

- (a) has, by false pretences or by means of any other fraud induced any person to give credit to the company ; or
- (b) with intent to defraud creditors of the company, has made or caused to be made any gift or transfer of or charge on, or has caused or connived at the levying of any execution against, the property of the company ; or
- (c) with intent to defraud creditors of the company, has concealed or removed any part of the property of the company since the date of any unsatisfied judgment or order for payment of money obtained against the company, or within two months before that date; he shall be punishable with imprisonment for a term which may extend to two years and shall also be liable to fine.

Sec. 541. Liability Where Proper Accounts Not Kept

- (1) Where a company is being wound up, if it is shown that proper books of account were not kept by the company throughout the period of two years immediately preceding the commencement of the winding up, or the period between the incorporation of the company and the commencement of the winding up, whichever is shorter, every officer of the company who is in default shall, unless he shows that he acted honestly and that in the circumstances in

which the business of the company was carried on, the default was excusable, be punishable with imprisonment for a term which may extend to one year.

- (2) For the purposes of sub-section (1), it shall be deemed that proper books of account have not been kept in the case of any company, if there have not been kept -
 - (a) such books or accounts as are necessary to exhibit and explain the transactions and financial position of the business of the company, including books containing entries made from day-to-day in sufficient detail of all cash received and all cash paid ; and
 - (b) where the business of the company has involved dealings in goods, statements of the annual stock takings and (except in the case of goods sold by way of ordinary retail trade) of all goods sold and purchased, showing the goods and the buyers and the sellers thereof in sufficient detail to enable those goods and those buyers and sellers to be identified.

Sec. 543. Power of Court to assess damages against delinquent directors, etc.

- (1) If in the course of winding up a company, it appears that any person who has taken part in the promotion or formation of the company, or any past or present director, manager, liquidator or officer of the company -

- (a) has misapplied, or retained, or become liable or accountable for, any money or property of the company ; or
 - (b) has been guilty of any misfeasance or breach of trust in relation to the company ; the Court may, on the application of the Official Liquidator, or the liquidator, or of any creditor or contributory, made within the time specified in that behalf in sub-section (2), examine into the conduct of the person, director, manager, liquidator or officer aforesaid, and compel him to repay or restore the money or property or any part thereof respectively, with interest at such rate as the Court thinks just, or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retainer, misfeasance or breach of trust, as the Court thinks just.
- (2) An application under sub-section (1) shall be made within five years from the date of the order for winding up, or of the first appointment of the liquidator in the winding up, or of the misapplication, retainer, misfeasance or breach of trust, as the case may be, whichever is longer.
- (3) This section shall apply notwithstanding that the matter is one for which the person concerned may be criminally liable. “

Substituted by Companies (Second amendment) Act,2002

543. Power of Tribunal to assess Damages against delinquent Directors, etc

- (1) If in the course of winding up of a company, it appears that any person who has taken part in the promotion or formation of the company, or any past or present director, manager, liquidator or officer of the company -
- (a) has misapplied, or retained, or become liable or accountable for, any money or property of the company ; or
 - (b) has been guilty of any misfeasance or breach of trust in relation to the company, the Tribunal may, on the application of the Official Liquidator, or the liquidator, or of any creditor or contributory, made within the time specified in that behalf in sub-section (2), examine into the conduct of the person, director, manager, liquidator or officer aforesaid, and compel him to repay or restore the money or property or any part thereof respectively, with interest at such rate as the Tribunal thinks just, or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retainer, misfeasance or breach of trust, as the

Tribunal thinks just.

- (2) An application under sub-section (1) shall be made within five years from the date of the order for winding up, or of the first appointment of the liquidator in the winding up, or of the misapplication, retainer, misfeasance or breach of trust as the case may be, whichever is longer.
- (3) This section shall apply notwithstanding that the matter is one for which the person concerned may be criminally liable.]

Defunct Companies (Section 560)

The expression ‘defunct company’ denotes a company which is not functioning and is almost dead. Where a company does not have adequate assets to meet out the cost of liquidation, the course followed is to strike the name of the company off the register of companies pursuant to section 560 of the Act.

1. Circumstances in which a company may be made a defunct company

The registrar has the power to strike off the name of a defunct company in the following cases:

- (a) **Registrar on believing that a company is not carrying on business or has ceased to be in operation**



Where a company has ceased to carry on business, the registrar may strike off the name of the company from the register of companies. The registrar shall follow the following procedure:

- (i) **Enquiry to determine whether the company is in operation.** Where the registrar has reasonable cause to believe that a company is not carrying on business or has ceased to be in operation, he shall send to the company a letter inquiring whether the company is carrying on business or is in operation.
- (ii) **Registered letter to show cause if no response is received for first letter.** If the registrar does not get any reply from the company within 1 month, he shall within next 14 days send to the company a registered letter referring to his earlier letter. The registered letter shall also state that if no reply is received within 1 month, a notice shall be published in the Official Gazette with a view to strike off the name of the company from the register of companies.
- (iii) **Publication of registrar's notice in the Official Gazette.** The registrar shall publish a notice in the Official Gazette that the name of the company will be struck off the register of companies if no cause is shown within 3 months. A copy of the notice shall also be served on the company by the registered post. The registrar has the power to publish such a notice in the Official Gazette in the following cases:
 - Where the registrar receives an answer from the company to the effect that it is not carrying on business or ceased to be in operation.
 - Where the registrar does not receive any reply from the company within 1 month of the date of sending the second letter.
- (iv) **Dissolution of the company.** If no reply is received or no cause is shown within 3 months of the date of publication of notice in the Official Gazette, the registrar shall strike off the name of the company from the register of companies and publish a notice thereof in the Official Gazette. On such publication, the company shall stand dissolved.

(b) Company in the course of winding up - No liquidator acting or no return received

Where a company is being wound up, the registrar shall have the power to strike off the name of the company if he has reasonable ground to believe that –

- (i) no liquidator is acting; or
- (ii) the affairs of the company have been completely wound up and any returns required to be made by the liquidator have not been made for a period of 6 consecutive months.

The registrar shall follow the following procedure:

- (i) **Publication in the Official Gazette.** The registrar shall publish a notice in the Official Gazette that the name of the company shall be struck off the register of companies if no cause is shown within 3 months. A copy of the notice shall also be served on the company or the liquidator by the registered post.
- (ii) **Dissolution of the company.** If no reply is received or no cause is shown within 3 months of the date of publication of notice in the Official Gazette, the registrar shall strike off the name of the company from the register of companies and publish a notice thereof in the Official Gazette. On such publication, the company shall stand dissolved.

2. Consequences of striking off the name of the company

- (a) **The company shall stand dissolved.** The company shall stand dissolved as from the date of publication of notice, striking the name of the company off the register, in the Official Gazette.

(b) Liability of managerial personnel and members is not affected. The dissolution of a company under section 560 does not affect the liability of its managerial personnel or its members. In other words, the liability of every director, manager or other officer who was exercising any power of management and of every member of the company shall continue and may be enforced as if the company had not been dissolved.

(c) Power of the Court to wind up the company. Dissolution of a company under section 560 does not affect the power of the Court to wind up the company. In other words, a winding up order may be passed without first getting the dissolution order vacated.

3. Mode of sending letters or notices to the company

All the letters or notices to be sent to a company by the registrar under section 560 shall be addressed to its registered office, or if no office has been registered, to the care of some director, manager, secretary or any responsible officer of a company. If no such address is available with the registrar, he shall send such notices to each of the subscribers to the memorandum of association.

Restoration of name of the company (Section 560)

Where the name of a company has been struck off by the registrar, the Court* has the power to restore the name of the company. The procedure in this regard is as under:

1. Application to the Court

An application may be made to the Court* for restoring the name of the company on the register of companies.

(a) Time limit for making the application. The application shall be filed with the Court* within 20 years from the date of publication of order of dissolution in the Official Gazette.

(b) Who can make the application? The application may be made by –

- (i) the company; or
- (ii) any member of the company; or
- (iii) any creditor of the company.

2. Restoration of company on satisfaction of Court

The Court* may order that the name of the company be restored to the register if the Court* is satisfied that –

- the company was, at the time of striking off the name, carrying on business or was in operation; or
- it is just and equitable that the name of the company be restored to the register.

3. Directions by the Court

While passing an order for restoration, the Court* may give such directions and make such provisions as seem just for placing the company and all other persons in the same position as nearly as may be as if the name of the company had not been struck off.

4. Filing of order with the registrar

The order of the Court* shall be filed with the registrar.

5. Restoration becomes effective on filing the order of registrar

The order of the Court* becomes effective only when a certified copy of the Court* has been delivered to the registrar for registration. Until the order of the Court* is filed with the registrar, the order remains in abeyance.



6. Effects of restoration

On restoration, the company shall be deemed to have continued its existence as if its name had not been struck off. The company, its creditors, debtors and members go back to the position in which they were before the date on which the name of the company was struck off.

[*Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect]

Contributory (Sections 428 to 432 and 467)

The provisions applicable to a contributory may be explained as follows:

1. Meaning (Section 428)

The term 'contributory' means every person liable to contribute to the assets of the company in the event of its being wound up. It also includes -

- (a) a holder of any shares which are fully paid up;
- (b) an alleged contributory for the purpose of proceedings prior to final determination of persons who are to be deemed as contributories.

2. Persons liable as contributories

Following persons shall be liable as contributories on the winding up of the company:

- (a) Present and past members (Section 426): A member of a limited company shall be liable to contribute the amount unpaid on the shares in respect of which he is a contributory, or the amount he has guaranteed to pay in the event of winding-up. A past member shall be liable to contribute if he ceased to be a member within one year before the commencement of winding-up and the present members fail to meet their liabilities in respect of the debts incurred while he was a member.(Section 426)
- (b) Directors and manager with unlimited liability (Section 427): Where the liability of any director or manager is unlimited (under the provisions of sections 322 and 323), he shall contribute as an ordinary member in respect of the shares held by him. Also, he shall have an additional liability to contribute as a member of an unlimited company.

Limitation of liability. A past director or manager shall not be liable to make the additional contribution (as a member of an unlimited company) :-

- ❖ if he has ceased to hold office for 1 year or upwards before the commencement of the winding up;
- ❖ in respect of any debt or liability of the company contracted after he ceased to hold office; a unless the Court deems it necessary that such additional contribution is required.
- (c) Legal representative of a deceased member (Section 430): The legal representative of a deceased member shall be liable for the debts of the deceased. But his liability is limited to estate inherited by him. In other words, on the death of a contributory, his legal representative will be deemed to be a contributory.
- (d) Official assignee of an insolvent member (Section 431): Where a contributory is adjudged an insolvent, his official assignee shall be liable to pay the debts of the insolvent contributory out of the estate of the insolvent. In other words, the official assignee or the official receiver, as the case may be, of a contributory who is adjudged an insolvent, shall be deemed to be a contributory.
- (e) Liquidator of a body corporate which is a member (Section 432): Where a body corporate is a contributory and is ordered to be wound up, the liquidator of such body corporate shall be treated as a contributory.

- (f) Subscribers to the Memorandum: Subscribers to the Memorandum are deemed to be members of the company even though their names may or may not be entered in the Register of members. Accordingly, in the event of winding-up, inspite of the fact that their names are not entered in the Register of Members, they shall be deemed as contributories for the amount remaining unpaid on the shares they agreed to subscribe for.

3. Liability of Contributories (Section 426)

For determining liability of contributories, the list of contributories shall be prepared in two parts, viz, List A and List B.

- ❖ **List A** shall include the present members of the company, i.e., members whose names appear in the company's register of members at the time of the winding-up of the company.
- ❖ **List B** shall include the past members of the company, i.e., members who ceased to be members within one year preceding the commencement of the winding-up of the company.

Liability of present members:

The liability of a present member (i.e., List A contributory) shall be limited-

1. In the case of a company limited by shares, to the amount remaining unpaid on the shares;
2. In the case of a company limited by guarantee, to the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up; and
3. In the case of a company limited by guarantee but also having share capital, to the amount undertaken to be contributed by him in the event of winding up as well as any sums unpaid on any shares held by him.

Liability of past members:

A past member (i.e., List B contributory) shall not be liable to contribute-

1. If he has ceased to be a member for one year or more before the commencement of the winding-up.
2. In respect of any debt or liability of the company contracted after he ceased to be a member.
3. If it appears to the court that the present members will be able to satisfy the contributions required to be made by them.

4. Nature of liability of a contributory (Section 429)

- (a) **Absolute liability.** The liability of a contributory is a liability created by law. Although the liability of a contributory becomes a statutory debt, it becomes payable only when the Court makes an order for calls to be made and the calls are made by the liquidator in accordance with the order of the Court (Section 429).
- (b) **Fresh cause of action to the liquidator.** The members of a company in liquidation are liable in respect of unpaid calls even though the calls were made by the company before it went into liquidation and suit of the company for its realisation had become time barred. Thus, on the commencement of winding up, a new liability is cast on the members in respect of unpaid calls. The liquidator gets a fresh right to enforce the payment of unpaid calls. His rights are independent of the rights which the company had before winding up [Pokhar Mai v Flour and Oil Mills Co. Ltd. AIR (1934) Lah. 1015].
- (c) **Ex-lege liability.** The liability of a member to be included in the list of contributories is not ex-contractu, i.e., it does not arise as a result of the contract of membership. His liability is ex-lege, i.e., the liability arises only by reason of the fact that his name appears in the register of members even though the allotment to him was void or that he had sold his shares to a purchaser who. has not got his shares registered with the company.



The Court has the power to rectify the register of members, if required (Section 467). Unless the Court orders the rectification of register of members, the liability of a contributory is absolute [Mphd. Akbar v Official Liquidator AIR 1950 Bom 386].

(d) When does the liability of a contributory arise? A contributory shall be required to pay an unpaid call only when such call is made on him. A call shall be made on a contributory when the assets of the company fall short of its liabilities and expenses of winding up. Also, a call may be made for adjustment of rights of contributories among themselves. In other words, a contributory shall be liable to pay the following sums:

- (i) An amount sufficient for payment of its debts and liabilities,
- (ii) The costs, charges and expenses of winding up.
- (iii) The amount payable for adjustment of rights of the contributories among themselves (Adjustment of rights becomes necessary when some shareholders have paid a higher amount on shares as compared to the amount paid by some other shareholders).

5. Settlement of list of contributories (Section 467)

(a) Two lists of contributories. After making a winding up order, the Court shall settle a list of contributories. It shall distinguish between the persons who are contributories in their own right and those who are contributories as being representatives of others. Accordingly, the liquidator prepares two lists of contributories, i.e., 'List A' and 'List B'.

- (i) 'List A' of contributories. 'List A' contains the names of present members of the company, i.e., the members whose names appear in the register of members as on the date of commencement of winding up of the company.
- (ii) 'List B' of contributories. 'List B' contains the names of past members of the company, i.e., the members who ceased to be members within 1 year preceding the commencement of winding up of the company.

(b) List of contributories may be dispensed with. If it appears to the Court that it will not be necessary to make calls or adjust the rights of the contributories, the Court may dispense with the settlement of list of contributories.

6. No right of set off

A member may be a creditor of the company for unpaid dividend or otherwise. Any such money due to a member cannot be set off against any claim of the company against a member. In other words, a member who is a creditor of the company cannot set off his debt against any liability for calls. Thus, a member or contributory has no right of set off where he is also a creditor of the company.

(a) Principle behind denial of set off. The principle underlying denial of right of set off is that where a person entitled to participate in a fund is also bound to make a contribution in aid of that fund, he cannot be allowed to participate until he has discharged his obligation [Re, Peruvian Railway Construction Co. (1915) 2 Ch. 442].

(b) Exceptions - Right of set off allowed as per section 469. In the following cases, a contributory shall have a right of set off:

- (i) In the case of an unlimited company, the Court may allow the set off in respect of any money due to a contributory on account of any independent dealing or contract between the company and the contributory,

- (ii) In the case of a limited company, the Court may allow the set off in respect of any money due to a director or manager whose liability is unlimited, on account of any independent dealing or contract between the company and such director or manager,
 - (iii) In the case of any company (whether limited or unlimited) when all the creditors have been paid in full, any money due to a contributory may be allowed to be set off against any subsequent call.
1. On the commencement of winding up the members of a company are referred to as 'contributories'.
 2. There is a difference between the terms 'member' and a 'contributory'. A holder of shares (whether partly paid or fully paid) shall be a contributory. However, he shall not be regarded as a member if his name has not been entered in the register of members.

Winding up of unregistered companies (Sections 582 to 589)

The provisions relating to winding up of unregistered companies are explained as follows:

1. Meaning of unregistered company (Section 582)

An unregistered company includes any partnership, association, or company having 8 or more members. Such membership must exist as on the day of presentation of petition of winding up. An unregistered company shall not include -

- (a) a railway company;
- (b) a company registered under the Companies Act, 1956;
- (c) a company registered under any of the previous Indian Companies Act (excluding a company whose registered office was situated in Burma, Aden or Pakistan immediately before the separation of that country from India);
- (d) an illegal association.

2. Applicability of provisions relating to winding up (Section 583)

An unregistered company may be wound up under the provisions of the Companies Act, 1956. In such a case, all the provisions of the Companies Act with respect to winding up shall apply to the unregistered company, with the following modifications:

- (a) Jurisdiction of Court*. The principal place of business of the unregistered company shall be deemed to be its registered office and the appropriate Court* of that place shall have the jurisdiction to wind up the unregistered company.
- (b) Mode of winding up. An unregistered company shall not be wound up voluntarily or subject to the supervision of the Court*. It shall be wound up only by the Court*.
- (c) Grounds for winding up. An unregistered company may be wound up on the following grounds:
 - (i) That the company has ceased to carry on its business or it is carrying on its business only to wind up its affairs.
 - (ii) That the company is unable to pay its debts,
 - (iii) That in the opinion of the Court* it is just and equitable that it should be wound up.

3. Inability to pay debts - meaning (Section 583)

An unregistered company shall be deemed to be unable to pay its debts in the following circumstances:

- (a) If a creditor, to whom the company is indebted in a sum exceeding ₹ 500, has served on the



company a demand under his hand requiring the company to pay the sum so due, and the company has, for three weeks neglected to pay the sum or to secure or compound for it to the satisfaction of the creditor.

- (b) Where any suit or legal proceeding has been instituted against a member for any debt due from the unregistered company and a notice thereof has been served and the company has not within 10 days thereafter -
 - (i) paid, secured or compounded the debt or demand; or
 - (ii) procured the suit or legal proceedings to be stayed; or
 - (iii) indemnified the defendant-member of the suit against costs, damages or expenses.
- (c) Where the company fails to satisfy a decree of any Court* in favour of a creditor.
- (d) Where it is proved that the company is unable to pay its debts.

4. Winding up of a foreign company (Section 584)

A body corporate incorporated outside India may be wound up as an unregistered company if it had been carrying on business in India and it has ceased to carry on business in India. It may be wound up even if it has been dissolved or has ceased to exist according to the law of the country where it had been incorporated.

5. Winding up of unregistered companies - provisions applicable (Sections 585 to 589)

(a) Contributory (Section 585)

Every person shall be deemed to be a contributory who is liable to pay -

- (i) any debt or liability of the company;
- (ii) the costs, charges and expenses of winding up;
- (iii) the amount payable for adjustment of rights of the members amongst themselves.

(b) Stay of suits (Sections 586 and 587)

- (i) Pending order of the Court*. At any time after the presentation of a winding up petition and before a winding up order has been made, the company, or any creditor or contributory, may apply to the Court* for stay of suits or proceedings against the company. The Court* may stay or restrain the suit or proceedings against the company on such terms as it thinks fit (Section 586).
- (ii) On order of winding up. On the making of a winding up order, all suits or legal proceedings are automatically stayed against a contributory. No suit or legal proceeding shall be started against a contributory except with the leave of the Court* and on such terms as the Court* may impose (Section 587).

(c) Directions as to property in certain cases (Section 588)

If an unregistered company has no power to sue in its own name, the Court* may order that all or any part of the property, movable or immovable, shall vest in the Official Liquidator by his official name. On such an order being made, the Official Liquidator may bring or defend in his official name any suit or legal proceeding relating to that property.

(d) Application of other provisions of the Act (Section 589)

Sections 582 to 590 apply to winding up of unregistered companies. Additionally, provisions of sections 425 to 560 (relating to winding up of companies registered under the Companies Act, 1956) shall also apply to an unregistered company.

[* Tribunal- Vide Companies (Second Amendment) Act, 2002- Yet to take effect]

1.13 COMPANIES INCORPORATED OUTSIDE INDIA

Foreign Company & Other Companies

1	2	3
Foreign Company	Part IX Registration	Application of Act to other Companies
1. Meaning of Foreign Company 2. ROC for Foreign Company 3. Documents to be delivered initially 4. Alteration of Documents 5. Filing of Accounts 6. Name, Country & Liability 7. Service on Foreign Company 8. Consequences of Non-Compliance 9. Other Provisions applicable 10. Provisions as to Prospectus	1. Joint Stock Company 2. Conditions & Restrictions 3. Documents to be submitted 4. Effect of Part IX Registration 5. Substitution of MOA / AOA	1. Companies governed by Special Acts 2. Government Companies 3. Nidhis

1. Foreign Companies [Sec.591 - 602]

Foreign Company: Foreign Company means a Company - (a) incorporated outside India, and (b) which has established a place of business within India.

Note: Foreign Company is not a Company u/s 2(10), but a Body Corporate u/s 2(7).

Indian Citizens/Bodies holding 50% Share Capital in Foreign Company: Where not less than 50% of the Paid-Up Share Capital (Equity or Preference or partly in both) of a Foreign Company is held by one or more - (a) citizens of India, and / or (b) Bodies Corporate incorporated in India, whether singly or in the aggregate, such Company shall comply with such of the provisions the Act with regard to the business carried on by it in India, as if it were a Company incorporated in India.

Foreign Controlled Company: It refers to a Company where the majority shareholding and voting power is held by Foreign Individuals and/or Bodies Corporate. Such Companies may be incorporated either in India or outside India. The application of Companies Act to such Companies is as under -

If a Foreign Controlled Company is -	Applicability of Companies Act
Incorporated in India	All provisions are applicable.
Incorporated outside India, having no place of business in India	Not Applicable, except certain provisions like winding-up [Sec.584], Prospectus [Sec.603] etc.
Incorporated outside India, establishes a place of business in India	Becomes a "Foreign Company" as given above. The Companies Act shall apply as per Part XI.
Meaning of "Place of Business" "Place of Business" includes a Share Transfer or Share Registration Office, [Sec.602] - If a Company incorporated outside India employs only agents but has no place of business in India, it will not be a Foreign Company. - If a Company incorporated outside India maintains a Liaison Office, it would also be a "Place of Business", even if no trading or manufacturing activity is carried out at that Liaison Office.	



Delivery of prescribed documents to ROC [Sec.597]

Principle [Sec.597]: A Foreign Company shall deliver the prescribed documents to -

- (a) ROC, New Delhi, and
- (b) ROC of the State in which the principal place of business of the Company is situated.

Obligations of a Foreign Company under Part XI of the Act.

1. To deliver certain documents to the ROC, upon establishment of place of business in India [Sec.592]
2. To deliver Returns in respect of alteration in certain documents/particulars [Sec.593]
3. To prepare Financial Statements and deliver 3 copies thereof to the ROC, along with List of places of business in India [Sec.594]
4. To state Name, Limited Liability and Country of Incorporation [Sec.595]
5. To give notice to ROC, of ceasing to have place of business in India [Sec.597]
6. To comply with other requirements of the Act, e.g. Registration of Charges, Inspection of Debenture Trust Deed, Proper Books of Account, Annual Return, Inspection, etc. [Sec.600]

For registering any document as required in Part XI, a fee of ₹5,000 shall be paid to the ROC. [Sec.601]

Documents to be furnished by a "Foreign Company" to the ROC, initially, i.e. upon establishment of place of business in India [Sec. 592]

1. Foreign Companies which establish a place of business within India shall, within 30 days of the establishment of the place of business, deliver to the ROC for registration -
 - (a) Certified copy of - (i) Charter, (ii) Statutes, (iii) Memorandum and Articles, or (iv) other instrument constituting or defining the constitution of the Company, and, if the instrument is not in the English language, a certified translation thereof,
 - (b) Full Address of the Registered or Principal Office of the Company,
 - (c) List of Directors and Secretary of the Company, containing the prescribed particulars,
 - (d) Name(s) and Address(es) of person(s) resident in India, authorised to accept on behalf of the Company service of process and any notices or other documents required to be served on the Company, and
 - (e) Full Address of the Office of the Company in India which is to be deemed its principal place of business in India,"

2. Prescribed Particulars in respect of Directors and Secretary are as under -

Situation	Each Director	Each Secretary
In the case of an Individual	• Present Name and Surname in full, • Any former Name(s)' and Surname(s) in full, • Usual Residential Address, • Nationality, and Nationality of Origin, where applicable, • Business Occupation, if any, or • If he has no business occupation but holds any other Directorship(s), particulars of that Directorship(s)	• Present Name and Surname in full, • Any former Name(s) & Surname(s) in full, • Usual Residential Address.

In the case of a Body Corporate	• Corporate Name, • Registered or Principal Office, and • Full Name, Address, Nationality, and Nationality of Origin, where applicable, of each of its Directors.	• Corporate Name, & • Registered or Principal Office.

Notes:

- Where all Partners in a Firm are Joint Secretaries of the Company, the Name and Principal Office of the Firm may be stated.
 - For determining "Surname", the principles in Sec. 303(l) Explanation (2) & (3) shall apply.
 - "Certified" means certified in the prescribed manner to be a true copy or a correct translation.
 - "Director", in relation to a Company, includes any person in accordance with whose directions or instructions the Board of Directors of the Company is accustomed to act.
 - "Secretary" includes any person occupying the position of Secretary, by whatever name called.
3. Ceasing to have Place of Business [Sec.597]: If any Foreign Company ceases to have a place of business in India, it shall forthwith give notice of the fact to the ROC. As from the date on which notice is so given, the obligation of the Company to deliver any document to the ROC shall cease, provided it has no other place of business in India.

Time Limits for communication of alteration in certain facts to the ROC by a Foreign Company.

Alteration is made or occurs in -	Time limit for filing the Return
1. (i) Charter, (ii) Statutes, (iii) Memorandum and Articles, or (iv) other instrument constituting or defining the constitution of the Company, 2. Registered or Principal Office of a Foreign Company, or 3. Directors or Secretary of a Foreign Company, or	On or before 31st January of the year following the year in which the alteration is made.
4. Name or Address of any of the person authorised to accept service on behalf of a Foreign Company, or 5. Principal Place of business of the Company in India,	Within 30 days of such alteration.

Requirements relating to preparation and maintenance of accounts by Foreign Companies under the Act.

1. Financial Statements [World or Global Business Accounts]:

- Every Foreign Company shall, in every calendar year, make out a Balance Sheet and Profit and Loss Account The form, annexures, attachments (including, relating to every Subsidiary) of such Balance Sheet and P & L A/c shall as if it had been a Company within the meaning of this Act, have been required to make out and lay before in General Meeting.
- The Central Government is empowered to exempt / modify the above requirements in respect of any Foreign Company or Class of Foreign Companies, by notification in the Official Gazette.

2. Filing with ROC: The following shall be delivered/filed with the ROC. 3 copies of –

- Balance Sheet and P&L A/c, along with its annexures and attachments, as submitted by it to the prescribed authority in the country of its incorporation, [If such document is not in the English language, a certified translation thereof shall be annexed to it.]



- (b) List of all places of business established by the Company in India as at the date of Balance Sheet.

3. Indian Business Accounts:

- (a) In respect of Indian Business, a Foreign Company shall file 3 copies of its Balance Sheet and P & L A/c, prepared in Indian Rupees, as per Schedule VI requirements.
- (b) Indian Business Accounts shall be audited by a Chartered Accountant practicing in India.

- 4. Time Limits:** The accounts shall be filed with the ROC, within 9 months of the close of the financial year. ROC may extend this period by further 3 months [Rule 18A in Appendix 1].

Documents which are required to be filed with the ROC by Foreign Companies, initially when they establish a place of business in India, and later on periodically or on the happening of certain events.

Situation	Documents to be delivered to ROC
1. Initially when they establish a place of business in India.	As per Sec.592 Refer Documents to be furnished by a "Foreign Company" to the ROC, initially, i.e. upon establishment of place of business in India as stated earlier.
2. Periodically or on the happening of certain events	❖ Details of Alteration [Sec.593] ❖ Annual Accounts [Sec.594] ❖ List of Places of Business [Sec.594] ❖ Notice of ceasing to have Places of Business [Sec.597] ❖ Charges on Properties [Sec.600] ❖ Annual Return [Sec.600] ❖ Prospectus relating to issue of Shares or Debentures [Sec.605]

Obligations of a Foreign Company to state its Name, Liability and Country of Incorporation. [Sec. 595]

1. Particulars to be disclosed	(a) Name of the Company, (b) Country in which it is incorporated, (c) If the liability of its Members is limited, such a fact.
2. Places of disclosure	(a) Every Prospectus inviting subscriptions in India for its Shares / Debentures, (b) On the outside of every office or place where it carries on business in India, (c) All Business Letters, Billheads, Letter Paper, Notices, and other Official Publications.

Note: The above particulars shall be written in legible letters in English language and local language.

Service of Documents, etc, on a Foreign Company [Sec.596]

Situation	Explanation	Service of process, notice, or other document, shall be done
General	Where Authorised Person u/s 592 is available	Addressed to any person whose name has been delivered to the ROC u/s 592, and left at, or sent by post to, such address.
Special	• If the Company makes default in delivering the Name & Address of the Authorised Person u/s 592, to the ROC, • If at any time all the Authorised Persons are dead or have ceased so to reside, or refuse to accept service on behalf of the Company, or for any reason, cannot be served,	By serving on the Company by leaving it at, or sending it by post to, any place of business established by the Company in India.

Consequences if a Foreign Company fails to comply with the requirements as to filing returns with ROC, etc. under Part XI [Sec.597& 598]

- 1. Fine [Sec.598]:** Failure to comply with any of the above, renders the Company and every Officer or Agent in default, liable to a fine upto ₹ 10,000, and in the case of a continuing offence, with an additional fine which may extend to ₹ 1,000 for every day during which the default continues.
- 2. No suit by Company [Sec.599]:** The Company shall not be entitled to bring any suit, claim any set-off, make any counter-claim or institute any legal proceeding in respect of any contract, dealing or transaction, until it has complied with the provisions of Part XI. However, failure by the Company shall not affect the validity of any contract, dealing or transaction entered into by the Company or its liability to be sued in respect thereof.

Other provisions of the Act which are applicable to a Foreign Company [Sec.600]

1.	Registration of Charges	- Provisions of Part V (Sec 124 to 145) shall apply mutatis mutandis to charges on properties in India which are created / acquired subject to charge, by a Foreign Company, - Where a charge is created, or the completion of the acquisition of the property takes place, outside India, Sec.125(5) and proviso to Sec. 127(1) shall have effect as if the property, wherever situated, were situated outside India.
2.	Debenture Trust Deed	Provisions relating to obtaining copies of, and inspection of Debenture Trust Deed u/s 118 shall apply mutatis mutandis to a Foreign Company.
3.	Proper Books of Account	Sec.209 shall apply to a Foreign Company to the extent of requiring it to keep at its principal place of business in India the books of account referred u/s 209, with respect to moneys received and expended, sales and purchases made, and assets and liabilities, in the course of or in relation to its business in India.
4.	Annual Return	Provisions relating to filing of Annual Return u/s 159 shall apply subject to such modifications or adaptations as specified in Foreign Companies Rules, 1975.
5.	Other Provisions	- Sec.209 - Proper Books of Account - Sec.209A - Inspection of Books of Account - Sec.233A - Special Audit - Sec.233B - Cost Audit - Sec.234 to 246 (both inclusive) - Inspection & Investigation shall apply only to the Indian business of a Foreign Company having an established place of business in India, as they apply to a Company incorporated in India.

Books of account to be maintained by a Foreign Company having established a place of business in India.

As per Sec.600-

- Sec.209 shall apply to a Foreign Company to the extent of requiring it to keep at its principal place of business in India the books of account referred u/s 209, with respect to moneys received and expended, sales and purchases made, and assets and liabilities, in the course of or in relation to its business in India.
- Sec.209 & 209A shall apply only to the Indian business of a Foreign Company having an established place of business in India, as they apply to a Company incorporated in India.

Provisions relating to Prospectus of a Company incorporated outside India [Sec.602 - 608]

Note: Part XI covers Sec.591 to Sec.608. Of these, Sec, 592 - 602 shall apply to "Foreign Companies", as defined in Sec.591. However, Sec.603 - 608 dealing with Prospectuses, shall apply to Companies



incorporated outside India, i.e. whether or not they have a established a place of business inside India.

A Company incorporated or to be incorporated outside India (i.e. existing or proposed Company), whether the Company has or has not established, or when formed will or will not establish, a place of business in India, (Note: Company incorporated outside India, not a Foreign Company u/s 591) shall issue, circulate or distribute in India, a prospectus offering Shares/Debentures for subscription. The conditions relating to be such Prospectus are given below –

A. Contents of Prospectus [Sec.603]: The Prospectus shall contain the following -

1. Instrument constituting or defining the constitution of the Company,
2. Enactments or provisions having the force of enactments, by or under which the incorporation of the Company was effected,
3. Address in India where the said instrument, enactments, or provision, or copies thereof, and if the same are not in English, a translation thereof certified in the prescribed manner, can be inspected,
4. Date on which and the country in which the Company was incorporated,
5. Whether the Company has established a place of business in India and, if so, the address of its Principal Office in India
6. Matters specified in Schedule II,
7. Date of Prospectus.

Note;

- "Prospectus", "Shares" and "Debentures" have the same meaning as when used in relation to a Company incorporated under this Act. [Sec.608]
- Sec. 603 will not apply in case of - (a) Rights Issues to existing Members / Debentureholders, and (b) Issue of Shares / Debentures which have the same character as existing Listed Shares / Debentures.
- Points (1), (2), (3) above shall not apply in the case of a Prospectus issued more than 2 years after the date at which the Company is entitled to commence business.
- Application Form for Shares / Debentures (except in case of Forms issued to Underwriters) shall be issued only along with a Prospectus which complies with Part XI.
- Any condition requiring or binding an Applicant for Shares / Debentures to waive compliance with the above disclosures, or purporting to affect him with notice of any contract, document or matter not specifically referred to in the Prospectus, shall be void.
- In case of non-compliance with or contravention of above disclosures, a Director or other person responsible for the Prospectus shall not incur any liability by reason of the non-compliance or contravention, if, -
 - (a) as regards any matter not disclosed, he proves that he had no knowledge thereof, or
 - (b) he proves that non-compliance or contravention arose from an honest mistake of fact on his part, or
 - (c) non-compliance / contravention was in respect of matters which, in the opinion of the Court dealing with the case, were immaterial, or was otherwise such as ought in the opinion of that Court, having regard to all the circumstances of the case, reasonably to be excused.

B. Expert's Consent [Sec.604]: Where the Prospectus includes a statement purporting to be made by an Expert -

1. He should have given, and before delivery of the Prospectus for registration, has not withdrawn, his written consent to the issue of the Prospectus
2. There appears in the Prospectus, a statement that he has given and has not withdrawn his consent as aforesaid.

C. Registration of Prospectus [Sec.605]:

1. Before issue, circulation or distribution, a copy of the Prospectus certified by the Chairman and 2 other Directors of the Company, should be delivered for registration to the ROC.
2. The Prospectus should state on its face that a copy has been delivered to the ROC.
3. On the copy of Prospectus, there should be an attachment / endorsement of -
 - (a) Expert's Consent to the issue of the prospectus required by Sec.604,
 - (b) Copy of any contract required to be stated in the Prospectus or, in the case of a contract not reduced into writing, a memorandum giving full particulars thereof, [If such contract / memorandum is wholly or partly in any language other than English, a certified translation thereof should be made available.]
 - (c) Statement of Adjustments as Clause 32 Part II of Schedule II, signed by those persons setting out the adjustments and giving the reasons therefor.

D. Issue of IDR's [Sec.605A]: In case of issue of Indian Depository Receipts (IDRs), the Company shall comply with Companies (Issue of Indian Depository Receipts) Rules, 2004, made by Central Government. These Rules shall provide for-

1. Issue of IDRs,
2. Requirement of disclosures in Prospectus or Letter of Offer issued in connection with IDRs,
3. Manner in which IDRs shall be dealt in a depository mode and by custodian and underwriters,
4. Manner of sale, transfer or transmission of IDR.

E. Consequences of Non-Compliance [Sec.606, 607]:

Contravention	Punishment
Any person who is knowingly responsible for - (a) Issue, circulation or distribution of a Prospectus, or (b) Issue of a Form of Application for Shares / Debentures / IDRs, in contravention of Sec.603, 604, 605, 605A,	Imprisonment upto 6 months and/ or Fine upto ₹ 50,000.

Note: Civil Liability under Sec.62 shall also apply. [Sec.607]

2. PART IX REGISTRATION

Part IX (Sec.565 - 581) permits registration of Partnership Firms, etc. as Companies under this Act, without having to form a separate entity, i.e. conversion of Firm into a Company.

Meaning of Joint Stock Company, for Part IX purposes. [Sec.566]

A Joint-Stock Company means a Company -

1. having a permanent paid-up or Nominal Share Capital of fixed amount,
2. (a) divided into Shares, of fixed amount, or (b) held and transferable as Stock, or (c) divided and held partly in the one way and partly in the other, and
3. formed on the principle of having for its Members, the holders of those Shares / Stock, and no other persons.



Such a Company, when registered with Limited Liability under the Act, shall be deemed to be a Company limited by Shares.

Conditions and restrictions as to registration under Part IX. [Sec.565]

- 1. Number of Members:** To register under Part IX, a Company should have 7 or more Members.
- 2. Type of Company:** An eligible Company (under Part IX), may at any time, register under the Act as - (a) Unlimited Company, or (b) Company limited by Shares, or (c) Company limited by Guarantee. The registration shall not be invalid by reason only that it has taken place with a view to the Company's being wound up.
- 3. Consent of Majority Members:**
 - (a) At a General Meeting summoned for the purpose, registration under Part IX should be sanctioned by a majority of members present in person or in proxy.
 - (b) Where a Company not having the liability of its members limited by any Statute is about to register as a Limited Company, special majority of not less than 3/4th of the Members present in person or in proxy is required.
 - (c) In computing the required majority, when a poll is demanded, regard shall be had to the number of votes to which each member is entitled according to the Regulations of the Company.
- 4. Guarantee Amount:** Where a Company is about to register as a Company limited by Guarantee, majority assent shall be accompanied by a resolution declaring that each Member undertakes to contribute a prescribed amount -
 - (a) to the assets of the Company, in the event of its being wound up while he is a Member, or within 1 year after he ceases to be a member,
 - (b) for payment of the debts and liabilities of the Company or of such debts and liabilities as may have been contracted before he ceases to be a Member, and
 - (c) for the costs, charges and expenses of winding up, and
 - (d) for the adjustment of rights of the Contributories among themselves,
- 5. Restrictions:**
 - (a) A Company registered under Indian Companies Act, 1882 or 1913 shall not register under Part IX.
 - (b) A Company having the liability of its members limited by a Statute (other than Companies Act) and not being a Joint-Stock Company as per Sec. 566, shall not register under Part IX.
 - (c) A Company having the liability of its members limited by any Statute (other than Companies Act) shall not register under Part IX as an Unlimited Company or as a Company limited by Guarantee,
 - (d) A Company that is not a Joint-Stock Company as per Sec.566 shall not register as a Company limited by Shares, So, only a Joint Stock Company can register as a Company limited by Shares,

Note: For (b) and (c) above, Statute refers to any Act of Parliament other than this Act or of any other Indian law (including a law in force in a Part B State), or of any Act of Parliament of the United Kingdom or Letters Patent in force in India.

Documents are to be furnished to the ROC, for registration under Part IX

Registration under Part IX, of a -	Documents to be delivered to the ROC
Joint Stock Company [Sec.567]	1. List showing Names, Addresses, and Occupations of all persons who on the specified date (i.e. within 6 clear days before the day of registration), were Members of the Company, with the details of Shares/ Stock held by them, 'distinguishing each share by its number, where applicable. 2. Copy of any Statute, Deed of Settlement, Deed of Partnership or other instrument constituting or regulating the Company 3. If the Co. is intended to be registered as a Limited Co, a statement specifying - (a) Nominal Share Capital of the Company and the Number of Shares into which it is divided or the amount of stock of which it consists, (b) Number of Shares taken and the amount paid on each Share, (c) Name of the Company, with the addition of the word "Limited" or "Private Limited" as the case may require, as the last word or words thereof, and (d) In case of a Company intended to be registered as a Company limited by Guarantee, a copy of the resolution declaring the amount of the guarantee.
Company other than a Joint Stock Company [Sec.568]	1. List showing Names, Addresses and Occupations of Directors, and Manager, if any, of the Company, 2. Copy of any Statute, Deed of Settlement, Deed of Partnership or other instrument constituting or regulating the Company 3. In case of a Company intended to be registered as a Company limited by Guarantee, a copy of the resolution declaring the amount of the guarantee.

Other Points:

- 1. Authentication of Statements [Sec.569]:** The documents required to be delivered to the ROC shall be duly verified by the declaration of any 2 or more Directors or other Principal Officers of the Company.
- 2. Evidence as to nature of Company [Sec.570]:** ROC may require such evidence as he thinks necessary for the purpose of satisfying himself, whether any Company proposing to be registered, is or is not a Joint-Stock Company as per Sec.566.
- 3. Change of Name [Sec.572]:** Where the name of a Company seeking registration under Part IX is one which in the opinion of ROC is undesirable, the Company may, with the approval of ROC signified in writing, change its name with effect from the date of its registration under Part IX. [Note: Assent of Members as required u/s 565 is also required for change of name.]

Consequences of incorporation or registration under Part IX

Certificate of Registration [Sec. 574]: On compliance with the requirements of Part IX with respect to registration, and on payment of the prescribed fees, the ROC shall certify under his hand that the Company applying for registration is incorporated as a Company under this Act, and in the case of a limited Company that it is limited and thereupon the Company shall be so incorporated.

The effects of registration under Part IX are given below: -

- 1. Addition of "Limited" or "Private Limited" to Name [Sec.573]:** the word(s) "Limited" or "Private Limited", shall form, and be registered as, the last word or words of its name. [Note: Sec.573 shall not be deemed to exclude the operation of Sec. 25.]



- 2. Statutory Vesting of Property [Sec.575]:** All property, movable and immovable (including actionable claims) belonging to or vested in a Company at the date of its registration under Part IX, shall on such registration, pass to and vest in the Company as incorporated under this Act for all the estate and interest of the Company therein. [Note: Separate document / sale deed / conveyance is not required to transfer any movable property].
- 3. Existing Liabilities not affected [Sec.576]:** The registration of a Company under Part IX shall not affect its rights or liabilities in respect of any debt or obligation incurred, or any contract entered into, by, to, with, or on behalf of, the Company before registration.
- 4. Continuation of pending legal proceedings [Sec.577]:**
 - (a) All suits and other legal proceedings taken by or against the Company, or any Public Officer or Member thereof, which are pending at the time of the registration of a Company under Part IX, may be continued in the same manner as if the registration had not taken place.
 - (b) However, execution shall not issue against the property or person of any individual member of the Company on any decree or order obtained in any such suit or proceeding, but, in the event of the property of the Company being insufficient to satisfy the decree or order, an order may be obtained for winding up the Company.
- 5. Stay or Restraint of Proceedings [Sec.580]:** The provisions of the Act with respect to staying and restraining suits and other legal proceedings against a Company at any time after the presentation of a petition for winding up and before making of a winding up order shall, in the case of a Company registered under Part IX, where the application to stay or restrain is by a Creditor, extend to suits and other legal proceedings against any Contributory of the Company,
- 6. Suits stayed on winding up order [Sec.581]:** Where an winding-up order has been made, or a Provisional Liquidator has been appointed for a Company registered under Part IX, no suit or other legal proceeding shall be proceeded with or commenced against the Company or its Contributory, in respect of any debt of the Company, except by leave of the Court and except on such terms as the Court may impose.
- 7. Contents of Statute, etc, = MOA & AOA [Sec.578(2)]:** All provisions contained in any Act of Parliament or other Indian law, or other instrument, constituting or regulating the Company, (including the guarantee resolution in the case of a Company limited by Guarantee) shall be deemed to be conditions and regulations of the Company, in the same manner as would, if the Company had been formed under this Act, have been required to be inserted in the Memorandum were contained in a registered Memorandum, and the residue thereof were contained in Registered Articles.
- 8. Application of the Act [Sec. 578(3)]:** All provisions of the Act shall apply to the Company, and Members, Contributors and Creditors thereof, in the same manner in all respects, as if it had been formed under this Act, subject to the following –
 - (a) Table A shall not apply unless and except in so far as it is adopted by Special Resolution.
 - (b) Provisions relating to numbering of Shares shall not apply to any Joint-Stock Company whose Shares are not numbered.
 - (c) The Company shall not have power to alter any provision contained in any Act of Parliament or other Indian Law relating to the Company.
 - (d) The Company shall not have power to alter any provision contained in any Act of Parliament of UK or Royal Charter or Letters Patent relating to the Company, without Central Government sanction.
 - (e) The Company shall not have power to alter any provision contained in the Statute (as per c & d above), with respect to the Objects of the Company.

Fresh MOA/AOA in case of a Company registered under Part IX

1. **Power to substitute:** A Company registered under Part IX, may, by special resolution, alter the form of its constitution by substituting a Memorandum and Articles, instead of any - (a) Deed of Partnership, (b) Act of Parliament of United Kingdom, (c) Royal Charter, or (d) Letters Patent, or (e) other instrument constituting or regulating the Company, not being an Act of Parliament or other Indian law.

Note: Alteration u/s 579 may be made either with or without any alteration of the objects of the Company.

2. **Application of the Act:** Provisions of Sec. 17 to 19 with respect to an alteration of the objects of a Company shall apply to any alteration u/s 579, with the following modifications -
 - (a) there shall be substituted for the printed copy of the altered MOA required to be filed with ROC, a printed copy of the substituted Memorandum and Articles, and
 - (b) on the registration of the alteration being certified by the ROC, the substituted Memorandum and Articles shall apply to the Company in the same manner as if it were a Company registered under this Act with that memorandum and Articles, and the earlier document (Deed of Partnership, etc.) shall cease to apply to the Company.

1.14. OFFENCES AND PENALTIES

The Companies Act, 1956 provides the legal basis for various corporate governance norms that are considered essential for proper corporate operation and protecting the rights of stakeholders. Violations of such norms are defined as offences with associated penalties. Essentially, law should be such that all subject entities should comply with it in their own interest.

Cognizance of Offences under the Companies Act.

1. Jurisdiction:

- (a) No Court inferior to that of a Presidency Magistrate or a Magistrate of the first class shall try any offence against the Act. [Sec.622]
- (b) If any offence against this Act which is punishable with fine only is committed by any person within a Presidency town, such person may be tried summarily and punished by any Presidency Magistrate of that Presidency town. [Sec.623]

2. **Nature of Offence [Sec. 624]:** Notwithstanding anything in the Code of Criminal Procedure, 1898, every Offence against this Act shall be deemed to be non-cognizable within the meaning of that Code.

3. **Complainant [Sec.621]:** The Court shall take cognizance of an offence against this Act, which is alleged to have been committed by any Company or any Officer thereof, only on the complaint in writing of - (a) ROC, or (b) a Shareholder of the Company, or (c) a person authorised by the Central Government in that behalf.

Note: The following points apply –

- For this purpose, a Liquidator of a Company shall not be deemed to be an Officer of the Company.
- Court may take cognizance of offence relating to - (a) issue and transfer of securities, and (b) non-payment of dividend, on a complaint in writing, by a person authorised by SEBI.
- Sec. 621 shall not apply to -
 - (a) prosecution of delinquent Officers / Members of the Company u/s 545.



- (b) prosecution by a Company of any of its Officers.
- (c) any action taken by the Liquidator of a Company in respect of any offence alleged to have been committed in respect of any of the matters included in Part VII (Sec.425 to 560) or in any other provision of this Act relating to the winding up of Companies.

4. Personal Attendance of ROC / Govt. excused [Sec.621]: Where the Complainant is the ROC or a person authorised by the Central Government, the personal attendance of the Complainant before the Court shall not be necessary, unless the Court, for reasons to be recorded in writing, requires his personal attendance at the trial. [This provision supersedes the Code of Criminal Procedure, 1898]

Compounding of Offences under the Companies Act. [Sec.621 A]

Provisions and procedure for Compounding of offences, which are punishable under Companies Act, 1956 are stipulated under section 621A of the act. The meaning of word compounding of offence is not defined under Companies Act, 1956. However if we try to analyze the section 621A, we can draw one clear interpretation i.e. "It's nothing but admission of guilt". In the process of compounding, the person may either Suo Moto or on receipt of notice of default/initiation of prosecution, admits the commission of default and make an application for compounding of the concern offence. The defaulters agree to pay penalty which may be ordered by the Central Government.

Compounding of Offences involves payment of a fine / penalty in lieu of prosecution. The provisions relating to Compounding of Offences under the Companies Act are given below :-

1.	Nature of Offence	Any Offence punishable under this Act, punishable with fine only can be compounded without Court permission. Note: An offence punishable - (a) with imprisonment only, or (b) with imprisonment and also with fine, shall be compoundable, only with the permission of the Court.
2.	Committed by	Company or any Officer thereof.
3.	Time period for compounding	Either before or after the institution of any prosecution.
4.	Authority	(a) Tribunal, or (b) Regional Director, where the maximum amount of fine which may be imposed for such offence does not exceed ₹ 50,000. Note: Regional Director shall exercise the powers to compound an offence, subject to the direction, control and supervision of the Tribunal.
5.	Application	Application for compounding of offence shall be made to the ROC, who shall forward the same, together with his comments thereon, to the Tribunal or Regional Director.
6.	Factors considered	In specifying the sum required to be paid or credited for the compounding of an offence, the sum, if any, paid by way of Additional Fee u/s 611(2) shall be taken into account.
7.	Compounding Order	The Offence may be compounded on payment or credit to the Central Government, by the Company/Officer, of the sum specified by Tribunal/ Regional Director. The sum so specified shall not exceed the maximum amount of the fine which may be imposed for the offence so compounded.

8.	Order to file documents with ROC	(a) Tribunal / Regional Director may also direct any Officer or other Employee of the Company to file or register with, or on payment of Fees and Additional Fee u/s 611, the Return, Account or other document (which was omitted to be filed), within such time as may be specified in the order. (b) Non-compliance thereof shall be punishable with imprisonment upto 6 months, and / or fine upto ₹ 50,000.
9.	Intimation to ROC	Where any offence is compounded u/s 621A, an intimation thereof shall be given by the Company to the ROC within 7 days from the date of which the offence is so compounded.
10.	Effect of Compounding Order	• Compounding before instituting prosecution: No prosecution shall be instituted in relation to such offence, by ROC or by any Shareholder or by any person authorised by the Central Government, against the offender in relation to such offence. • Compounding after instituting prosecution: Such composition shall be brought to the notice of the Court, by the ROC, in writing. On such notice being given, the Company or its Officer shall be discharged, in relation to such offence.
11.	Second or Subsequent Offences	• Composition is not permissible in respect of offence committed by a Company or its Officer within 3 years from the date on which a similar offence committed by it or him was compounded u/s 621A. • Any second or subsequent offence committed after the expiry of 3 years from the date on which the offence was previously compounded, shall be deemed to be a first offence.

Liability of a shareholder for bringing frivolous or vexatious proceedings against the Company / Officer thereof [Sec.625]

In respect of any case instituted upon the complaint of a Shareholder, against the Company or its Officer, the following provisions shall apply -

- 1. Show Cause Notice to Shareholder:** If the Magistrate by whom any such case is heard discharges or acquits all or any of the accused, and is of opinion that the accusation against any or all of them was false and either frivolous or vexatious, the Magistrate may, by his order of discharge or acquittal :

Situation	Magistrate may
If the Complainant Shareholder is present in the Court	Call upon him forthwith to show cause why he should not pay compensation to such accused, or to each or any of such accused,
If the Complainant Shareholder is not present in the Court	Direct the issue of a summons to him to appear and show cause as aforesaid.

2. Order for Compensation:

- The Magistrate shall record and consider any cause which such Shareholder may show.
- If the Magistrate is satisfied that the accusation was false and either frivolous or vexatious, he may, for reasons to be recorded, direct that compensation to a specified amount be paid by such Shareholder to the accused or to each or any of them, not exceeding ₹ 1,000 in all.
- The Magistrate may further order that, in default of payment, the Shareholder shall suffer simple imprisonment for a term not exceeding 2 months. Sec.68 and 69 of the Indian Penal Code shall, so far as may be, apply to such imprisonment.



3. Other Liability:

- (a) A person who has been directed to pay compensation u/s 625 shall not, by reason of such order, be exempted from any civil or criminal liability in respect of the complaint made by him.
- (b) However, any amount paid to an accused person u/s 625 shall be taken into account in awarding compensation to such person in any subsequent civil suit relating to the same matter.

4. Right of Appeal:

- (a) A Complainant who has been ordered to pay compensation u/s 625 may appeal from the order, in so far as it relates to the payment of compensation, as if such complainant had been convicted on a trial held by such Magistrate.
- (b) Where an order for payment of compensation to an accused person is made, the compensation shall not be paid to him before the period allowed for the presentation of appeal has elapsed, or, if an appeal is presented, before the appeal has been decided.

Punishments in respect of other “Offences” under the Companies Act.

Sec.	Nature of Offence	Punishment
628	If in any Return, Report, Certificate, Balance Sheet, Prospectus, Statement or other document required by or for the purposes of any of the provisions of the Act, any person makes a statement - (a) which is false in any material particular, knowing it to be false, or (b) which omits any material fact knowing it to be material,	Save as otherwise expressly provided in the Act, he shall be punishable with imprisonment upto 2 years, & shall also be liable to fine.
629	If any person intentionally gives false evidence - (a) upon any examination upon oath or solemn affirmation, authorised under the Act, or (b) in any affidavit, deposition or solemn affirmation, in or about the winding up of any Company under the Act, or otherwise in or about any matter arising under the Act.	He shall be punishable with imprisonment upto 7 years, and shall also be liable to fine.
629 A	If a Company or any other person contravenes - - any provision of the Act for which no punishment is provided elsewhere in the Act, or - any condition, limitation or restriction subject to which may approval, sanction, consent, confirmation, recognition, direction or exemption in relation to any matter has been accorded or granted.	Company and every Officer in default or such other person shall be punishable with Fine upto ₹ 5,000, and a further Fine upto ₹500 per day, where the contravention is a continuing one.

630	If any Officer or Employee of a Company - (a) wrongfully obtains possession of any property of a Company, or (b) having any such property in his possession, wrongfully withholds it or knowingly applies it to purposes other than those expressed or directed in the AOA and authorised by the Act	On the complaint of the Company or any Creditor/Contributory, he shall be punishable with fine upto ₹ 10,000, [See Note]
631	If any person(s) trade or carry on business under any name or title of which the word(s) "Limited" or "Private Limited", or any contraction or limitation thereof is / are the last word(s), without being duly incorporated as a Company / Private Company with limited liability	Such person(s) shall be punishable with fine upto ₹ 500 for every day upon which that name or title has been used.

Miscellaneous provisions in respect of "Offences" under the Companies Act.

- 1. Appointment of Company Prosecutors [Sec.624A]:** The Central Government may appoint generally, or in any case, or for any specified class of cases in any local area, Company Prosecutor(s) for the conduct of prosecutions arising out of this Act. The Company Prosecutor(s) shall have all the powers and privileges conferred by Cr. P.C on Public Prosecutors, appointed by a State Government u/s 492 of that Code.
- 2. Appeal against acquittal [Sec.624B]:** The Central Government may, in any case arising out of this Act, direct any Company Prosecutor or authorise any other person either by name or by virtue of his office, to present an appeal from an order of acquittal passed by any Court other than a High Court. An appeal presented by such Prosecutor or other person shall be deemed to have been validly presented to the appellate Court.
- 3. Application of Fines [Sec.626]:** The Court imposing any fine under this Act may direct that the whole or any part thereof shall be applied in or towards payment of the costs of the proceedings, or in or towards the rewarding of the person on whose information or at whose instance the fine is recovered.
- 4. Inspection in case of Suspected Offence [Sec.627]:**

Situation	Order may be made
Where it is shown that there is reasonable cause to believe that- (a) any person has, while he was on Officer of the Company, committed an offence in connection with the management of the Company's affairs, and (b) evidence of the commission of the offence is to be found in any books or papers of or under the control of the Company,	• Authorising the inspection the said books or papers or any of them, for the purpose of investigation, and obtaining evidence of the commission of the offence, or • Requiring the Manager / Officer of the Company to produce the said books or papers or any of them, and at a place and time, to the person appointed for inspection.

Other provisions in respect of "Legal Proceedings" under the Companies Act.

- 1. Security for Costs [Sec.632]:** Where a Limited Company is Plaintiff or Petitioner in any suit or other legal proceeding, the Court having jurisdiction may, if there is reason to believe that the Company will be unable to pay the costs of the defendant if he is successful in his defence, require sufficient security to be given for those costs, and may stay all proceedings until the security is given.



2. Grant of Relief in case of honest and reasonable acts [Sec.633]:

- (a) If in any proceeding for negligence, default, breach of duty, misfeasance or breach of trust against an Officer of a Company, it appears to the Court that he is or may be liable in respect of such negligence, etc, but that he has acted honestly and reasonably, and that having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused, the Court may relieve him, wholly or partly, from his liability.
- (b) Where any such Officer has reason to apprehend that any claim will or might be made against him as above, he may apply to the High Court for relief. On such application, the High Court shall have the same power to relieve him as aforesaid.
- (c) In a criminal proceeding u/s 633, the Court shall have no power to grant relief from any civil liability which may attach to an Officer in respect of such negligence, default, breach of duty, misfeasance or breach of trust.
- (d) Relief shall be granted only when the Court has, by notice, required the ROC and any other person, as it thinks necessary, to show cause why such relief should not be granted.

3. Acts done in good faith [Sec.635A]: No suit, prosecution or other legal proceeding shall lie against the Government or any Officer of Government or any other person, in respect of -

- (a) anything which is in good faith done or intended to be done in pursuance of the Act / Rules, or
- (b) publication by or under the authority of Govt or such Officer, of any report, paper or proceedings.

4. Non-disclosure of information [Sec.635AA]: Notwithstanding anything contained in any other law, the ROC, any Officer of Government or any other person shall not be compelled to disclose to any Court, Tribunal or other authority whence he got any information which -

- (a) has led the Central Government to direct a special audit u/s 233A or to order an investigation under Sec.235, 237, 247, 248 or 249, or
- (b) is or has been material or relevant in connection with such special audit or investigation.

Enforcement of Court/Tribunal Orders under the Companies Act.

Order	Manner of enforcement of Order
Orders of Courts [Sec.634]	Enforced in the same manner as a decree made by the Court in a suit pending therein.
Orders of Tribunal [Sec.634A]	1. Enforced by Tribunal in the same manner as if it were a decree made by a Court in a suit pending therein. 2. In the case of its inability to execute such order, Tribunal shall send, to the Court within the local limits of whose jurisdiction - (a) in the case of an order against a Company, the Registered Office of the Company is situated, or (b) in case of an order against any other person, the person concerned voluntarily resides, or carries on business or personally works for gain.

Orders of one Court to be enforced by Other Courts [Sec.635]	1. Where any order made by one Court is required to be enforced by another Court, a certified copy of the order shall be produced to the Proper Officer of the Court required to enforce the order. 2. The production of such certified copy shall be sufficient evidence of the order. 3. Upon the production of such certified copy, the Court shall, take the requisite steps for enforcing the order, in the same manner as if it had been made by itself. 4. Where any order made by Tribunal is required to be enforced by a Court, a certified copy of the order shall be produced to the Proper Officer of the Court required to enforce the order. Points 2 & 3 shall apply.

Note: Except as expressly provided in this behalf elsewhere in the Act, where by any provision of this Act, any order of Court / Tribunal is required to be filed with ROC/ Company / any other person, within a period specified therein, then, in computing that period, the time taken - (a) in drawing up the order, and (b) in obtaining a copy thereof, shall be excluded. [Sec.640A]

RELATIVELY UNKNOWN OFFENCES AND PENALTIES

The Companies Act, 1956 is one of the voluminous statutes of India. The provisions of the Act impose numerous obligations on the company, its directors and officers, non-compliance of which entails penalties in the form of fine and imprisonment. The knowledge of the provisions of the Companies Act, 1956, thus, becomes vital for the directors and officers of the company.

The law relating to penalties arising from non-compliance of various legalities is provided in tabulated format here in below:

Section	Nature of Offence	Penalty
39(2)	Failure to send copies of Memorandum, Articles or agreement to members on demand.	Fine upto ₹500/-.
58A(5) (a)	Failure by a company to make repayment in terms of sub-section (3)(c)/(4)	Fine not less than twice the amount of deposit not repaid.
58A(5) (a)(i)	Acceptance of deposits in excess of prescribed limits and contrary to rules.	Fine not less than the amount of deposits.
58A(5) (a)(ii)	Invitation of deposits in excess of prescribed limits and contrary to rules	Fine upto ₹10,00,000 but not less than ₹50,000.
58A(5) (b)	Failure of repay deposit in accordance with the provisions of section 3(c)/(4)	Imprisonment upto 5 years and also fine.
116	Deceitfully personating as an owner of any shares or interest in a company	Imprisonment upto three years and also fine.
127(2)	Failure to deliver to the Registrar for registration particulars of charges on company acquiring property subject to charge.	Fine upto ₹5,000/-
143(2)	Failure to make entry in register of charges.	Fine upto ₹5,000/-
144(3)	Refusing to allow inspection of copies of instruments creating charges and company's register of charges	Fine upto ₹500/- and further fine upto ₹200/- per day



146(4)	Non-compliance with the requirements of section 146 in regard to registered office.	Fine upto ₹500/- per day.
147(2)	Non-compliance with the provisions of section 147(1)(a) or in regard to painting on affixing its name and address of registered office outside office or place of business.	Fine upto ₹500/- per day.
147(2)	Non-compliance with the provisions of section 147(1)(a) or in regard to painting on affixing its name and address of registered office outside office or place of business.	Fine upto ₹500/- per day.
147(3)	Non-compliance with the provisions of section 147(1)(b) or (c) in regard to engraving name on seal and mentioning name and registered office in business letters, etc.	Fine upto ₹5,000/-.
147(4)	Misuse of seal, letterhead etc., by an Officer.	Fine upto ₹5,000/-.
163(5)	Refusing Inspection, making of any extract or sending any copy within specified time, of registers, returns, etc.	Fine upto ₹500/- per day.
192(6)	Failure to annex copies of certain resolutions or agreements to articles or not forwarding to members on request copy of certain resolutions or agreements	Fine upto ₹100/-
197A	Managing Director and 'manager appointed or employed at the same time.	Fine upto ₹5,000/- and further fine upto ₹500/- for each day of default
200(1)	Payment of remuneration free of tax to any officer or employee of the company.	Fine upto ₹5,000/- and further fine upto ₹500/- for each day of default
218	Improper issue, circulation or publication of balance sheet or profit and loss account.	Fine upto ₹5,000/-
219(3)	Failure to send to members, etc., copies of balance sheet, auditors report, etc., twenty-one days before date of meeting.	Fine upto ₹5,000/-
219(4)	Default in complying with certain demands for copies of balance-sheet, etc., within seven days of such demand	Fine upto ₹5,000/-
299(4)	Failure to disclose interest in a contract by the Director	Fine upto ₹50,000/-
300(4)	Participation in Board meeting by interesting director	Fine upto ₹50,000/-
301(4)	Non-compliance with the provisions of section 301(1), (2) and (3) in regard to register of contracts, companies and firms in which directors are interested.	Fine upto ₹5,000/-
302(5)	Failure to disclose the members director's interest in contract appointing manager / managing director	Fine upto ₹10,000/-
303(3)	Failure to keep register of directors or to file with the Registrar return of directors, managing director, manager and secretary	Fine upto ₹500/- per day
304(2)	Refusing inspection to any member of register kept under section 303	Fine upto ₹500/-

383A (IA)	Failure to appoint whole-time secretary or filing of certificate of company from a practising company secretary	Fine upto ₹500/- per day
614A(2)	Failure to file document with the Registrar as directed by the court	Imprisonment upto 6 months or fine or with both.
615(6)	Failure to furnish information of statistics, etc., required by the Central Government	Imprisonment upto 3 months or fine upto ₹10,000/- or with both.
621A(6)	Failure to comply with the order of Company Law Board or Regional Director for filing any document, return, etc.	Imprisonment upto 6 months or fine upto ₹50,000/- or with both.
625(4)	Failure on the part of a shareholder to pay compensation.	Imprisonment upto two months.
628	False statement made in any return, balance-sheet, prospectus etc.	Imprisonment upto 2 years and also fine.
629	False evidence given on oath or in any affidavit.	Imprisonment upto 7 years and also fine.
630	Wrongful withholding of property of the company by an officer	Fine upto ₹10,000/-
631	Improper use of the words "limited" and "private limited".	Fine upto ₹500/- per day.

1.15. E - GOVERNANCE

Section 610B of the Companies Act, 1956 as inserted by the Companies (Amendment) Act, 2006 empowers the Central Government to introduce E-Governance and to modify the Act to facilitate electronic filing of forms, returns and documents with the ROC.

E-Governance-Meaning

Electronic Governance is the application of information technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance. E-Governance is a highly complex process requiring provision of hardware, software, networking and re-engineering of the procedures for better delivery of services.

Traditionally, the interaction between citizens or business and Government agency takes place in a Government office. In e-Governance, the interaction takes place virtually using Internet based technology, thus reducing time and cost involved. Even better, E-Governance enhances the citizens and business access to Government information and services and provides new ways to increase citizen participation in the democratic process.

Advantages of e-Filing

- **Business** shall be enabled to register a company and file statutory documents quickly and easily.
- **Public** to get easy access to relevant records and get their grievances re-dressed effectively.
- **Professionals** to be able to offer efficient services to their client companies.
- **Financial institutions** to find registration and verification of charges easy.
- **Government** to ensure proactive and effective compliance of relevant laws and corporate governance.
- **MCA employees** shall be enabled to deliver best of services.



Launch of MCA-21 Programme

Ministry of Company (now, 'Corporate') Affairs (MCA) has launched a major E-Governance initiative (MCA-21). It envisages e-filing of all documents relating to company matters on the MCA portal. MCA 21 Project is a project of the Ministry of Company Affairs carried out under the National e-governance Programme of the Government - an online portal www.mca.gov.in to enable e-filing under the Companies Act, 1956.

MCA is moving from the traditional paper-based operation to a near paperless environment. Consequently, the conventional forms prescribed for various transactions have been adapted for use through electronic medium. The processes and forms of MCA have been simplified and standardized for electronic filing (e-Filing) through e-Forms.

Salient Features of the MCA-21 include :

- Corporations, professionals and the public at large will no longer need to visit the Registrar of Companies offices and would be able to interact with the Ministry using the MCA-21 portal from their offices or home or by going to the facilitation centres, which have been set-up.
- The users will have multiple options to make payments in the online mode either through credit cards or the Internet banking facility. Besides this, the traditional payment through demand draft would be accepted against a system-generated challan at more than 200 bank branches across the country.
- The programme also introduces the concept of Director Identification Number (DIN), which is a unique and lifetime identification number being issued to all current and prospective directors. It is mandatory for all directors who wish to interact with the Ministry in future to acquire a DIN. By a General Circular dated 4-3-2011 [No. 5/2011 (F. No. 2011-CL V)] the M.C.A. has simplified the process of application and issuance of DIN. Now application will only be made on-line accompanied by scanned and self-verified documents, certified by a recognised professional.
- The system would also enable the stakeholder to track the service request through a Service Request Number (SRN).

MCA has *vide* Notification No. GSR 56(E) dated 10th February, 2006, issued the Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2006 and notified new e-forms. The statutory filing of forms and returns in the offices of ROCs is now on the basis of new E-forms only from 15-9-2006; all manual filing of documents has been discontinued.

Permanent documents of existing companies like, Memorandum of Association, Articles of Association, current charge documents, etc. are presently maintained in paper form across various Registrar of Companies (RoC) offices. Almost all of these documents have been converted into electronic format. The scope of E-filing covers only the offices of RoCs, Regional Directors and the Headquarters at New Delhi and it does not include Official Liquidators, Company Law Board/Tribunal and Courts.

The present scope of the MCA 21 includes services provided by the Secretariat at New Delhi, the four Regional Directorates (RDs) and the 20 offices of the Registrar of Companies (RoC) located all over the country. The E-filing facility includes :

- Registration and incorporation of new companies
- Filing of Annual Returns and Balance Sheets
- Filing of forms for change of names/address/Director's details
- Registration and verification of charges
- Inspection of documents
- Applications for various statutory services from MCA
- Investor grievance redressal.

In the process of E-filing system the ROC office will become the Back Office of the Ministry. There are likely to be a number of companies/entities who may find it difficult to switch over to E-filing at the initial stage. Facilitation Centres known as Physical Front Offices (PFOs) have been set up at 53 locations throughout the country to provide requisite comfort for e-filing to such companies.

Most of the e-Forms require the digital signature of the Managing Director or Director, Manager or Secretary of the company for successful filing/submission. Further, the digital signature of a third party may also be required in certain cases. In the case of an e-Form for creation or modification of charges, such digital signature is also required from the Bank or Financial Institution. In certain cases, a certificate from the Chartered Accountant or Cost Accountant or Company Secretary in whole-time practice is also required to authenticate the particulars contained in the e-Form. The MCA has also issued guidelines for the Bank and Financial Institutions on 4th March, 2006 for filing process.

For the purpose of standardization and better understanding, the proposed e-Forms have been grouped under the following broad categories :

- (a) New Company Registration
- (b) Compliance Related Filing- Whether annually or event based include Annual Return, Balance Sheet and Profit & Loss Account, Return of allotment, Return of buy back of securities, Return of deposits, Return of appointment of managing director, whole-time director, Notice of appointment of auditor, Statutory report, Cost audit report, etc.
- (c) Change services - It covers matters in respect of any change in the capital structure, changes in the registered office or the persons appointed as directors, secretaries and authorized representatives.
- (d) Charge Management - For registration of charge created or modified and satisfaction of charge, to be filed with the ROC. It also includes filing of e-Forms for appointment and cessation of receiver and filing of accounts by receiver. Various Forms have been deleted which includes Form 13, relating to charges.
- (e) Investor Services- E-filing system accepts complaints filed against a company by an investor as part of investor services. There is a specific e-Form for this purpose.
- (f) Application for ROCs approval – ROC is having powers to give direction in relation to the matters pertaining to the change of name of an existing company and the conversion of a public company to private company. In addition, ROC approval is required in case of extension of time period for holding AGM, holding AGM at place other than registered address, declaring a company as defunct, extension of the period of annual accounts, amalgamation of companies, Forms relating to winding up, etc. The MCA has also prescribed several new E-Forms, for which there were no prescribed Forms available.
- (g) Information Services – It covers those forms which are to be filed with ROC for informational purposes, in compliance with the provisions of the Companies Act, viz., declaration of solvency in case company decides to buy back its shares. Form 23 for filing of resolutions and agreements, Form 23AA regarding place where books of account are kept, Form 35A in case company decides to transfer its shares to another company, Form 21 regarding order received from Court or Company Law Board, etc.

In the e-filing system search facilities are available for viewing public documents, getting certified copies, finding the Corporate Identity Number (CIN), checking company name, finding name availability. The categories of public documents includes incorporation documents, charge documents, annual returns and balance sheets, change in directors and other documents.

Certification of company documents by practising professionals has not been continued by MCA-21 in its e-Forms filing but the same has also been extended to several other forms comprising of e-Forms 2, 3, 5, 8, 10, 17, 18, 23, 24AB, 32, etc. This pre-certification can be carried out either by Company Secretaries in whole-time practice, Chartered Accountants or Cost Accountants in practice.



Five Step e-Filing Process

If you have a PC of reasonable configuration, a printer/scanner, an Internet connection and the Digital Signature Certificate, you can carry out e-Filing all by yourself through the five steps described below:

Step 1: Register Yourself

- Only registered users will be allowed to do e-Filing.
- Registration is a simple one-time process, where guidance will be available on MCA-21 portal to create your personalized login ID - this is to ensure security and also serves as a channel for providing you personalized information as the functionality evolves.
- If you possess a Digital Signature Certificate (DSC) and if you intend to sign the e-Forms as an authorised signatory, you will need to also register your DSC. You will need to Register your DSC every time you procure a new DSC or renew/revalidate your DSC.

Step 2 : Download e-Form

- **Step 2: Download e-Form** e-Forms are freely downloadable and are in the 'PDF' format. You will need Adobe Reader v7.0.5 which is downloadable through link available on MCA-21 portal.
- There are new set of e-Forms available on MCA-21 portal and you may need to familiarize yourself with the new set of e-Forms. Once these new e-Forms are notified, the old forms will not be accepted thereafter.
- Instruction kits for each e-Form would also be available alongside the e-Forms.

Step 3: Complete e-Form

- e-Forms are essentially PDF documents, specifically tailored by MCA to meet e-filing needs as required by the Companies Act, 1956. You may choose to fill-in an e-Form offline at your convenience without staying connected to internet.
- These e-Forms can be filled-in and signed digitally. for informational purposes, in compliance with the **provisions** of the *Compa-Application for ROCs approval* - ROC is having powers to give direction in
- As a part of the simplification of form filing, certain fields can be filled-up automatically by the System (to the extent such data is available in the database of MCA) by selecting the "pre-fill" option that is available in the form.
- You will also be able to do "automated pre-scrutiny" a step that will ensure that your e-Form is complete in all respects and is good for e-filing.
- You may also attach supporting documents, where applicable, but please make sure that these are also in PDF format - support for conversion of popular formats such as Microsoft Office into PDF will be made available in the MCA-21 portal.
- Make sure that you keep the size of your attachments minimal, wherever possible.
- Sign the e-Form using the Digital Signature Certificate.
- If more than one signatory is involved, you can send the e-Form either on suitable media or as an e-mail attachment (or transfer a file over the network) to other individuals who can also sign digitally.
- Multiple signatures can be applied on a given e-Form, but just make sure that contents of the e-Form are not altered after it has been signed, in which case the document will become invalid and will be rejected during the e-filing process.
- After all individuals have digitally signed the form, it is ready for submission.

Step 4: Submit e-Form

- You will need to connect to the Internet if you want to carry out e-Filing.
- Submission will need to be made at the MCA-21 portal using specialized functionality that is provided.
- Sending the e-Form by email DOES NOT constitute e-Filing and should be avoided.
- Submission of e-Form will generally take a couple of minutes and will depend on the size of e-Form/attachments and the speed/quality of your Internet connection - better the connection, faster the process.
- If the e-Form is defective as may be identified by the MCA-21 system during submission, it will be rejected and returned to the user with clear details of the nature of the defect - such defect could be a result of incorrect data that may have been entered in the e-Form or due to missing or invalid digital signatures.
- If your e-Form is correct in all respects, you can proceed to the next step.
- It is advisable to save a copy of the document before submission (using submit button) as a part of your records.

Step 5: Make Payment

- Fee calculation is done automatically by the system as applicable under law and the fee for the service is displayed to the user.
- MCA-21 system supports following methods of payment:
 - (i) Credit Card
 - (ii) Internet Banking
 - (iii) challan (i.e. at the Bank counter)
- A total of two hundred branches of five banks have been authorised to collect MCA payment. These bank branches will be fully computerized (over a period of time) and have the facility to send data in e-form to MCA to acknowledge the payment that is made by you.
- The list of Banks is given below:
 - (i) State Bank of India
 - (ii) Punjab National Bank
 - (iii) Indian Bank
 - (iv) ICICI Bank
 - (v) HDFC Bank
- In the case of Credit Card and Internet banking method, the computer of the authorised bank will take over at this stage to carry forward the transaction to completion. It is to be noted that the charges/commissions towards this facility, as may be levied by the bank, will be charged in addition to MCA payments by the concerned bank and will need to be borne by you. System will generate a receipt that you can retain as a part of your records.
- In the case of challan payment, a fully completed challan will be generated by the system that can be printed by you and taken to any of the nearest authorised branch. You may choose to pay either through cash (limits as stipulated by Law will be applicable) or through a local cheque or DD. The acknowledged copy of the challan will serve as your receipt.
- Once you have made the payment in the Bank following the challan payment system, the filing is



complete. Based on confirmation of payment by the bank to the MCA-21 system, the document will be transmitted to the Back Office for further processing.

- In case you are approaching the last day of time-bound filing (e.g. in the case of ARs and BSs), you have to ensure that you complete the payment process on or before the last day failing which you will have to pay the delayed filing fees. Suitable arrangements have been made to generate the challans accordingly. Local cheques will need to be remitted well in advance so that the same is cleared before the challan expiry date.
- In case you do not make payment within the period stipulated in the challan i.e., five days from the date of submission (subject to the caveat of last date of time-bound filing), your request submitted earlier will automatically expire. If you are desirous of filing a document that has expired, start the process from Step 4 (or Step 3 if any changes to the e-Form are required).

Assistance at the Facilitation Centre

If you do not have access to necessary computing infrastructure or you are not familiar with the process of e-Filing, you may seek the services of a Facilitation Centre i.e., **PFO** located conveniently near you. At the **PFO**, the following can be accomplished:

- You will have kiosk facility where you can download and fill in the e-Form (you may alternatively choose to do this on your home PC or at a cyber cafe).
- Assistance will be provided to help you digitally sign the e-Forms and submit the same. For this, remember to bring your Digital Signature Certificate along with you.
- Scanning facility for attachments is also provided.
- A challan copy generated by the system will be provided to you, which you may take to any authorised bank branch located conveniently and make necessary payment.
- The facilitation centre will assist you in completing your transaction as explained under Step 5 above.

Completion of e-Filing

e-Filing will be completed once the necessary payment is remitted either through electronic payment means or through the challan based method. Banks will authorize the transactions after which the documents filed by you will be electronically forwarded to the concerned RoC Office (also referred to as Back Office) for further processing within two working days. You will also be provided a facility at MCA-21 portal to check if the e-Filing has been completed successfully. The challan number that is printed on the challan or the computer generated receipt will be helpful for future reference of your service request.

Getting Ready for e-Filing

Change is not easy and MCA has taken all steps to make this as simple as possible. There are, however, a few simple steps that need to be followed in order to get ready for e-Filing. These are:

- **Register yourself as a Director :** All directors, be it those of existing companies or first time directors, will need to register themselves online for obtaining the Director Identification Number (DIN). Details for obtaining a DIN will be made available as soon as the MCA-21 portal is made operational. Two months' time will be provided for this purpose from the date of commencement of this facility, within which directors of existing companies will need to complete this process. In case you have difficulty doing it by yourself, please visit any of the facilitation centres where assistance will be available. Make sure you carry one photograph of yours, a photo identity card and address proof when you visit the facilitation centre to complete this process. After obtaining the DIN, intimate the same to all companies in which you are a Director.
- **Acquire a Digital Signature Certificate (DSC) :** A director or authorised representative of a company (including branches of foreign companies) engaged in signing documents and professionals who

wish to attest documents that will be e-Filed, will need to obtain a DSC from any of the authorised agencies by the Government. A list of authorised agencies are published in the website of Controller of Certifying authorities, www.cca.gov.in. MCA will shortly notify the requirements related to the type of DSC that will need to be procured. Typically, these certificates are provided on a variety of media, the most popular being the USB token or a smart card. These DSCs are generally valid for a period of one year and will need to be renewed thereafter each year. There is a cost associated with the first time procurement and subsequent renewal of these DSCs that will need to be borne by you. It will be essential to submit only digital signed electronic documents as part of e-Filing as per the requirements of the Information Technology Act, 2000. It is sufficient that you procure one DSC irrespective of the role you play i.e., director or professional in practice, as long as there is no conflict of interest (i.e., professionals will not be able to attest documents of the companies if they serve as directors in the same company).

- **Register your DSC :** Once you have procured your DSC, you will also need to register your DSC with the MCA-21 portal using your personalized login. In case you have to renew your DSC, you will need to register these as well. Thereafter, you can also use your DSC to login to the MCA-21 system directly.
- **Familiarize Basics :** Familiarize yourself with the new e-Forms and find out the facilitation centre (PFO) and Bank branch that is conveniently located nearest to you.

Detailed Information

Detailed information is available on the MCA-21 portal. One can access all the key e-Forms on this site.

Details of New Forms

Ministry of Company Affairs has notified the e-Forms as of 10th February, 2006 and made operational from 28th February, 2006.

The prescribed forms may be filed through electronic media or through any other computer readable media as referred under section 610A of the Companies Act, 1956. The electronic form shall be authenticated by authorised signatories using digital signatures, as defined under the Information Technology Act, 2000. The Forms, when filed in physical form, may be authenticated by authorised signatory for affixing his signature manually.

Amendment to the Companies Act with respect to e-Filing

New sections inserted by Companies (Amendment) Act, 2006 relating to e-filing of forms, are as below:

After section 610A of the Principal Act, the following sections are inserted:

"Section 610B - Provisions relating to filing of applications, documents inspection etc., through electronic form- (1) Notwithstanding anything contained in this Act, and without prejudice to the provisions contained in section 6 of the Information Technology Act, 2000, the Central Government may, by notification in the Official Gazette, make rules so as to require from such date as may be specified in the rules, that:

- (a) such applications, balance-sheet, prospectus, return, declaration, memorandum of association, articles of association, particulars of charge, or any other particulars or document as may be required to be filed or delivered under this Act or rules made thereunder, shall be filed, through the electronic form and authenticated in such manner as may be specified in the rules;
- (b) such document, notice, any communication or intimation, required to be served or delivered under this Act, shall be served or delivered under this Act through the electronic form and authenticated in such manner as may be specified in the rules;
- (c) such applications, balance-sheet, prospectus, return, register, memorandum of association, articles of association, particulars of charge, or any other particulars or document and return filed under this Act



or rules made thereunder shall be maintained by the Registrar in the electronic form and registered or authenticated, as the case maybe, in such manner as may be specified in the rules;

- (d) such inspection of the memorandum of association, articles of association, register, index, balance-sheet, return or any other document maintained in the electronic form, which is otherwise available for such inspection under this Act or rules made thereunder, may be made by any person through the electronic form as may be specified in the rules;
 - (e) such fees, charges or other sums payable under this Act or rules made thereunder shall be paid through the electronic form and in such manner as may be specified in the rules;
 - (f) the Registrar shall, register change of registered office, alteration of memorandum of association or articles of association, prospectus, issue certificate of incorporation or certificate of commencement of business, register such document, issue such certificate, record notice, receive such communication, as may be required to be registered or issued or re-corded or received, as the case may be, under this Act or rules made thereunder or perform duties or discharge functions or exercise powers under this Act or rules made thereunder or do any act which is by this Act directed to be performed or discharged or exercised or done by the Registrar, by the electronic form, in such manner as may be specified in the rules.
- (2) The Central Government may, by notification in the Official Gazette, frame a scheme to carry out the provisions specified under sub-section (1) through the electronic form :

Provided that the Central Government may appoint different dates in respect of different Registrars of Companies or Regional Directors from which such Scheme shall come into force."

"Section 610C - Power to modify Act in relation to electronic records (including the manner and form in which electronic records shall be filed). - (1) The Central Government may, by notification in the Official Gazette, direct that any of the provisions of this Act, so far as it is required for the purpose of electronic record specified under section 610B in the electronic form:

- (a) shall not apply, in relation to the matters specified under clauses (a) to (f) of sub-section (1) of section 610B, as may be specified in the notification; or
- (b) shall apply, in relation to the matters specified under clauses (a) to (f) of sub-section (1) of section 610B only with such consequential exceptions, modifications or adoptions as may be specified in the notification.

Provided that no such notification which relates to imposition of fines or other pecuniary penalties or demand or payment of fees or contravention of any of the provisions of this Act or offence shall be issued under this sub-section.

(2) A copy of every notification proposed to be issued under sub-section (1), shall be laid in draft before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in disapproving the issue of the notification or both Houses agree in making any modification in the notification, the notification shall not be issued or, as the case may be, shall be issued only in such modified form as may be agreed upon by both the Houses.'

Section 610D - Providing of services through electronic form

The Central Government may provide such value added services through the electronic form and levy such fees as may be prescribed.

Section 610E - Application of provision of Information Technology Act, 2000

All the provisions of the Information Technology Act, 2000 relating to the electronic records (including the manner and format in which the electronic records shall be filed), insofar as they are not inconsistent with this Act, shall apply, or in relation, to the records in electronic form under section 610B.

Note: A circular has been issued by the Department of Corporate Affairs, Government of India, to the effect that 'Role Check' procedure will be on to accept any e-filing in MCA 21 Portal. Role Check means checking that the document being filed bears signature(s) of persons who are authorized to file and their digital signature certificates are already registered with the portal. The copy of the circular is given hereunder:

Register Digital Signature Certificate

Role check for Indian companies is to be implemented in the MCA application. Role check can be performed only after the authorized signatories have registered their Digital Signature Certificates (DSC) with MCA.

Once the role check is implemented, system shall verify whether the signature on the e-form filed, is of an authorized signatory of the company.

Notice for Practising members of ICSI and ICWAI

- “ Practising members of ICSI may encounter problems in registering their DSC because the numeric part of the membership number is common for Fellow and Associate members. The system is being updated to cater to these cases and the issue would be resolved soon.
- “ Practising members of ICWAI will not be able to register their DSC as the database of members has not been received from ICWAI.

Step by step process for DSC registration by Director, Manager/Secretary and by Practising Professional

Step by step process for Director

Step by step process to be followed for DSC registration of Director's DSC is as under :

1. Click on the 'Register DSC' link available on the MCA portal homepage.
2. On the next screen, click on the 'Director' link on the left hand panel and fill-up your DIN. Please ensure that the DIN is approved and typed correctly.
3. System shall verify that the DIN is valid and approved. If the DIN is filed incorrectly or DIN filled is not approved, system will throw an error message to that effect.
4. Fill-up rest of the particulars and ensure that details filled are as per DIN-1. If the applicant has filed DIN-4, then fill the details as submitted in DIN-4 form.
5. Click on the 'Next' button. The system would verify the details.
6. If the details filed do not match with DIN-1 /DIN-4, as the case may be, for the reason that you do not have your DIN application details, you can retrieve DIN-1 form from 'Get DIN application' link on the MCA portal or in the case of DIN-4, you can get the details from the company in which you are a director.
7. If the details are correct, the system would prompt you to select the DSC.
8. Click on the 'Select Certificate' button to browse and select the certificate. Please ensure that the selected DSC belongs to the applicant, whose particulars are being registered.
9. System shall validate the DSC. If the selected DSC is already registered against given DIN, system will give an informatory message. If a different DSC is already registered against the given DIN, system will ask if the user wants to update his/her DSC.
10. Type the displayed system generated text for verification in the box provided.
11. Click on 'I agree' button to agree to the declaration that details furnished are correct.
12. Click on the 'Submit' button to register your DSC.
13. Acknowledgement message is displayed to the user.



14. User can take a print-out of the acknowledgement.
15. The applicant can click on the 'Reset' function to clear the data in the fields.

Step by step process for Manager/Secretary

Step by step process to be followed for DSC registration of Manager's/Secretary's DSC is as under.

1. Click on the 'Register DSC' link available on the MCA portal homepage.
2. On the next screen, click on the 'Manager/Secretary' link on the left hand panel and fill-up the particulars. Please ensure that the Income-tax PAN and other details are as per the information filed in DIN-3 Form.
3. Click on the 'Next' button. The system would verify the details.
4. If PAN details do not exist in the system due to non-filing of DIN-3 Form or details filed do not match with details submitted in DIN-3 Form, system will throw an error message to that effect.
5. If the details do not match with DIN-3 filing for the reason that you do not have the details filed in DIN-3 Form, you can get the details from the company in which you are Manager/Secretary.
6. If the details are correct, the system would prompt you to select the DSC.
7. Click on the 'Select Certificate' button to browse and select the certificate. Please ensure that the selected DSC belongs to the applicant, whose particulars are being registered.
8. System shall validate the DSC. If the selected DSC is already registered against given PAN, system will give an informatory message. If a different DSC is already registered against the given PAN, system will ask if the user wants to update his/her DSC.
9. Type the displayed system generated text for verification in the box provided.
10. Click on 'I agree' button to agree to the declaration that details furnished are correct.
11. Click on the 'Submit' button to register your DSC.
12. Acknowledgement message is displayed to the user.
13. User can take a print-out of the acknowledgement.
14. The applicant can click on the 'Reset' function to clear the data in the fields.

Step by step process for Practising Professional

Steps to be followed for registration of Practising Professional's DSC is as under :

1. Click on the 'Register DSC' link available on the MCA portal homepage.
2. On the next screen, click on the 'Practising Professional' link on the left hand panel and fill-up the particulars. Please ensure that the details filed are as per the records of your professional institute.
3. Click on the 'Next' button. The system would verify the details from the records provided by the concerned professional institute.
4. If the membership or enrolment number is wrong or details filled do not match with the records provided by the professional institute, system will throw an error message to that effect. If you do not have the details recorded by your Institute, you can get the details from your Institute.
5. If the details are correct, the system would prompt you to select the income-tax PAN.
6. The applicant is asked to verify and confirm the PAN. On confirmation, the system would prompt to select the DCS.

7. Click on the 'Select Certificate' button to browse and select the certificate. Please ensure that the selected DSC belongs to the applicant, whose particulars are being registered.
8. Type the displayed system generated text for verification in the box provided.
9. Click on 'I agree' button to agree to the declaration that details furnished are correct.
10. Click on the 'Submit' button to register your DSC.
11. Acknowledgement message is displayed to the user.
12. User can take a print-out of the acknowledgement.
13. The applicant can click on the 'Reset' function to clear the data in the fields.

Study Note - 2

LAWS AND PROCEDURES FOR CORPORATE RESTRUCTURING



This Study Note includes

- 2.1 Mergers**
- 2.2 Reconstruction vs. Amalgamation**
- 2.3 Sale of undertaking of the Company [Sec. 39-394]**
- 2.4 Acquiring Shares in another Company [Sec. 395]**
- 2.5 Compulsory Amalgamation in public interest [Sec. 396]**

2.1 AMALGAMATION/MERGER

"Amalgamation"/"Merger"- Meaning

The term "amalgamation" is not defined in the Companies Act, 1956. The term is defined under the Income-tax Act, 1961 ("IT Act"). The Companies Act makes a reference to "amalgamation" in section 394 while dealing with the powers of the National Company Law Tribunal ("Tribunal") [prior to amendment by the Companies (Amendment) Act, 2002 the "Court"]. In addition there is reference to "amalgamation" in sections 396 and 396A dealing with the power of the Central Government to amalgamate companies in public interest and the maintenance of records by the amalgamated company.

In the absence of a definition of the term amalgamation in the Companies Act one will have to look to the meaning the term in the dictionary meaning. "Amalgamation" is to compound, to consolidate or to combine (business interest of firms). The Halsbury's Laws of England, Vol. VU(2) para 1461 page 1103, it is said

"Neither 'reconstruction' nor 'amalgamation' has a precise legal meaning. Amalgamation is a blending of two or more existing undertakings into one undertaking, the shareholders of each blending company becoming substantially the shareholders in the company which is to carry on the blended undertakings. There may be amalgamation either by the transfer of two or more undertakings to a new company, or by the transfer of one or more undertakings to an existing company. Strictly, 'amalgamation' does not, it seems, cover the mere acquisition by a company of the share capital of other companies which remain in existence and continue their undertakings, but the context in which the term is used may show that is intended to include such an acquisition."

"A "merger" may be defined as an arrangement whereby the assets of two (a merger may involve more than two companies) companies become vested in, or under the control of, one company (which may or may not be one of the original two companies), which has as its shareholders all, or substantially all, the shareholders of one or both of the merging companies exchanging their shares (either voluntarily or as the result of legal operation) for shares in the other or a third company."

The definition of the term "amalgamation" as contained in section 2(1B) of the IT Act is as follows:

"2(1B) "amalgamation", in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the

company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that—

- (i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;
- (ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;
- (iii) shareholders holding not less than three-fourths in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation,

otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first-mentioned company".

The definition contained in IT Act cannot, it is submitted, be adopted in interpreting the term "amalgamation" under the corporate law, though, by and large, the definition will have the same meaning. The requirements of the IT Act are different than that of the corporate law. The definition in IT Act specifically mentions that amalgamation is a 'merger'.

From the above we may understand by "amalgamation" - one company blending with another company - both being existing companies carrying on business, while by "merger" means two or more companies blend to form a third company and thus 'merge' with each other. In the case of 'amalgamation' only the amalgamating company or companies cease to exist after the blending and the company into which it or they blended (amalgamated) continue to have the same legal existence, while in the case of 'merger' all the merging companies would cease to exist after the blending and only the new company which is formed specifically for the purpose would have legal existence. This is a very minor difference between the two terms. However, in this book the terms 'amalgamation' and 'merger' are used interchangeably to refer to the blending of one or more companies under a scheme for arrangement sanctioned by the Court, until the operational establishment of the National Company Law Tribunal constituted under sub-section (1) of Section 10FB of the Companies Act, 1956 (the "Tribunal").

Objectives of corporate amalgamations

Corporate restructuring through acquisitions and consequent amalgamation or merger is resorted to achieve *inter alia* the economies of scale - economies of scale in production and marketing. With the spread of shareholding population and the need to tap resources for growth the companies have also to consider increase in shareholders' value by increasing profits and by reducing the costs. Broadly the following are the reasons for companies to seek to grow non-organically:

1. To achieve economies of scale;
2. To reduce the gestation period for new businesses which would be complementary to the existing business of the company;
3. To compete globally;
4. To put to use the liquidity available with the company for achieving growth through diversification;
5. To acquire and maximise the available managerial skill to increase the profitability; and
6. To take advantage of concession given by tax laws.



We deal below with some of the objectives:

1. The combination of two or more companies and their resources - production facilities, marketing outlets, managerial skills, liquidity etc. - could be used to achieve economies of scale and thus improve the profitability and attain synergetic operating economies. It will result in reduction in advertising costs, administration costs and production costs.
2. To develop new businesses will need a gestation period and might amount to 'reinventing the wheel'. If, however, a company can acquire another company which has a profitable business running and merge with it, it is possible to avoid the initial teething trouble period of a new business and venture into new fields with relative ease.
3. With globalisation, unless a company is large in size and capital, it will be very difficult to compete with nations where the cost of production is lower due to economies of scale. In a free competitive world it is necessary to position oneself in such a manner to compete with the best and prove one is better than the best. For this growth shorter route is necessary. This could be achieved only by acquisition and merger of companies in the same line of business and create a niche world market for oneself.
4. Finance is a scarce commodity. Liquidity could be better put to use by acquiring competing and complementary businesses. Sometimes mergers take place by a cash strapped company with a cash rich company and thus take advantage of the cash available with the merged company.
5. It is possible that a company may have expertise and skilled managerial personnel having gained experience and for reasons beyond their control the company may not be able to; compete with another company. In such cases the other company would benefit by merging with the former company and take full advantage of the available managerial skill and thus save costs and improve its own profitability and at the same time the skilled persons are also gainfully employed.
6. Very often tax incentives are given for healthy companies to take over sick companies and thus contribute to the national growth and provide employment to larger section of the public. In this regard mention can be made of various benefits available under the IT Act, 1961, including the benefit "of accumulated loss of a sick company made available for set off against the profits of the merged healthy company.

The case of amalgamation of Mafatlal Fine Spinning and Manufacturing Co. Ltd with Mafatlal Industries Ltd is an illustration on the advantages of an amalgamation. The reasons for amalgamation in that case were:

- (1) The proposed amalgamation will pave the way for better, more efficient and economical control in the running of operations.
- (2) Economies in administrative and management costs will improve the combined profitability;
- (3) The amalgamated company will have the benefit of the combined reserves, manufacturing assets, manpower and cash flows of the two companies. The combined technological, managerial and financial resources are expected to enhance the capability of the amalgamated company to invest in larger and sophisticated projects to ensure rapid growth.
- (4) The amalgamated company will have a strong and large resource base. With a strong resource base, the risk bearing capacity of the amalgamated company will be substantial. Hitherto, with limited resources and capacity, either company had to forgo business opportunities which would otherwise have been profitable to the group. f
- (5) "Exports" have been identified as a "thrust"; area for' both the companies and response in time to customers' needs is considered to be critical in this area of operations. An amalgamated company will be strategically better placed to reduce the response time. Customers' confidence in dealing with such a mega company ensures timely delivery of large orders.

- (6) The amalgamated company will be able to source and absorb new technology and spend on research and development, market surveys, etc., more comprehensively.
- (7) More particularly in the textiles division, with five operating units at the company's disposal, the flexibility in operations will be very much pronounced. The managers will not be inhibited by capacity constraints and will have the freedom of choosing from various options.
- (8) Both the companies have been subject to the pressures of raw material price fluctuations and of adverse market conditions in their respective product mix. Hence, the amalgamation will neutralise the adverse effects of contrary business cycles. The operations of one unit will be complementary to the other and a stable profitability will be achieved.

Types of Amalgamation or mergers

Mergers could be classified into the following types:

- (a) Horizontal mergers;
- (b) Vertical mergers; and
- (c) Conglomerate merger.

Horizontal mergers

A merger is horizontal if it involves the merger of two or more companies which are producing or rendering essentially the same products or services, or products and/or services which compete directly with each other, (e.g. sugar and artificial sweeteners). Horizontal mergers result in eliminating duplication of facilities and operations and broadening the product line, reduction in finance for working capital, widening the market area, and reducing unhealthy competition. Care should be taken while attempting horizontal mergers to avoid impediment to competition and result in monopolistic organisation, as this would attract governmental restraints.

Vertical mergers

A merger is vertical merger where backward integration is possible. In case one or more companies are the suppliers of some of the basic inputs for the final product to be manufactured by a company, then the latter company merges with the former company or companies so that it is assured of supplies and is able to control the quality of production of the supplies and also effect economies and improve the profitability of the final product. A car manufacturer acquires and merges the suppliers of some of the essential parts and product of which parts could be more economically carried out by it. Here the object is to ensure source of supply or/and outlet for products or services and improve efficiency.

Conglomerate merger

A conglomerate merger is a merger where two or more companies carrying different businesses are acquired and merged to diversify the products marketed. The companies may not be related to each other horizontally. In a "pure conglomerate" there are no important common factors between the companies in production, marketing, research and development or technology. Conglomerate merger is quite often the result of desire

- (i) to obtain greater stability of earnings through spreading activities in different industries with different business cycles or to diversify out of static or dying industry;
- (ii) to employ spare resources, whether of capital or management;
- (iii) where there are some common factors, to obtain benefit of economies of scale, particularly to "staff functions (such as personnel, advertising, accounting and financial);
- (iv) defensive diversifications, designed to make the company too large to be likely, to be the object of a take-over, or perhaps to make it a less attractive object;



- (v) to provide an outlet for the ambitions of management, where anti-monopoly laws make further acquisitions (or perhaps even growth) in the company's own field impracticable.

Premerger activity

As stated earlier, unless there are existing companies which, are either under the same control or there exists a holding-subsiary relationship, normally an acquisition or takeover precedes merger. The acquisition could be a private limited company or a listed company or an overseas company. Some of the premerger activities - such as due diligence, memorandum of understanding - are not totally relevant in cases other than when acquisition precedes a merger. However issues like valuation of the companies and preparation of a scheme of amalgamation etc. would be applicable in all cases. With these preliminary observations, we now proceed to consider the premerger requisites:

Formulating business objectives

The first step to be taken by the management of a company which wishes to acquire another company is to assess its own strengths and evolve the strategy for growth. They should express their plan and the strategy to be adopted for growth by increasing the market share, geographical access, new products, synergies arising out of available technologies and financial synergies. Thereafter an action plan should be drawn for implementation of the objectives.

Identifying the target company

The next stage is identifying the target company or companies which would fit the growth plan envisaged. In this exercise the management should evaluate the ideal target company based, inter alia, on the following:

- (a) Will the target company fit into the growth strategy planned?
- (b) Will the acquisition and later merger result in the maximum number of synergies which would contribute to its growth?
- (c) What are the new regions or countries which the company could reach for its existing products through this acquisition?
- (d) Does the company have the resources to acquire and in case it has to raise resources then at what cost and whether such actions will jeopardise the existing business?
- (e) What are the areas of manufacturing or "sale of products which the company considers conflicting with its present business and what would be the cost of discontinuing such products or line of manufacturing?
- (f) What problems, if any, will be faced for integrating the acquired company into the existing organisation?
- (g) What is the time frame for acquisition and merger?

Due diligence

Once the management team zeroes in on the target company, it should carry out preliminary due diligence work - commercial due diligence from the following sources:

- (i) Published information sources
 - (a) News papers;
 - (b) Commercial databases if available;
 - (c) General trade directories;
 - (d) Buyers' guides;
 - (e) Market reports;

- (f) Trade magazines;
- (g) Company journals and brochures;
- (h) The internet.
- (ii) Market information sources
 - (a) Gathering intelligence through the market;
 - (b) If in competitive business gathering information from sources within the Target; ;
 - (c) Interview with market experts;
 - (d) From suppliers;
 - (e) From customers
- (iii) Internal source
 - (a) Employees who have worked previously with the Target;
 - (b) Sometimes through persons employed with the Target for the specific purpose of gathering information
 - (c) Expertise available within the organisation.

Valuation

Based on the above due diligence an estimate of the valuation of the company should be arrived at so that an offer could be made to the target company's promoters/holders of controlling interest in the said target company. If the valuations indicate that the objectives stated earlier could be achieved in a cost effective manner, the next move should be made. At this stage no need to arrive at swap ratio or the exchange ratio on merger of the companies, though this aspect should also be kept in mind.

Memorandum of Understanding

If the earlier actions satisfy the management that the company in question is the right option to be the target company, then approaches should be made to the promoters and or controlling shareholders to acquire their interest. In this regard if the target company's management also concurs for acquisition and later merger, then suitable Memorandum of Understanding should be signed, followed by a confidentiality agreement to carry out detailed due diligence on the following matters:

Financial due diligence

- (i) Audited financial accounts;
- (ii) Un audited information supplied by the seller or given in press publications;
- (iii) Information with stock exchanges;
- (iv) In the case of acquisition through agreement recent management accounts generated.

Legal due diligence

- (v) Memorandum and Articles of Association;
- (vi) Prospectus filed at the time raising funds from public;
- (vii) Information with the Stock Exchanges;
- (viii) Documents filed with Registrar of Companies including registration of charges;
- (ix) Documents with Registrar relating to immovable properties;
- (x) In the case of acquisition through agreement
 - 1) all agreements, guarantees and indemnities issued,



- 2) title deeds to property,
- 3) covenants,
- 4) insurance cover,
- 5) taxation records,
- 6) health and safety measures,
- 7) environmental law compliance,
- 8) compliance with other regulations,
- 9) pending litigation,
- 10) banking facilities and borrowing powers, lending agreements,
- 11) product liability,
- 12) any non-compliance with any regulations or agreements,
- 13) compliance with special industry legislations,
- 14) labour agreements, labour compensations and benefit schemes etc.

Powers of liquidator to sell whole or part of business or property of a company in liquidation

We may now consider the provisions of section 494 of Companies Act 1956, which could, in our view, appear to facilitate amalgamation through purchase under the powers vested with the liquidator appointed by the members by a resolution for voluntary winding up of a company. The section reads as follows:

Sec.494: Power of liquidator to accept shares, etc., as consideration for sale of property of company:-

(1) Where —

- (a) a company (in this section called “the transferor company”) is proposed to be, or is in course of being, wound up altogether voluntarily; and
- (b) the whole or any part of its business or property is proposed to be transferred or sold to another company, whether a company within the meaning of this Act or not (in this section called “the transferee company”);

the liquidator of the transferor company may, with the sanction of a special resolution of that company conferring on the liquidator either a general authority or an authority in respect of any particular arrangement,—

- (i) receive, by way of compensation or part compensation for the transfer or sale, shares, policies, or other like interests in the : transferee company, for distribution among the members of the transferor company; or
 - (ii) enter into any other arrangement whereby the members of the transferor company may, in lieu of receiving cash, shares, policies, or other like interests or in addition thereto, participate in the profits of, or receive any other benefit from, the transferee company.
- (2) Any sale or arrangement in pursuance of this section shall be binding on the members of the transferor company.
- (3) If any member of the transfer or company who did not vote in favour of the special resolution expresses his dissent therefrom in writing addressed to the liquidator, and left at the registered office of the company within seven days after the passing of the resolution, he may require the liquidator either—
- (a) to abstain from carrying the resolution into effect; or

- (b) to purchase his interest at a price to be determined by agreement or by arbitration in the manner provided by this section.
- (4) If the liquidator elects to purchase the member's interest, the ' purchase money shall be paid before the company is dissolved, and be raised by the liquidator in such manner as may be determined by special resolution.
- (5) A special resolution shall not be invalid for the purposes of this section by reason only that it is passed before or concurrently with a resolution for voluntary winding up or for appointment liquidators; but if an order is made within a year for winding up the company by or subject to the supervision of the Court, the special resolution shall not be valid unless it is sanctioned by the Court.
- (6) The provisions of the Arbitration Act, 1940 [X of 1940), other than those restricting the application of that Act in respect of the subject matter of the arbitration, shall apply to all arbitrations in pursuance of this section.

To summarise, the provisions of section 494 provides for exercise of the following powers by the liquidator:

- (a) power to transfer or sell the whole or part of the business or property of the company to another company;
- (b) power to receive by way of compensation for such transfer or sale shares, policies and other like interest of the transferee company for distribution among the members of the company; and
- (c) power to settle, by agreement or through arbitration, with dissentient members by purchasing, their shares at a price to be acceptable to such members.

The powers of the liquidator are as per the special resolution passed by the members. The liquidator could, as we had seen earlier, make an application, in terms of section 394, to the Court/Tribunal to seek the Court/Tribunal's approval for the transfer of the whole or part of the business or property.

There is no power with the liquidator to transfer liabilities similar to the powers of the Court/Tribunal under section 394, referred to earlier. Though the power to transfer liabilities could be achieved by the liquidator through holding a meeting of the creditors (which he is bound to do under section 495 if he cannot settle their dues). Further in terms of powers vested with the liquidator under section 546, the liquidator could reach a compromise or arrangement, but such action is subject to the control of the Court. In any case if the creditors do not agree to the manner of settlement of their dues either by way of transfer to the transferee company or otherwise, within one year of the passing of the resolution by the members they could approach the Court/Tribunal and once they approach the Court/Tribunal the special resolution will not be valid unless the Court approves it. In this sense, the power of the liquidator to transfer or sell the whole or part of the business or property is not absolute. Hence care has to be taken in exercise of such powers.

From the above it would be seen that the powers of the liquidator under a voluntary liquidation arise as per the terms of the special resolution passed by the members at a general meeting called by the members or by the liquidator as against the meeting to be called by the Court/Tribunal under section 391(1) of Companies Act 1956; and that these powers are not complete inasmuch as the special resolution could be invalidated by any dissenting persons approaching the Court/Tribunal. As against this the powers of the Court/Tribunal, rightly so, are very wide and covers all eventualities in case of amalgamation.

Powers of liquidator to arrive at a compromise or arrangement with the creditors Similar powers as given in section 494 could be exercised by the liquidator if he was appointed by the creditors. In this connection, refer to provisions of section 507 of Companies Act 1956. This section reads as follows:

Sec.507: Application of section 494 to a creditor's voluntary winding up

The provisions of section 494 shall apply in the case of a creditor's voluntary winding up as in the case



of a members' voluntary winding up, with the modification that the powers of the liquidator under that section shall not be exercised except with the sanction either of the Court or of the committee of inspection.

The powers of compromise or arrangement with creditors are as provided by section 546, which reads as follows:

Sec. 546: Liquidator to exercise certain powers subject to sanction —

(1) The liquidator may —

- (a) with the sanction of the Court, when the company is being wound up by or subject to the supervision of the Court; and
- (b) with the sanction of a special resolution of the company, in the case of a voluntary winding up,—
 - (i) pay any classes of creditors in full;
 - (ii) make any compromise or arrangement with creditors or persons claiming to be creditors, or having or alleging themselves to have any claim, present or future, certain or contingent, ascertained or sounding only in damages, against the company, or whereby the company may be rendered liable; or
 - (iii) compromise any call or liability to call, debt, and liability capable of resulting in a debt, and any claim, present or future, certain or contingent, ascertained or sounding only in damages, subsisting or alleged to subsist between the company and a contributor or alleged contributory or other debtor or person apprehending liability to the company, and all questions in any way relating to affecting the assets or liabilities or the winding up of the company, on such terms as may be agreed, and take any security for the discharge of any such call, debt, liability or claim, and give a complete discharge in respect thereof.
- (2) In the case of a voluntary winding up, the exercise by the liquidator of the powers conferred by sub-section {1} shall be subject to the control of the Court.
- (3) Any creditor or contributory may apply to the Court with respect to any exercise or proposed exercise of any such power.

Need to have prior approval of the Commissioner of Income-tax before effecting the transfer or sale

It should be noted that when amalgamation by way of purchase is attempted through voluntary liquidation as per section 494 or 507 of Companies Act 1956, there is requirement to comply with provisions of section 178 of IT Act, 1961. This section reads as follows:

Sec.178: Company in liquidation —

(1) Every person —

- (a) who is the liquidator of any company which is being wound up, whether under the orders of a court or otherwise; or
- (b) who has been appointed the receiver of any assets of a company,
(hereinafter referred to as the liquidator) shall within thirty days after he has become such liquidator, give notice of his appointment as such to the Assessing Officer who is entitled to assess the income of the company.
- (2) The Assessing Officer shall, after making such enquiries or calling for such information as he may deem fit, notify to the liquidator within three months from the date on which he receives notice of the appointment of the liquidator the amount which, in the opinion of the Assessing Officer, would be sufficient to provide for any tax which is then, or is likely thereafter to become, payable by the company.

(3) The liquidator —

- (a) shall not, without the leave of the Chief Commissioner or Commissioner, part with any of the assets of the company or the properties in his hands until he has been notified by the Assessing Officer under sub-section (2); and
- (b) on being so notified, shall set aside an amount equal to the amount notified and, until he so sets aside such amount, shall not part with any of the assets of the company or the properties in his hands:

Provided that nothing contained in this sub-section shall debar the liquidator from parting with such assets or properties for the purpose of the payment of the tax payable by the company or for making any payment to secured creditors whose debts are entitled under law to priority of payment over debts due to Government on the date of liquidation or for meeting such costs and expenses of the winding up of the company as are in the opinion of the Chief Commissioner or Commissioner reasonable.

- (4) If the liquidator fails to give the notice in accordance with subsection (1) or fails to set aside the amount as required by subsection (3) or parts with any of the assets of the company or the properties in his hands in contravention of the provisions of that sub-section, he shall be personally liable for the payment of the tax which the company would be liable to pay:

Provided that if the amount of any tax payable by the company is notified under sub-section (2), the personal liability of the liquidator under this sub-section shall be to the extent of such amount.

- (5) Where there are more liquidators than one, the obligations and liabilities attached to the liquidator under this section shall attach to all the liquidators jointly and severally.
- (6) The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other law for the time being in force.

Thus no part of the assets could be parted without getting approval of the Commissioner of Income-tax. Hence any agreement for transfer or sale of the whole or part of the business or property of the company in liquidation requires prior approval of the tax department.

Is amalgamation through voluntary winding up covered by definition of “amalgamation” under the Income-tax Act, 1961

The definition treats both amalgamation of one company with another or more than one company forming a new company as amalgamation so long as, by virtue of the amalgamation, all the ‘property’ and all the ‘liabilities’ of the transferor company/ies become the ‘property’ or ‘liability’ of the transferee company and at least 75% of the members of the transferor company/ies are also members of the transferee company. But the section seems to specifically exclude amalgamation through purchase of property as can be seen from the use of the following words:

“otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of distribution of such property to the other company after the winding up of the first mentioned company”.

It appears by the term ‘property’ in the above definition would cover the business and both tangible and intangible assets. If that interpretation is adopted then amalgamation through purchase may not be treated as amalgamation under the Income-tax Act, 1961, though it could be treated as amalgamation under the Companies Act, 1956. This is a grey area. In fact the Chokshi Committee had recommended that the definition under the Income-tax Act should cover all amalgamations under section 394 of the Companies Act 1956. This was not accepted. Further, whether or not the words “for distribution among the members of the transferor company” used in section 494 of Companies Act 1956 could disentitle the benefits of the tax concession to both companies amalgamating and amalgamated pursuant to section 494/507, unless such amalgamation is approved under section 394 of the Companies Act 1956, is highly debatable.



Merger of an Indian company with a foreign company, whether a holding company or not, is possible under section 494.

The Competition Act, 2002 (12 of 2003)

The preamble to the Competition Act states that it has been enacted “to provide, keeping in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in India, and for matters connected therewith or incidental thereto.”

Compared to this its predecessor, if it can be called so, the Monopolies and Restrictive Trade Practices Act, 1969 stated in its preamble

“An Act to provide that the operation of the economic system does not result in the concentration of economic power to the common detriment, for the control of monopolistic and restrictive trade practices and for matter connected therewith or incidental thereto.”

The US and EU laws require prior approval for mergers above certain thresholds, they also impose a timeliness requirement on the relevant authority, with delays being subject to limitation. There is no pre-notification requirement in the existing U.K. law.

We have seen one of the legitimate means by which a company can grow is by amalgamation or merging with other companies. This process is generally a part of the natural process of industrial evolution and restructuring as new entity and growth. If a merger of company has a potential for reducing competition it is a matter of public concern.

Keeping these in mind the Competition Act contains provisions relating to:

- (1) prohibition of agreements which impair competition;
- (2) prohibition of abuse of dominant position; and
- (3) regulation of combination.

Regulation of combinations is discussed hereunder as it relates to amalgamation and mergers of companies:

Regulation of combinations [Section 6]

- (1) No person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void.
- (2) Subject to the provisions contained in sub-section (1), any person or enterprise, who or which proposes to enter into a combination, [shall] give notice to the Commission, in the form as may be specified, and the fee which may be determined, by regulations, disclosing the details of the proposed combination, within [thirty days] of
 - (a) approval of the proposal relating to merger or amalgamation, referred to in clause (c) of section 5, by the board of directors of the enterprises concerned with such merger or amalgamation, as the case may be;
 - (b) execution of any agreement or other document for acquisition referred to in clause (a) of section 5 or acquiring of control referred to in clause (b) of that section.
- (2A) No combination shall come into effect until two hundred and ten days have passed from the day on which the notice has been given to the Commission under sub-section (2) or the Commission has passed orders under section 31, whichever is earlier.
- (3) The Commission shall, after receipt of notice under sub-section (2), deal with such notice in accordance with the provisions contained in sections 29, 30 and 31.

- (4) The provisions of this section shall not apply to share subscription or financing facility or any acquisition, by a public financial institution, foreign institutional investor, bank or venture capital fund, pursuant to any covenant of a loan agreement or investment agreement.
- (5) The public financial institution, foreign institutional investor, bank or venture capital fund, referred to in sub-section (4), shall, within seven days from the date of the acquisition, file, in the form as may be specified by regulations, with the Commission the details of the acquisition including the details of control, the circumstances for exercise of such control and the consequences of default arising out of such loan agreement or investment agreement, as the case may be.

Explanation.-For the purposes of this section, the expression

- (a) "foreign institutional investor" has the same meaning as assigned to it in clause (a) of the Explanation to section 115AD of the Income-tax Act, 1961;
- (b) "Venture capital fund" has the same meaning as assigned to it in clause (b) of the Explanation to clause (23 FB) of section 10 of the Income-tax Act, 1961.

Meaning of combination

For this purpose the meaning of combination is to be found in section 5 of the Competition Act. The relevant provisions of section 5 of the Competition Act read as follows:

Combination [Section 5]

The acquisition of one or more enterprises by one or more persons or merger or amalgamation of enterprises shall be a combination of such enterprises and persons or enterprises, if

- (a) any acquisition where
 - (i) the parties to the acquisition, being the acquirer and the enterprise, whose control, shares, voting rights or assets have been acquired or are being acquired jointly have,
 - (A) either, in India, the assets of the value of more than rupees one thousand crores or turnover more than rupees three thousand crores; or
 - (B) in India or outside India, in aggregate, the assets of the value of more than five hundred million US dollars, including at least rupees five hundred crores in India, or turnover more than fifteen hundred million US dollars, including at least rupees fifteen hundred crores in India; or
 - (ii) the group, to which the enterprise whose control, shares, assets or voting rights have been acquired or are being acquired, would belong after the acquisition, jointly have or would jointly have,
 - (A) either in India, the assets of the value of more than rupees four thousand crores or turnover more than rupees twelve thousand crores; or
 - (B) in India or outside India, in aggregate, the assets of the value of more than two billion US dollars, including at least rupees five hundred crores in India, or turnover more than six billion US dollars, including at least rupees fifteen hundred crores in India; or]
- (b) acquiring of control by a person over an enterprise when such person has already direct or indirect control over another enterprise engaged in production, distribution or trading of a similar or identical or substitutable goods or provision of a similar or identical or substitutable service, if
 - (i) the enterprise over which control has been acquired along with the enterprise over which the acquirer already has direct or indirect control jointly have,



- (A) either in India, the assets of the value of more than rupees one thousand crores or turnover more than rupees three thousand crores; or
- (B) in India or outside India, in aggregate, the assets of the value of more than five hundred million US dollars, including at least rupees five hundred crores in India, or turnover more than fifteen hundred million US dollars, including at least rupees fifteen hundred crores in India; or]
- (ii) the group, to which enterprise whose control has been acquired, or is being acquired, would belong after the acquisition, jointly have or would jointly have,
 - (A) either in India, the assets of the value of more than rupees four thousand crores or turnover more than rupees twelve thousand crores; or
 - (B) in India or outside India, in aggregate, the assets of the value of more than two billion US dollars, including at least rupees five hundred crores in India, or turnover more than six billion US dollars, including at least rupees fifteen hundred crores in India; or
- (c) any merger or amalgamation in which-
 - (i) the enterprise remaining after merger or the enterprise created as a result of the amalgamation, as the case may be, have,
 - (A) either in India, the assets of the value of more than rupees one thousand crores or turnover more than rupees three thousand crores; or
 - (B) in India or outside India, in aggregate, the assets of the value of more than five hundred million US dollars, including at least rupees five hundred crores in India, or turnover more than fifteen hundred million US dollars, including at least rupees fifteen hundred crores in India; or
 - (ii) the group, to which the enterprise remaining after the merger or the enterprise created as a result of the amalgamation, would belong after the merger or the amalgamation, as the case may be, have or would have,
 - (A) either in India, the assets of the value of more than rupees four thousand crores or turnover more than rupees twelve thousand crores; or
 - (B) in India or outside India, in aggregate, the assets of the value of more than two billion US dollars, including at least rupees five hundred crores in India, or turnover more than six billion US dollars, including at least rupees fifteen hundred crores in India;

Explanation. – For the purposes of this section,-

- (a) “control” includes controlling the affairs or management by –
 - (i) one or more enterprises, either jointly or singly, over another enterprise or group;
 - (ii) one or more groups, either jointly or singly, over another group or enterprise;
- (b) “group” means two or more enterprises which, directly or indirectly, are in a position to-
 - (i) exercise twenty-six per cent. or more of the voting rights in the other enterprise; or
 - (ii) appoint more than fifty per cent. of the members of the board of directors in the other enterprise; or
 - (iii) control the management or affairs of the other enterprise;
- (c) *the value of assets shall be determined by taking the book value of the assets as shown, in the audited books of account of the enterprise, in the financial year immediately preceding the financial year in which the date of proposed merger falls, as reduced by any depreciation, and the value of assets shall include the brand value, value of goodwill, or value of copyright,*

patent, permitted use, collective mark, registered proprietor, registered trade mark, registered user, homonymous geographical indication, geographical indications, design or layout design or similar other commercial rights, if any, referred to in sub-section (5) of section 3.

Meaning of 'enterprise'

- (h) "enterprise" means a person or a department of the Government, who or which is, or has been, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services, of any kind, or in investment, or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, either directly or through one or more of its units or divisions or subsidiaries, whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or at different places, but does not include any activity of the Government relatable to the sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space.

Explanation.- For the purposes of this clause, -

- (a) "activity" includes profession or occupation;
- (b) "article" includes a new article and "service" includes a new service; (c) "unit" or "division", in relation to an enterprise, includes
- (i) a plant or factory established for the production, storage, supply, distribution, acquisition or control of any article or goods;
- (ii) any branch or office established for the provision of any service;

Consequent to the above, if an amalgamation proposal comes within the purview of the prohibited combination viz. amalgamation resulting in a book asset value of the transferee company to be over ₹ 1,000 crores or the turnover of the transferee company after the amalgamation is likely to exceed ₹ 3,000 crores in case of the group to which the transferee company belongs would have an asset value of ₹ 4,000 crores or a turnover of ₹ 12,000 crores, the transferee company concerned must at its option send the proposal to the Competition Commission.

The Commission, if it is prima facie of the opinion that the combination has, or is likely to have, an appreciable adverse effect on competition, it shall, within seven working days from the date of receipt of the response of the parties to the combination, [or the receipt of the report from Director General called under sub section (1A), whichever is later] direct the parties to the said combination to publish details of the combination within ten working days of such direction, in such manner, as it thinks appropriate, for bringing the combination to the knowledge or information of the public and persons affected or likely to be affected by such combination. The Commission may invite any person or member of the public, affected or likely to be affected by the said combination, to file his written objections, if any, before the Commission within fifteen working days from the date on which the details of the combination were published under sub-section (2). The Commission may, within fifteen working days from the expiry of the period specified in sub-section (3), call for such additional or other information as it may deem fit from the parties to the said combination. The additional or other information called for by the Commission shall be furnished by the parties referred to in sub-section (4) within fifteen days from the expiry of the period specified in sub-section (4). After receipt of all information and within a period of fortyfive working days from the expiry of the period specified in sub-section (5), the Commission shall proceed to deal with the case in accordance with the provisions contained in section 31. If the Commission does not, on the expiry of a period of [two hundred and ten days from the date of notice given to the Commission under sub-section (2) of section 6], pass an order or issue direction in accordance with the provisions of sub-section (1) or sub-section (2) or sub-section (7), the combination shall be deemed to have been approved by the Commission.



Explanation.-For the purposes of determining the period of two hundred and ten] days specified in this sub-section, the period of thirty working days specified in sub-section (6) and a further period of thirty working days specified in sub-section (8) shall be excluded. Where any extension of time is sought by the parties to the combination, the period of ninety working days shall be reckoned after deducting the extended time granted at the request of the parties.

It is also provided that the Competition Commission could suggest modification of the scheme so as to enable competition and if the transferee company complies with such modification then it would give its approval.

Any combination violative of the Competition Act, cannot be given effect to. If any person does not abide by the directions of the Commission, penalties will be levied under the said Act. Hence care should be taken while considering amalgamation.

The Competition (Amendment) Act, 2007 made a few significant modifications. In the context of mergers and amalgamation, it has inserted the need to have certain amount of turnover in India in addition to the amount of turnover outside India as a prerequisite for application of the Competition Act. The more significant change is the insertion of sub-section (2A) to section 6 providing that all combinations will need prior approval of the Competition Commission to be effective in so far as India is concerned.

Chart showing the threshold for joint assets/turnover under Competition Act, 2002

		ASSETS		TURNOVER	
IN INDIA	NO. GROUP	₹ 1000 crores		₹ 3000 crores	
	GROUP	₹ 4000 crores		₹ 12000 crores	
		ASSETS		TURNOVER	
IN INDIA OUTSIDE INDIA		TOTAL	IN INDIA	TOTAL	IN INDIA
	NO GROUP	\$ 500 MIL-LION	₹ 500 Cr	\$ 1,500 ml	₹ 1,500 Cr
	GROUP	\$ 2,000 ml	₹ 500 Cr	\$ 6,000 ml	₹ 1,500 Cr

1 Crore = 10 million

Income-tax Act, 1961

One of the important aspects which is required to be considered in deciding about amalgamation of two companies is the effect of such amalgamation on the transferor company and the transferee company under the various provisions of the Income-tax Act. We have referred to various factors which may influence the decision for amalgamation and one of them is the concessions given or treatment meted out under the Income-tax Act, 1961.

Definition of Amalgamation

According to section 2(1B) of the Income-tax Act, 1961 (hereinafter referred to as the Act), amalgamation in relation to companies means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that

1. All the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of amalgamation

2. All the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of amalgamation
3. Shareholders holding not less than $\frac{3}{4}$ th in value of the shares in amalgamating company or companies (other than shares held therein immediately before the amalgamation or by a nominee for the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation, otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of distribution of such property to the other company after the winding up of first mentioned company.

With effect from April 1, 2000 (i.e., for the assessment year 2000-2001 and subsequent years) it is sufficient if shareholders holding three-fourths in value of the shares in the amalgamating company become shareholders of the amalgamated company. Prior to this not less than nine-tenths in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the „ amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation.

It should be noted that the requirement is not all the shareholders of the amalgamating company must be shareholders of the amalgamated company, but it is only $\frac{3}{4}$ th of the value of shares in the amalgamating company should have been shareholders of the amalgamated company. If 75% of the shares in amalgamating company is held by one person and he is one among 100 shareholders and thus form only 1% of the number of shareholders, yet it is possible to be covered under the definition of 'amalgamation' under IT Act.

It would appear that while the ITA 1961 talk of shareholders of amalgamating company having not less than $\frac{3}{4}$ th in value of shares should become shareholders of the amalgamated company for getting the benefit of tax laws, the Accounting Standard as per Section 211(3A) of the CA 1956 talk of 'not less than 90%'. All mergers where the requirement of 90% is not satisfied will be treated as 'merger by way of purchase'. Hence it is possible that there could be a merger where more than 75% but less than 90% of the shareholders of the transferor company become shareholders of the transferee company. Whether such a merger would be treated as merger for tax purposes is not clear, specially as such merger is treated as merger by way of purchase under the Accounting Standards.

Tax Concessions

If any amalgamation takes place within the meaning of section 2(1B) of the Act, the following tax concession shall be available

1. Tax concession to amalgamating company.
2. Tax concession to shareholders of the amalgamating company.
3. Tax concession to amalgamated company.

(1) Tax Concession to Amalgamating company: Capital Gains tax not attracted : According to section 47(vi) where there is a transfer of any capital asset in the scheme of amalgamation, by an amalgamating company to the amalgamated company, such transfer will not be regarded as a transfer for the purpose of capital gain provided the amalgamated company, to whom such assets have been transferred, is an Indian company

(2) Tax concessions to the shareholders of an amalgamating company section 47(vii):

Where as shareholder of an amalgamating company transfers his shares, in a scheme or amalgamation, such transaction will not be regarded as a transfer for capital gain purposes, if following conditions are satisfied:

- The transfer of shares is made in consideration of the allotment to him of any share or shares in the amalgamated company and



- The amalgamated company is an Indian company

Cost of acquisition such shares of the amalgamated company are later on transferred. The cost of acquisition of such shares of the amalgamated company shall be the cost of acquisition of the shares in the amalgamating company. Further, for computing the period of holding of such shares, the period for which such shares were held in the amalgamating company shall also be included.

(3) Tax concessions to the amalgamated company: The amalgamated company shall be eligible for tax concessions only if the following two conditions are satisfied:

- The amalgamation satisfies all the three conditions laid down in section 2(1B) and
- The amalgamated company is an Indian company

If the above conditions are satisfied, the amalgamated company shall be eligible for the following tax concessions:

(a) Expenditure on Scientific Research [Section 35(5)]: Where an amalgamating company transfers any asset represented by capital expenditure on scientific research to the amalgamated Indian company in a scheme of amalgamation, the provisions of section 35 which were applicable to the amalgamating company shall become applicable to the amalgamated company consequently.

- Unabsorbed capital expenditure on scientific research of the amalgamating company will be allowed to be carried forward and set off in the hands of the amalgamated company.
- If such asset ceases to be used in a previous year for scientific research related to the business of the amalgamated company and is sold by the amalgamated company without having been used for other purposes, the sales price, to the extent of the cost of the asset, shall be treated as business income of the amalgamated company. The excess of the sale price over the cost of the asset shall be subject to the provisions of the capital gains.

(b) Expenditure on acquisition of patent rights or copy rights [Section 35A(6)]: Where the patent or copyrights acquired by the amalgamating company is transferred to any amalgamated Indian company, the provisions of section 35A which were applicable to the amalgamating company shall become applicable in the same manner to the amalgamated company consequently.

- The expenditure on patents/copyrights not yet written off shall be allowed to the amalgamated company in the same number or balance instalments.
- Where such rights are later on sold by the amalgamated company, the treatment of the deficiency/surplus will be the same as would have been in the case of the amalgamating company.

However, if such expenditure is incurred by the amalgamating company after 31-3-1998, deduction under section 35A is not allowed, as such expenditure will be eligible for depreciation as an intangible asset. In this case, provisions of depreciation shall apply.

(c) Expenditure of know-how [Section 35AB(3)]: With effect from assessment year 2000-01, where there is a transfer of an undertaking under a scheme of amalgamation, the amalgamated company shall be entitled to claim deduction under section 35AB in respect of such undertaking to the same extent and in respect of the residual period as it would have been allowable to the amalgamating company, had amalgamation not taken place.

However, if such expenditure is incurred by the amalgamating company after 31-3-1998, deduction under section 35AB is not allowed, as such expenditure will be eligible for depreciation as an intangible asset. In this case, provisions of depreciation shall apply.

(d) Expenditure for obtaining licence to operate telecommunication services [Section 35ABB(6)]

Where in a scheme of amalgamation, the amalgamating company sells or otherwise transfers its licence to the amalgamated company (Being an Indian Company), the provisions of Sec.35ABB which were applicable to the amalgamating company shall become applicable in the same manner to the amalgamated company, consequently:

- The expenditure on acquisition on licence , not yet written off, shall be allowed to the amalgamated company in the same number of balance instalments.
- Where such licence is sold by the amalgamated company, the treatment of the deficiency/surplus will be same as would have been in the case of amalgamating company.

(e) Treatment of preliminary expenses [Section 35D(5)]: Where an amalgamating company merges in a scheme of amalgamation with the amalgamated company, the amount of preliminary expenses of the amalgamating company, which are not yet written off, shall be allowed as deduction to the amalgamated company in the same manner as would have been allowed to the amalgamating company.

(f) Amortisation of expenditure in case of amalgamation [Section 35DD]: Where an assessee, being an Indian company, incurs any expenditure, on or after the 1st day of April, 1999, wholly and exclusively for the purposes of amalgamation or demerger of an undertaking, the assessee shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the amalgamation or demerger takes place.

(g) Deduction for expenditure on prospecting, etc., for certain minerals [Section 35E]: Where an undertaking entitled to deduction on expenditure on prospecting is transferred in a scheme of amalgamation, no further deduction will be allowed to the amalgamating company, but the amalgamated company will enjoy the benefits as if the amalgamation had not taken place.

(h) Treatment of capital expenditure on family planning [Section 36(1)(ix)]: Where the asset representing the capital expenditure on family planning is transferred by the amalgamating company to the Indian amalgamated company, in a scheme of amalgamation, the provisions of section 36(a)(ix) to the amalgamating company shall become applicable in the same manner, the amalgamated company. Consequently

- Such transfer shall not be regarded as transfer by the amalgamating company
- The capital expenditure on family planning not yet written off shall be allowable to the amalgamated company in the same number of balance instalments
- Where such assets are sold by amalgamated company, the treatment of the deficiency/surplus will be same as would have been in the case of amalgamating company

(i) Treatment of bad debts [Section 36(1)(vii)]: Where due to amalgamation, the debts of amalgamating company have been taken over by the amalgamated company and subsequently such debt or part of the debt becomes bad, such bad debt will be allowed a deduction to the amalgamated company

(j) Special provision for deduction in case of business for prospecting, etc., for mineral oil [Section 42]: In the business of prospecting for mineral oil, the balance of expenditure disallowed in the hands of the amalgamating company will not be allowed to the amalgamated company, nor will the excess received on transfer subjected to tax.

(k) Deduction available under [Section 80-1A or 801B]: Where an undertaking which is entitled to deduction under section 801A/80-1B is transferred in the scheme of amalgamation before the expiry of the period of deduction under section 80-1A or 80-1B then



- No deduction under section 80-1A or 80-1B shall be available to the amalgamating company for the previous year in which amalgamation takes place and
- The provisions of section 80-1A or 80-1B shall apply to the amalgamated company in such manner in which they would have applied to the amalgamating company

(I) Carry forward and set off of business losses and unabsorbed depreciation of the amalgamating company: Under the new provisions of Section 72A of the Act, the amalgamated company is entitled to carry forward the unabsorbed depreciation and brought forward loss of the amalgamating company provided the following conditions are fulfilled

- The amalgamation should be of a company owning an industrial undertaking or ship
 - The amalgamated company holds at least 3/4th of the book value of fixed assets of the amalgamating company for a continuous period of 5 years from the date of amalgamation
 - The amalgamated company continues the business of the amalgamating company for period of 5 years from the date of amalgamation
- The amalgamated company fulfills such other conditions, as may be prescribed to ensure that revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purposes

It may be noted that in case of amalgamation, the amalgamated company gets a fresh lease of 8 years to carry forward and set off the brought forward loss and unabsorbed depreciation for the amalgamating company.

Amalgamation of Shipping Companies under Tonnage Tax scheme

The Finance Bill, 2004, has for the first time proposes to introduce certain special provisions relating to income of shipping companies. In this regard, the Bill proposes to insert a new Chapter XII-G, consisting of sections 115V to 115VZC. It is proposed that in case of a company having income from the business of operating qualifying ships, the company is given the option to either be subject to tax on computation of income under sections 28 to 43G or be subject to tax on a notional income as given in section 115VG based on the tonnage of ships operated during the financial year. For this purpose, the company should make an application under section 115VP and get its name approved to be covered under the tonnage tax scheme. Such option will be valid for a period of ten years. The company could opt out of the scheme by filing a declaration seeking to be assessed to tax in the normal way. Such company could again opt for the scheme within a year from the end of the year when the option ceases to have effect.

A qualifying company inter alia must be a company formed and registered under the Companies Act, 1956, with its main object the carrying on of business of operating qualifying ships, having its place of effective management in India, and owning at least one qualifying ship. Qualifying ship has been given a very wide meaning and apart from being required to be registered under the Merchant Shipping Act, 1958, it includes a sea going ship or vessel, fishing vessels, factory ships, pleasure crafts, harbour and river ferries, off-shore installations, and dredgers. Thus only an Indian registered company with Indian flag vessels alone could be covered under this special provision,

We are not concerned with the manner in which such companies would be liable to pay tax, but are concerned with the effect in case of amalgamation of one of opted companies or amalgamation with an opted company.

Section 115VY, as per the said Bill, reads as follows:

115VY Where there has been an amalgamation of a company with another company or companies, then, subject to the other provisions of this section, the provisions relating to the tonnage tax scheme shall, as far as may be, apply to the amalgamated company if it is a qualifying company;

Provided that where the amalgamated company is not a tonnage tax company, it shall exercise an

option for tonnage tax scheme under sub-section (1) of section 115VP within three months from the date of the approval of the scheme of amalgamation;

Provided further that where the amalgamating companies are tonnage tax companies, the provisions of this Chapter shall, as far as may be, apply to the amalgamated company for such period as the option for tonnage tax scheme which has the longest unexpired period continues to be in force;

Provided also that where one of the amalgamating companies is a qualifying company as on the 1st day of October, 2004 and which has not exercised the option for tonnage tax scheme within the initial period, the provisions of this Chapter shall not apply to the amalgamated company and the income of the amalgamated company from the business of operating qualifying ships shall be computed in accordance- with the other provisions of this Act.

Only if the amalgamating company is a qualifying company and has opted to the tonnage tax scheme, the benefit would be available to the amalgamated company,

Excise law implications on amalgamation of companies

Central Excise duty is an indirect tax levied on goods manufactured. The taxable event under the Central Excise law is manufacture and the liability of Central Excise duty arises as soon as the goods are manufactured. The duty is now called the 'Central Value Added Tax (CENVAT)'.

Generally every manufacturer is required to discharge his CENVAT liability in respect of clearances made during the month, by the 5th of the following month: The present system allows instant CENVAT Credit to be taken of duties paid on inputs and capital goods received in a factory for the manufacture of any dutiable final product. This credit can be utilised to pay Excise duty on any final product.

Rule 2(c) of the Central Excise Rules, 2002, defines "assessee" means any person who is liable for payment of duty assessed or a producer or manufacturer of excisable goods or a registered person of a private warehouse in which excisable goods are stored and includes an authorized agent of such person. Thus in case of a company which is carrying on an industrial undertaking the company is the assessee - or the tax payer who will be entitled to the credit of CENVAT.

Under Rule 9(1) it is provided that every person, who produces, manufactures, carries on trade, holds private store-room or warehouse or otherwise uses excisable goods, shall get registered:

Where any goods on which duty had been paid at the time of removal thereof are brought to any factory for being re-made, refined, re-conditioned or for any other reason, the assessee shall state the particulars of such receipt in his records and shall be entitled to take CENVAT credit of the duty paid as if such goods are received as inputs under the CENVAT Credit Rules, 2002 and utilise this credit according to the said rules,

Rule 3 CENVAT credit Rules 2002 provides that the manufacturer or producer of final products shall be allowed to take CENVAT credit of the duty paid on inputs lying in stock or in process or inputs contained in the final products lying in stock on the date on which any goods cease to be exempted goods or any goods become excisable. It also provides that the CENVAT credit may be utilized for payment of any duty of excise on any final products or for payment of duty on inputs or capital goods themselves if such inputs are removed as such or after being partially processed, or such capital goods are removed as such:

Provided that while paying duty, the CENVAT credit shall be utilized only to the extent such credit is available on the last day of the month for payment of duty relating to the month. This proviso was substituted with effect from 1st April, 2003 vide Notification No. 13/2003-C.E. (N.T.), dated 1st March, 2003. Prior to this the proviso read as follows:

Provided that while paying duty, the CENVAT credit shall be utilised only to the extent such credit is available on the fifteenth day of a month for payment of duty relating to the first fortnight of the month, and the last day of a month for payment of duty relating to the second fortnight of the month or in case of a manufacturer availing exemption by a notification based on value of clearances in a



financial year, for payment of duty relating to the entire month.

Rule 8(1): If a manufacturer of the final products shifts his factory to another site or the factory is transferred on account of change in ownership or on account of sale, merger, amalgamation, lease or transfer of the factory to a joint venture with the specific provision for transfer of liabilities of such factory, then, the manufacturer shall be allowed to transfer the CENVAT credit lying unutilized in his accounts to such transferred, sold, merged, leased or amalgamated factory.

(2) The transfer of the CENVAT credit under sub-rule (1) shall be allowed only if the stock of inputs as such or in process, or the capital goods is also transferred alongwith the factory to the new site or ownership and the inputs, or capital goods, on which credit has been availed of are duly accounted for to the satisfaction of the Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise, as the case may be.

In case of amalgamation the following issues to be attended to:

- (a) when transfer of excisable goods from transferor to transferee should be done in accordance with Rule 8 and it should be ensured that the stock inputs or in process goods or the capital goods are transferred along with the factory to the new owners;
- (b) the transferor company which ceases manufacture should apply and deregister itself;
- (c) the transferee company should take steps to get a new registration as a new owner of the same factory;
- (d) care should be taken not to lose sight of the time limit by which CENVAT credit can be claimed for final goods as per the revised rules which are effective from 1 March, 2003;
- (e) since all liabilities are being taken over the transferee company will be required to settle the dues of the transferor company as a successor to the business;
- (f) the transferee company cannot be responsible for any penalty for short payment as the penal liability is on the 'manufacturer' who failed to observe the Rules. This cannot be passed on to the transferee;
- (g) keep proper records of the duty payable and CENVAT credit available for the intervening period when the petition had already been filed but the Tribunal's final order had not been issued. As we stated earlier once the Tribunal's order becomes effective the date of transfer relates back to the date as per the scheme. Although during this period both the transferor and the transferee would have to keep paying the duty and claiming the credit, after the order becomes effective the duty would be clubbed and duty reworked.

Value Added Tax provisions

In all the States, Sales Tax has been replaced by Value Added Tax (VAT). Specific provision has been made to deal with interse transfer between amalgamating companies in Assam, Goa, Gujarat, Jammu & Kashmir, Jharkhand, Maharashtra, Manipur, Meghalaya, Mizoram, Nagaland, Orissa, Punjab, Rajasthan, Tripura and Uttaranchal. The provision in these States except in case of Maharashtra Rajasthan reads as follows:

- (a) When two or more companies are to be amalgamated by the order of a Court or of the Central Government and the order is to take effect from a date earlier to the date of order and any two or more such companies have sold or purchased any goods to or from each other in the period commencing on the date from which the order is to take effect and ending on the date of order, then such transactions of sale or purchase will be included in the turnover of sales or of purchases, as the case may be, of the respective companies and will be assessed to tax accordingly.
- (b) Notwithstanding anything contained in the said order, for the purposes of this Act, the said two or more companies shall be treated as distinct companies and shall also be treated as such for all

periods upto the date of the said order, and the registration certificate of the company, which merged, shall be cancelled with effect from the date of the said order.

Explanation. — Words and expressions used in this sub-section, but not defined, shall have the respective meanings as assigned to them in the Companies Act, (1 of 1956) 1956. In Maharashtra section 47 of the Maharashtra VAT Act, 2002 provides for demerger as well and this section reads as follows:

47. Amalgamation or demerger Of Companies

- (1) When two or more companies are to be amalgamated by the order of Court or of the Central Government passed after the appointed day and is to take effect from a date, earlier to the date of the order and any two or more of such companies have sold or purchased any goods to or from each other in the period commencing on the date from which the order is to take effect and ending on the date of the order, then such transactions of sale and purchase shall be included in the turnovers of sale or purchase of the respective companies and shall be assessed to tax accordingly.
- (2) Notwithstanding anything contained in the said order, for all of the purposes of this Act, the said two or more companies shall be treated as distinct companies for all the periods upto the date of the said order and the registration certificates of the said companies shall be cancelled, where necessary, with effect from the date of the said order.
- (2A) (a) When any company is to be demerged by the order of the Court or of the Central Government passed after the appointed day and is to take effect from a date earlier to the date of the order, then for all of the purposes of this Act, it shall be presumed that the two or more companies brought into existence by the operation of the said order have not sold or purchased any goods to each other from the date of effect of the order to the date of the order.
- (b) Notwithstanding anything contained in the said order, for the purposes of this Act, the said two or more companies shall be treated as a single company for all the periods upto the date of the said order and the registration certificate of the company to be demerged shall be cancelled with effect from the date of the said order and the said two or more companies shall, subject to rules, be granted registration certificates from the date of the said order.
- (3) Words and expressions used in this section but not defined shall have the respective meanings assigned to them in the Companies Act, (1 of 1956) 1956.

The Rajasthan VAT, section 46 states as follows:

46 Liability in case of amalgamation of companies

- (1) When two or more companies are to be amalgamated by the order of a court or of the Central Government and the order is to take effect from a date earlier to the date of the order and any two or more of such companies have sold or purchased any goods to or from each other in the period commencing on the date from which the order is to take effect and ending on the date of the order, then such transactions of sale and purchase shall be included in the turnover of sales or purchases of the respective companies and shall be assessed to tax accordingly.
- (2) Notwithstanding anything contained in the said order of amalgamation, for all of the purposes of this Act, the said two or more companies shall be treated as distinct companies for all periods up to the date of the said order and the registration certificates of the said companies shall be cancelled, where necessary, with effect from the date of said order.
- (3) Any tax or other sum found recoverable under this Act for the period prior to the operative date of amalgamation, from the company being amalgamated, shall be payable by the company formed after amalgamation.
- (4) Words and expressions used in this section, but not defined shall have the respective meaning assigned to them in the Companies Act, 1956, (Central Act No. 1 of 1956).



From the above it would appear that while sub-section one talks of a case where the order of amalgamation were to take effect from a date earlier to the date of the order, in sub-section 2 provides that the amalgamating companies would be treated as distinct companies upto the date of the order. However, it is provided that the cancellation of the registration will be done from the effective date of the amalgamation. The Rajasthan legislation provides for the tax to be paid by the 'company formed after amalgamation'. It is not clear what will be the position in case of merger with an existing company. Though the wordings may appear to need some clarification, it is clear that provisions have been made to ensure that the VAT in respect of transactions between the amalgamating companies would be treated as the liability of the respective companies.

There does not appear to be any specific provision relating to liability to VAT in respect of sale of valuable goods to parties other than the interse transactions between amalgamating companies. Such cases will be covered by the general provisions as applicable to transfer of business.

In case of transfer of business, when the ownership of the business of a dealer liable to pay tax is entirely transferred, the transferor and the transferee, shall jointly and severally be liable to pay any tax, interest and penalty, if any payable in respect of such business and remaining unpaid at the time of the transfer and the transferee shall also be liable to pay tax on sales or purchases made by the transferee on and from the date of such transfer and shall forthwith apply for the grant of a registration certificate unless such certificate is already possessed by him. Further it is provided that where a dealer liable to pay tax transfers the ownership of a part of his business the transferor shall be liable to pay tax in respect of the stock of goods transferred with that part of the business.

It would be seen that section 33C which was inserted by the Maharashtra Tax Laws Levy and Amendment) Act, 2002, published on 4th May, 2002, in the Bombay Sales & x Act, 1959 with retrospective effect from July 1, 1981 This section covered cases of amalgamation of two companies, and provided that the transferor and the transferee companies would be treated as separate entities from the appointed date under the scheme up to the date of approval of the scheme of amalgamation by the court and to tax the transactions between the two during the said period as sale transactions. This section reads as follows:

33C. (1) When two or more companies are to be amalgamated by the order of a court or of the Central Government and the order is to take effect from a date anterior to the date of said order and any two or more of such companies have sold or purchased any goods to or from each other during the period commencing on the date from which the order is to take effect and ending on the date of the order, then notwithstanding anything contained in the said amalgamation order, such transactions of sale and purchase shall be included in the turnover of sales or, as the case may be, purchases of the respective companies and 'shall be assessed to tax accordingly, and for the purposes of this Act, the said two or more companies shall be treated as distinct companies and shall be treated as such for the entire period up to the date of the said order, and the registration certificates of the said companies shall be cancelled, or amended, where necessary, with effect from the date of the said amalgamation order.

(2) Words and expressions used in this section, but not defined, shall have the respective meanings assigned to them in the Companies Act, 1956."

The wordings are similar to the provisions of section 47 of the Maharashtra VAT Act referred to earlier. The Bombay High Court in National Organic Chemical Industries Ltd. and another v. State of Maharashtra and Others [2004] 135 STC 50 considered the provisions and its retrospective effect on companies amalgamating and observed that

Once the court has declared that the corporate personality of a company shall come to an end from a particular date, then that status can be altered only by the court. The said status cannot be altered by the State even in exercise of its legislative powers as it would amount to directly interfering with the order passed by the court.

Moreover, there cannot be different dates of amalgamation for different authorities. It cannot be said

that for the purposes of Companies Act a company loses its corporate personality from a particular date and for the purposes of the BST Act the said company loses its corporate personality from another date. Once the court declares that a company stands destroyed from a particular date then the corporate personality of that company is destroyed completely from that date. Prospectively for the purposes of sales tax, it may be open to the State Legislature to artificially preserve the separate identity of the companies up to the date or which the court approves the scheme of amalgamation.

In our opinion, section 33C in fact creates a new liability by treating the transferee-company and the transferor-company carrying on business as agent or trustee of the transferee-company as two separate entities from the appointed date till the date of approval of the scheme by the court. But for this new impost sales tax could not be levied in respect of the transactions between the transferee-company and the transferor-company carrying on business as agent of the transferee-company. In the light of several decisions of the apex Court set out hereinabove where the transferor and the transferee form one entity, it cannot be said that there were sale transactions between two entities. Even if the State is competent to create such a legal fiction, it cannot be created retrospectively. Under these circumstances, we have no hesitation in holding that section 33C imposes new levy, a new principle and, therefore, the same cannot be said to be clarificatory or explanatory in nature.

In *Castrol India Ltd. v. State of Tamil Nadu* [1999] 114 STC 468, the Madras High Court considered the question of levy of sales tax in case of amalgamation. In that case the assessee-dealer in Madras, having corporate office in Bombay, claimed that the buying company Indtech Speciality Chemicals Limited (ISCL) in Bangalore ceased to exist from 1st January, 1992 which date was the "transfer date" consequent upon the orders of the High Court of Judicature at Bombay and High Court of Karnataka on the scheme of amalgamation of ISCL with it and that any transfer of goods, subsequent to that date should be taken as branch transfer and not as sales. The Court held –

"that when the courts specify a date as the transfer date, the amalgamation would take effect from that date and when the court has not specified any other date and merely sanctioned the scheme presented to it, the date of amalgamation/date of transfer would be the date specified in the scheme as the "transfer date". Following the decision of the Supreme Court in *Marshall Sons and Co, (India) Ltd. v. Income-tax Officer* [1997] 223 ITR 809, it must be held that the amalgamation took effect from January 1, 1992 and from that date, the transferor-company, ISCL, continued only for the benefit of the transferee-company. When it has no separate entity, the transfer by the assessee-dealer in favour of ISCL cannot be regarded as the sale which would attract the provisions of the Central Sales Tax Act. The view of the Appellate Tribunal that it would attract the provisions of the Central Sales Tax Act is not in conformity with the decision of the Supreme Court, and the order of the Appellate Tribunal is set aside."

Considering the above it can be said under the provisions contained in the VAT Acts of the different States, in all cases of amalgamation until the effective date of the order of the Court/Tribunal, the inter-se transactions would be liable to VAT in the respective companies' hands.

Stamp Act provisions

A. CHARGEABILITY TO STAMP DUTY

Section 3 of the Indian Stamp Act creates a charge for levy of stamp duty on execution of an instrument. Similar charge is created by the Stamp Acts of different States.

The expression "conveyance" has been defined in section 2, sub-section (10) of the Indian Stamp Act as follows:

"(10) Conveyance. — 'Conveyance' includes a conveyance on sale and every instrument by which property, whether movable or immovable, is transferred inter vivos and which is not otherwise specifically provided for by Schedule 1 ; or by Schedule IA, as the case may be."

With a view to putting matters beyond doubt the Draft Bill seeking to amend the Indian Stamp Act, the meaning of 'conveyance' is proposed to be as follows:



(10) "Conveyance" includes-

- (i) a conveyance on sale;
- (ii) every decree or final order of any civil court or revenue authority;
- (iii) every order made by the High Court/Tribunal under Section 394 of the Companies Act, 1956 in respect of the amalgamation or reconstruction of companies; and ever]' order made by the Reserve Bank of India under section 44 A of the Banking Regulation Act, 1949 in respect of amalgamation or reconstruction of Banking Companies;
- (iv) any other instrument, by which property, whether movable or immovable, or any estate or interest in any property is transferred to, or vested in any other person, inter vivos and which is not specifically provided for by Schedule-1;

Explanation:- An instrument, whereby a co-owner of any property transfers his interest to another co-owner of the 4 property and which is not an instrument of partition, is for the purposes of this clause, an instrument by which the property is transferred.

The General Clauses Act does not define "instrument". Therefore, the instrument must be taken to have been used in the sense in which it is generally understood in legal parlance. The term 'instrument' is defined as "a writing, and generally imports a document of a formal legal kind" [Stroud's Judicial Dictionary of Words and Phrases (third edition, volume 2, page 1472)]. However, the Indian Stamp Act has defined the term in section 2(14) as follows:

"(14) Instrument. — 'Instrument' includes every document by which any right or liability is, or purports to be, created, transferred, limited, extended, extinguished or recorded."

In the draft bill to amend the Indian Stamp Act, it is proposed to include 'electronic record' as well; the proposed definition is as under:

(14) "Instrument" includes every document and every "electronic record" as defined under clause (t) of Section 2 of the Information Technology Act, 2000 (21 of 2000) by which any right or liability is or purports to be created, transferred, limited, extended, extinguished or recorded; and any other document mentioned in the Schedule-1.

Thus an 'instrument' is a writing by which any right or liability is, or purported to be, created, transferred, limited, extended, extinguished or recorded.

B. DATE ON WHICH THE STAMP DUTY IS CHARGEABLE

We have already seen that the date on which property is transferred is the date as mentioned in the Scheme of Amalgamation and not the date of the order of the Tribunal. [Marshall Sons and Co. (India) Ltd. v. Income-tax Officer [1997] 223 ITR 809 (SC)]. Hence for stamp duty purposes the market price should be taken as of the appointed day - effective date of amalgamation.

However, in the case of shares allotted for the first time (not the shares given in exchange) the stamp duty will be as on the date of such allotment.

C. WHERE PAYABLE

It is possible that the transferee company may be in one State, while the transferor company would be registered in another State. Similarly, immovable property of the transferor company could be situated in different States. A question arises as to in which State the stamp duty is payable. We have seen that an order of the Tribunal would be treated as 'instrument' on which stamp duty is payable. It is the transferor who transfers the property and the transferee is the recipient of the property. Stamp duty would be payable in the State where the order is passed in the case of the transferor. The conveyance could be executed in the State where the transferee is registered. Hence there is a possibility of stamp duty being levied in two States; Still there are set-off provisions under the Stamp Acts of different States or the Indian Stamp Act to avoid such double taxation; still there could be problems in the valuation

for stamp duty purposes in that when the duty is paid on the order of the Tribunal it would be based on the value of the shares exchanged. But in case of immovable property each State would have a different method to evaluate the value of the property. Since the instrument is the same set off should be available.

D. Rate of duty

The rate of duty is different in different States. Except in the case of Maharashtra, [Gujrat, Karnataka and Kerala where there exists separate Stamp Acts, the Indian Stamp Act would apply, subject to modifications made by each State.

SEBI AND LISTING AGREEMENT REQUIREMENTS

A. Disclosure under the DIP Guidelines

There are certain requirements of disclosures under the SEBI (Disclosure and Investors Protection) Guidelines (DIP). Consequent to the coming into force of ICDR Regulations, the DIP Guidelines have been rescinded and hence no longer valid. However, we have reproduced some of the requirements under the DIP Guidelines for benefit of the readers:

1. An unlisted company may make an application to the Board for relaxation from applicability of clause (b) to sub-rule (2) of Rule 19 of the Securities Contracts (Regulation) Rules, 1957 for listing of its shares without making an initial public offer if it satisfies the following conditions:

- (i) Shares have been allotted by the unlisted company (transferee company) to the holders of securities of a listed company (transferor company) pursuant to a scheme of reconstruction or amalgamation under the provision of the Companies Act, 1956 and such scheme has been sanctioned by the High Court/s of the Judicature.
- (ii) The listing of the shares of the unlisted transferee company is in terms of scheme of arrangement sanctioned by the High Court/s of the Judicature.
- (iii) Atleast 25% of the paid-up share capital, post scheme, of the unlisted transferee company seeking listing comprises shares allotted to the public holders of shares in the listed transferor company.
- (iv) The unlisted company has not issued/re-issued any shares, not covered under the scheme.
- (v) There are no outstanding warrants/instruments/agreements which gives right to any person to take the shares in the unlisted transferee company at any future date. If there are such instruments in the scheme sanctioned by the Court, the percentage referred to in point (iii) above, shall be computed after giving effect to the consequent increase of capital on account of compulsory conversions outstanding as well as on the assumption that the options outstanding, if any, to subscribe for additional capital will be exercised.
- (vi) The share certificates have been despatched to the allottees pursuant to the scheme of arrangement or their names have been entered as beneficial owner in the records of the depositories.
- (vii) That the shares of the transferee company issued in lieu of the locked-in shares of the transferor company are subjected to the lock-in for the remaining period.
- (viii) In addition to the requirements of Clause (vii) above, the following conditions are also to be complied with:
 - (a) in case of a hiving off of a division of a listed company (say 'A') and its merger with a newly formed company or existing company (say 'B') there would not be any additional lock-in, if the paid-up share capital of company 'B' is only to the extent of requirement for incorporation purposes.
 - (b) in case of merger where the paid-up share capital of the company seeking listing (company 'B') is more than the requirement for incorporation; the promoters' shares shall be locked-in



to the extent 20% of the post-merger paid-up capital of the unlisted company, for a period of 3 years from the date of listing of the shares of the unlisted company. The balance of the entire pre-merger capital of the unlisted company shall also be locked-in for a period of 3 years from the date of listing of the shares of the unlisted company.

2. An application to the Board under Clause 1 shall be made through the designated stock exchange of the listed company and the designated stock exchange may recommend the application giving the reason therefore.
3. The unlisted company shall take steps for listing, simultaneously on all stock exchanges where the shares of the (transferor) listed company are/ were listed, within 30 days of the date of the final order of the High Court/s approving the scheme. The formalities for commencing of trading shall be completed within 45 days of the date of final order of the High Court/s.
4. Before commencement of trading, the company shall give an advertisement in one English and one Hindi newspaper with nationwide circulation and one regional newspaper with wide circulation at the place where the registered office of the company is situated, giving details as specified in Schedule XXVIII.

Non-Applicability of the guidelines

Clauses 13.1 (Pricing of the issue) to 13.5 shall not be applicable in the following cases:

- (i) where the further shares are allotted in pursuance to the merger and amalgamation scheme approved by the High Court.

Securities Ineligible for Computation of Promoters' Contribution

1. Where the promoters of any company making an issue of securities have acquired equity during the preceding three years, before filing the offer documents with the Board, such equity shall not be considered for computation of promoters contribution if it is;
 - (i) acquired for consideration other than cash and revaluation of assets or capitalisation of intangible assets is involved in such transaction(s); or
 - (ii) resulting from a bonus issue, out of revaluation reserves or reserves without accrual of cash resources;

2. In case of public issue by unlisted companies, securities which have been issued to the promoters during the preceding one year, at a price lower than the price at which equity is being offered to public shall not be eligible for computation of promoters' contribution.

Provided that the shares for which the difference between the offer price and the issue price for these shares is brought in by the promoters shall be considered eligible subject to issuer company complying with the applicable provisions of the Companies Act, 1956 (such as passing of revised resolution by shareholders or issuer's Board, filing of revised return of allotment with ROC, etc.

3. In respect of companies formed by conversion of partnership firms, where the partners of the erstwhile partnership firm and the promoters of the converted company are the same and there is no change in management, the shares allotted to the promoters during previous one year out of the funds brought in during that period shall not be considered eligible for computation of promoters' contribution unless such shares have been issued at the same price at which the public offer is made,

Provided that if the partners' capital existed in the firm for a period of more than one year on a continuous basis, the shares allotted to promoters against such capital shall be considered eligible.

4. In respect of Clauses 1, 2 and 3, such ineligible shares acquired in pursuance to a scheme of merger or amalgamation approved by a High Court shall be eligible for computation of promoters' contribution.

B. Merger of corporate broking firms and Consolidation of memberships by corporate brokers

By its Circular No. SMD/Policy (Brk.Reg.)/Cir-18/98 July 9, 1998, SEBI had given certain requirements in regard to merger of corporate broking firms. The gist of the Circular is given below:

- (1) When two or more corporate broking firms merge leading to creation of a new entity, the SEBI registration granted to the extinguishing entity does not automatically devolve upon the emerging entity and the new entity has to fulfill the eligibility criteria and apply afresh for registration and pay the registration fees.
- (2) It is generally seen that while the application comes to SEBI after the court has approved the scheme of amalgamation/merger, the existing entity is required to seek prior approval from SEBI in case of any change in its constitution, in terms of Rule 4(c) of SEBI (Stock Brokers and Sub-brokers) Rules and Regulations, 1992. Therefore, you are advised that as soon as the application for merger is filed before the High Court, the extinguishing broking entity should approach SEBI through the Stock Exchange for obtaining prior permission, to the scheme of merger/amalgamation giving all necessary details of the proposal.
- (3) It is also seen that some of the Stock Exchanges would be inclined to disconnect the trading terminal of the extinguishing entity, on the approval of the scheme of the merger by the High Court until SEBI grants registration to the new emerging entity. As this may cause hardship to the business interests of the emerging entity, it is suggested that the emerging entity may be allowed to trade on the registration of the extinguishing entity for a period of, say 45 days. However, the emerging entity should apply to SEBI at the earliest and give an undertaking to be liable for the act of the extinguishing entity and such applications in any case should be made not later than 30 days of the registration granted by the Registrar of Companies to the emerging entity. In view of the above, you may consider amending the Bye-laws/ trading rules suitably.

SEBI also considered the question of merger of one or more corporate broking firms under the same management viz, one corporate broking firm having membership of different stock exchanges through other corporate entities under the same management. Same management would mean where majority of directors of one company are also majority directors in the other company and the majority shareholding/controlling stake of both the companies is with the same group.

Where merger of such corporate entities takes place for consolidation of multiple membership SEBI has by its Circular No. SMD/DBA-II/POLICY/CIR-1/99 dated January 12, 1999 given the following clarification:

- (i) If the transferee/applicant is a SEBI registered corporate broker and acquiring a membership in another Exchange, from a corporate under the same management which is also registered with SEBI as a corporate broker, then as both the entities were registered with SEBI, the transferee company will not apply to SEBI for a fresh registration. Instead the transferee and as well as the transferor will apply to SEBI under Rule 4 (c) of the SEBI (Stock Brokers and Sub-brokers) Rules and Regulations, 1992 for approval of change in status.

For e.g. ABC & Co., which is a member of X Exchange acquires the membership from XYZ & Co., which is a member of Y Exchange. ABC & Co. and XYZ & Co., will then apply to SEBI for change in status under Rule 4 (c) of SEBI (Stock Brokers and Sub-brokers) Rules, 1992 only if XYZ & Co., is a corporate broker under the same management.

The application should be forwarded to SEBI with the registration certificate of the transferor member/corporate and this registration would be cancelled.. SEBI will be issuing a New Registration Number to the applicant/ transferee on the Exchange on which it is acquiring the membership, which would also reflect that it is a multiple member henceforth.

- (ii) The transferee/applicant company will have to satisfy all the financial and other norms under the SEBI Act, 1992 and SEBI (Stock Brokers and Sub-brokers) Rules and Regulations, 1992.



- (iii) The transferee/applicant company will be required to give an undertaking that it would honour all the rights/liabilities including any SEBI action to be taken against the transferor company as well as liabilities, in respect of fees under SEBI (Stock Brokers and Sub-brokers) Regulations, 1992, etc..
- (iv) If consolidation is made in a manner where a new entity comes into existence, it would be treated as case of application by a new entity and SEBI requirements in respect of registration, payment of registration fee etc., will be required to be complied with.

In view of the above, in case of corporate broking firms seeking approval of the Tribunal for amalgamation/merger with another corporate broking firm, care should be taken to seek prior permission of SEBI. It would appear that in case of merger of a non-broking corporate with a corporate broking firm no such requirement would apply.

C. SEBI directions in regard to Amalgamation and mergers

SEBI had issued a Press Release 311-2003 dated 17 December 2003, giving summary of their proposals for disclosures to shareholders under section 393. The Press Release stated that the disclosure requirements would be implemented through the Listing Agreement. As of date to our knowledge, no such requirement has been made as part of the Listing Agreement. However, as the information supposed to be disclosed in the Explanatory Statement calling for meeting of shareholders to approve merger proposals, and is very relevant we give below the said requirements:

1. The terms "company/companies" mean the companies which are parties to the terms of arrangement of merger/demerger/amalgamation specified under Sections 391 to 394 of the Companies Act, 1956.
2. The term "resultant company" shall mean the company which comes into existence as a result of the scheme of arrangement for merger/demerger/ amalgamation.
3. The term "issuing company" shall mean the listed company which is seeking approval of shareholders for the scheme of arrangement for merger/ demerger/amalgamation.

Details about the companies:

1. Names & registered office of the companies.
2. The extent to/manner in which the companies are related to each other.
3. Capital structure of the companies.
4. Shareholding pattern clearly indicating the shares held by the promoters and by persons other than promoters.
5. Line of business.
6. Dates of agreement, if any, with the other companies which are parties to the scheme of arrangement.
7. Names and Profile of the promoters and directors - viz. age, educational qualifications, experience, personal addresses etc of the companies.
8. Names of subsidiary/group companies and companies with which the promoters of the resultant company are associated.
9. Indicate whether there would be a change in control in the resultant company vis-a-vis the issuing company,
10. Capital Structure and Shareholding pattern, before (of issuing company) and after (of resultant company) the proposed scheme of arrangement, and the management's views on the change in the public holding on how it would affect the shareholders at large.
11. Audited Financial statements of the companies for the last 3 years including the latest audited

financial statement (not more than 6 months old) and material development after balance-sheet date (as per the format given in clause 49 of Listing agreement).

Details about the scheme:

1. Basis of valuation,
2. Nature of consideration if any, payable/receivable under the scheme,
3. Mode of payment/receipt,
4. Manner of surrender/receipt of shares or securities,
5. The time schedule within which the shares/securities are to be surrendered/received and payments to be made/received,
6. Tentative date by which the scheme would become effective under the provisions of the Companies Act,
7. Details of approvals obtained/to be obtained/sought from creditors, authorities like stock exchanges/authorities under Companies Act etc.
8. Dates of Board Meeting when the proposal was considered/approved,
9. Any other details which deemed necessary for information to shareholders enabling them to make an informed decision about the proposed scheme, including those required under Section 393 of the Companies Act, 1956.

D. Listing Agreement requirements

Listing agreement of the Mumbai Stock Exchange requires a listed company to comply with the following:

1. The company agrees that it shall file any scheme/petition proposed to be filed before any Court or Tribunal under sections 391, 394 and 101 of the Companies Act, 1956, with the stock exchange, for approval, at least a month before it is presented to the Court or Tribunal [Clause 24(f)].
2. The company agrees to ensure that any scheme of arrangement/ amalgamation/merger/reconstruction/reduction of capital, etc., to be presented to any Court or Tribunal does not in any way violate, override or circumscribe the provisions of securities laws or the stock exchange requirements.

Explanation : For the purpose of this sub-clause, 'securities laws' mean the SEBI Act, 1992, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and the provisions of the Companies Act, 1956 which are administered by SEBI under section 55A thereof, the rules, regulations, guidelines etc. made under these Acts and the Listing Agreement. [Clause 24(g)].

3. The company agrees that in the explanatory statement forwarded by it to the shareholders u/s 393 or accompanying a proposed resolution to be passed u/s 100 of the Companies Act, it shall disclose the pre and post-arrangement or amalgamation (expected) capital structure and shareholding pattern. [Clause 24(h)]
4. The Company will promptly notify the Exchange of any action which will result in the redemption, cancellation or retirement in whole or in part of any securities listed on the Exchange [Clause 27(a)].
5. The Company will not make any change in the form or nature of any of its securities that are listed on the Exchange or in the rights or privileges of the holders thereof without giving twenty-one days' prior notice to the Exchange of the proposed change and making an application for listing of the securities as changed if the Exchange shall so require. [Clause 28]
6. File with the Stock Exchange three copies of all the notices, call letters or any other circulars including



notices of meetings convened u/s 391 or section 394 read with section 391 of the Companies Act, 1956 together with Annexures thereto, at the same time as they are sent to the shareholders, debenture holders or creditors or any class of them or advertised in the Press [Clause 31(c)].

7. File with the Stock Exchange three copies of all notices, circulars, etc., issued or advertised in the press either by the Company, or by any company which the Company proposes to absorb or with which the Company proposes to merge or amalgamate, or under orders of the court or any other statutory authority in connection with any merger, amalgamation, re-construction, reduction of capital, scheme or arrangement, including notices, circulars, etc. issued or advertised in the press in regard to meetings of shareholders or debenture holders or creditors or any class of them and copies of the proceedings at all such meetings. [Clause 31(e)]

The relevant clauses of the Bombay Stock Exchange of Listing Agreement are given below:

Clause 24

- (g) The company agrees to ensure that any scheme of arrangement/ amalgamation/merger/ reconstruction/reduction of capital, etc., to be presented to any Court or Tribunal does not in any way violate, override or circumscribe the provisions of securities laws or the stock exchange requirements.

Explanation: For the purpose of this sub-clause, 'securities laws' mean the SEBI Act, 1992, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and the provisions of the Companies Act, 1956 which are administered by SEBI under section 55A thereof, the rules, regulations, guidelines etc. made under these Acts and the Listing Agreement.

- (h) The company agrees that in the Explanatory statement forwarded by it to the shareholders u/s. 393 or accompanying a proposed resolution to be passed u/s. 100 of the Companies Act, it shall disclose the pre and post-arrangement or amalgamation (expected) capital structure and shareholding pattern and the "fairness opinion" obtained from an Independent merchant bankers on valuation of assets/shares done by the valuer for the company and unlisted company.

In the case of Chemidye Mfg.Co (Pvt) Ltd, In re. [2006] 69 SCL 10 (Bom.) the Court held that there is nothing either in the Listing Agreement or in the SCR Act which indicates that non-compliance of the terms and conditions of the Listing Agreement would bar a company from making an application under sections 391 and 394 for merger or would entail an automatic dismissal of such a petition. The consequence of non-compliance with any of the provisions of the Listing Agreement would entail action by the relevant exchange under the provision of the Listing Agreement and SCR Act, 1956. For instance, the BSE may initiate action against a defaulting member including by delisting the member. Such non-compliance does not ipso facto entail consequences under the Companies Act. It observed that the "non-compliance with the provisions of Clause 24(f), (g) and (h) of the Listing Agreement does not, by itself, bar a company from seeking sanction of a scheme of amalgamation under sections 391 to 394. Nor does it entail an automatic dismissal of such a petition."

Clause 31

The Company will forward to the Exchange promptly and without application...

- (c) three copies of all the notices, call letters or any other circulars including notices of meetings convened u/s 391 or section 394 read with section 391 of the Companies Act, 1956 together with Annexures thereto, at the same time as they are sent to the shareholders, debenture holders or creditors or any class of them or advertised in the Press.
- (e) three copies of all notices, circulars, etc., issued or advertised in the Press either by the Company, or by any company which the Company proposes to absorb or with which the Company proposes to merge or amalgamate, or under orders of the court or any other statutory authority in connection with any merger, amalgamation, re-construction, reduction of capital, scheme or arrangement, including notices, circulars, etc. issued or advertised in the Press in regard to

meetings of shareholders or debenture holders or creditors or any class of them and copies of the proceedings at all such meetings.

Clause 36

Apart from complying with all specific requirements as above, the Company will keep the Exchange informed

7(ii) Acquisition, merger, de-merger, amalgamation, restructuring, scheme of arrangement, spin-off or selling divisions of the company, etc.

Foreign Exchange Management Act provisions - Acquisition of shares under a Scheme of Amalgamation/ Merger

Where a Scheme of Merger or Amalgamation of two or more Indian companies has been approved by a Court in India, the transferee company may issue shares to the shareholders of the transferor company, resident outside India subject to ensuring that the percentage of shareholding of persons resident outside India, in the transferee or new company does not exceed the percentage specified in the approval granted by the Central Government or the Reserve Bank. In case the percentage is likely to exceed the percentage specified in the approval or the Regulations, the transferor company or the transferee or new company may, after obtaining an approval from the Central Government, apply to the Reserve Bank for its approval under these Regulations. Further, the transferor company or the transferee or new company shall not engage in agriculture, plantation or real estate business or trading in TDRs.

Accounting requirements

One other issue which is to be considered in the case of amalgamation is the accounting aspects of the transactions. In this regard sub-section (3A) of section 211 provides that "every profit and loss account and balance sheet of the company shall comply with the accounting standards". Section 2(1A) defines the term "accounting standards" as "the standards of accounting, recommended by the Institute of Chartered Accountants of India, constituted under the Chartered Accountants Act, 1949, and which may be prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards constituted under subsection (1) of section 210A".

By the Notification G.S.R. 739 (E) dated 7th December, 2006, the Government has prescribed that the Accounting Standards 1 to 7 and 9 to 29 as recommended by the Institute of Chartered Accountants of India as the Accounting Standards under the CA 1956. The said Standards would be applicable to all accounting years ending after the date of the Notification. Thus Accounting Standard 14 issued by the Institute of Chartered Accountants is now prescribed as the Standard for accounting in case of amalgamation of companies.

TAKE OVERS/ACQUISITIONS

'Takeover' - Definition

Broadly speaking, a "take-over" refers to acquisition of a company by another company. M.A. Weinberg, one of the pioneers in treating the law and practice relating to takeovers, has defined a take-over as

"a transaction or series of transactions whereby a person (individual, group of individuals or company) acquires control over the assets of a company, either directly by becoming the owner of those assets or indirectly by obtaining control of the management of the company. Where shares are closely held (i.e. by a small number of persons), a take-over will generally be effected by agreement with the holders of the majority of the share capital of the company being acquired. Where the shares are held by the public generally, the takeover may be effected (1) by agreement between the acquirer and the controllers of the acquired company; (2) by purchase of shares on the Stock Exchange; or (3) by means of a "take-over bid"."



Companies Act provisions

The law relating to take-overs is contained in both the Companies Act, 1956 and the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (SEBI Takeover Code).

The Companies Act 1956 deals with the power of a company to acquire shares of another company generally (section 372A), and specifically, in relation to acquiring shares from persons who did not sell or have not agreed to sell shares held by them, notwithstanding approval of the scheme or contract for acquisition of the shares, by shareholders owning 90% and over of the shares (section 395). The company being acquired could be either a public quoted company or a private limited company.

The SEBI Takeover Code deals with the law relating to substantial acquisition of shares or control of a public quoted company (listed company) or an unquoted public limited company or a private limited company (an unlisted company) including a foreign registered company, which owns or controls a listed company.

Acquisition of shares by a company of another company

Power of a company to invest in shares of another company is generally governed by its memorandum and is further subject to certain restrictions placed by the Companies Act. Section 372 as it stood prior to amendment by the Companies (Amendment) Act, 1988, prohibited inter corporate investment in shares in excess of 10% of the subscribed capital of the company whose shares are being purchased or subscribed and subject to an overall limit in respect of investment in all bodies corporate of 30% of the subscribed capital of the investing company. Investment could be made in excess of these limits, if the investment is approved by the shareholders by a resolution and further approved by the Central Government.

After the Companies (Amendment) Act, 1988, section 372 of the Companies Act prohibited inter corporate investment in excess of 30% of the subscribed equity capital or the aggregate of the paid up equity and preference share capital of such other body corporate whichever is less. In addition there were restrictions on investment in all bodies corporate as also limits relating to investment by the company along with its subsidiaries and/or group companies. The restriction of 10% of the subscribed capital (be it preference and/or equity) was removed. Further the approval by the Central Government should have been obtained, in case of investment in excess of the limits prescribed, prior to making of the investment. This was achieved by adding the word "previously" before "approved by the Central Government" in sub-section (4) of section 372.

However, by the Companies (Amendment) Act, 1999, the existing provisions of section 372 were made inoperative effective from 31st October, 1998 and instead a new provision viz section 372A was introduced. Relevant provisions of Section 372A read as follows:

372A. Inter corporate loans and investments.—

- (1) No company shall, directly or indirectly;
 - (a) make any loan to any other body corporate;
 - (b) give any guarantee, or private security, in connection with a loan made by any other person to, or to any other person by, any body corporate; and
 - (c) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate.

exceeding sixty per cent, of its paid-up share capital and free reserves, or hundred per cent, of its free reserves, whichever is more:

Provided that where the aggregate of the loans and investments so far made, the amounts for which guarantee or security so far provided to or in all other bodies corporate, along with the investment, loan, guarantee or security proposed to be made or given by the board,

exceeds the aforesaid limits, no investment or loan shall be made or guarantee shall be given or security shall be provided unless previously authorized by a special resolution passed in a general meeting:

Provided.....

Provided also that the notice of such resolution shall indicate clearly the specific limits, the particulars of the body corporate in which the investment is proposed to be made..... to be given, the purpose of the investment,....., specific sources of funding and such other details.

- (2) No investment shall be made by the company unless the resolution sanctioning it is passed at a meeting of the board with the consent of all the directors present at the meeting and the prior approval of the public financial institution referred to in section 4A, where any term loan is subsisting, is obtained :

Provided that prior approval of a public financial institution shall not be required where the aggregate of the loans and investments so far made, the amounts for which guarantee or security so far provided to or in all other bodies corporate, along with the investments, loans, guarantee or security proposed to be made or given does not exceed the limit of sixty per cent, specified in subsection (1), if there is no default in repayment of loan instalments or payment of interest thereon as per the terms and conditions of such loan to the public financial institution :

- (3)

- (4) No company, which has defaulted in complying with the provisions of section 58A, shall, directly or indirectly,—

(a).....

(b).....

(c) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate, till such default is subsisting.

- (5) (a) Every company shall keep a register showing the following particulars in respect of every investment or loan made,..... by it in relation to any body corporate under sub-section (1), namely :—

(i) the name of the body corporate;

(ii) the amount, terms and purpose of the investment

(in) the date on which the investment has been made; and

(iv)

(v) The particulars of investment, ... referred to in clause (a) shall be entered chronologically in the register aforesaid within seven days of the making of such investment.....

- (6) The register referred to in sub-section (5) shall be kept at the registered office of the company concerned and—

(a) shall be open to inspection at such office ; and

(b) extracts may be taken there from and copies thereof may be required, by any member of the company to the same extent, in the same manner, and on payment of the same fees as in the case of the register of members of the company; and the provisions of section 163 shall apply accordingly.

- (7) The Central Government may prescribe guidelines for the purposes of this section.



(8) Nothing contained in this section shall apply,—

(a) any investment made by—

- (i) a banking company, or an insurance company, or a housing finance company in the ordinary course of its business, or a company established with the object of financing industrial enterprises, or of providing infrastructural facilities ;
- (ii) a company whose principal business is the acquisition of shares, stock, debentures or other securities ;
- (iii) a private company, unless it is a subsidiary of a public company.

(b) to investment made in shares allotted in pursuance of clause (a) of sub-section (1) of section 81.

(c)

(d)

(e) to acquisition by a holding company, by way of subscription, purchases or otherwise, of securities of its wholly owned subsidiary.

(9) If default is made in complying with the provisions of this section, other than sub-section (5), the company and every officer of the company who is in default shall be punishable with imprisonment which may extend to two years or with fine which may extend to fifty thousand rupees :

Provided that.....

Provided further.....

(10) If default is made in complying with the provisions of sub-section (5), the company and every officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees and also with a further fine which may extend to five hundred rupees for every day after the first day during which the default continues.

Explanation.—For the purposes of this section,—

(a) “loan” includes debentures or any deposit of money made by one company with another company, not being a banking company;

(b) “free reserves” means those reserves which, as per the latest audited balance-sheet of the company, are free for distribution as dividend and shall include the balance to the credit of the securities premium account but shall not include share application money.

Presently, the powers of investment in shares together with loans granted or issue of guarantee issued by a company have been very much relaxed. The power of the Board of Directors is restricted to sixty per cent, of the investing company's paid-up share capital and free reserves, or hundred per cent of its free reserves, whichever is more. The restrictions cover, not only investment in shares but also includes loans granted as also guarantees issued. No separate limit for each viz. shares, loans and guarantees, is provided. But the company could exceed this limit if special resolution (not ordinary resolution) of the shareholders is obtained. While authorizing investment in shares of another company care should be taken to consider the loans granted to other bodies corporate and guarantees issued in connection with loan made by any other person or bodies corporate. Such approval of the shareholders is required to be obtained prior to the board authorizing the investment.

The section covers both direct investment as well as indirect investment. See the use of the words “No company shall directly or indirectly” in the beginning of the section. It is rather unfortunate that the term “indirectly” has not been spelt out as was the case in section 372, In section 372 the words used are “(whether by itself, or by an individual, or association of individuals in trust for it or

for the benefit or on its account)". May be the use of word "indirectly" could cover instances as stated in section 372 and also any other method of indirect investment' such as investment by persons acting in concert.

Though provisions of section 369 (inter corporate loan) has been deleted the new section 372A covers both investment in shares as also grant of loans and issue of guarantees. The term 'loan' has been defined to include debentures and any deposit of money, other than deposit in a banking company.

In considering takeovers, the Board of Directors of a company will need to comply with these provisions, in addition to the provisions of the SEBI Takeover Code and other law or regulations. Note that if a company has defaulted in repayment of deposit to customers such a company cannot invest in another company unless it returns the deposit. It is also provided that investment must be recorded in the register specifically required to be maintained for this purpose, within 7 days of the investment.

Non-applicability of investment restrictions

The provisions of section 372A are not applicable to investments made by:

- (a) a banking company or an insurance company or housing finance company in the ordinary course of its business;
- (b) a company established with the object of financing industrial enterprises of providing infrastructural facilities;
- (c) a company whose principal business is the acquisition of shares, stock, debentures or other securities;
- (d) a private company which is not a subsidiary of a public company;
- (e) exercise of rights under section 81(1)(a) of Companies Act; and
- (f) a holding company in relation to investment by subscription, purchase or otherwise, in securities of its wholly owned subsidiary.

The provisions of section 372A are applicable to an investing company which is a public limited company (whether it is a listed company or unlisted company) as also a private limited company which is a subsidiary of a public limited company. Hence if a public limited company were to invest in a private limited company these provisions would apply, though the provisions of SEBI Takeover Code would not apply in such a case so long as that private company does not control a listed company. A company which is a trader in securities is exempt, possibly as the investment would have been made as its "stock-in-trade" and not as a capital investment. Investment by a private company is not restricted, though its investment in a public listed company might attract the provisions of SEBI Takeover Code.

Further, one should note the words "body corporate" instead of "company" in clause (c) of sub-section (1) of section 372A. We have seen that definition of a "body corporate" includes a company incorporated outside India, while a company is a company incorporated under the Companies Act 1956. The definition of 'body corporate' is an inclusive definition and it will not only include companies incorporated in India, but also companies incorporated outside India. Hence if an Indian public limited company or its subsidiary were to acquire shares in a foreign company it needs to comply with the provisions of section 372A though the provisions of SEBI Takeover Code may not apply.

Purchase of shares of dissentient shareholders in a friendly takeover

In a friendly takeover it is possible that the board of directors of the company (transferor company) whose shares are sought to be acquired by another company (transferee company), they would seek the approval of the shareholders. In such cases, even after the shareholders of the transferor company agreeing to accept the offer from the transferee company, there could be certain shareholders who may have failed to transfer the shares or may disagree with the terms of offer by the transferee



company. Such shareholders are referred to as “dissentient shareholders”. A separate provision exists for purchase of shares held by dissentient shareholders in case of offer of shares by a transferee company under a scheme or contract approved by majority of the shareholders of the transferor company. These provisions are contained in section 395 of the Companies Act. This provision is similar to provisions contained in section 209 of the English Companies Act, 1948. Under the present Companies Act, 2006, the English law provides elaborately on takeovers and gives right to the acquirer to acquire the shares of dissentient shareholders or the right to the minority dissentient shareholders to compel the acquirer to acquire his shares. These provisions are contained in Chapter 3 of Part 28 of the Companies Act, 2006 viz. “Squeeze out” [section 979] and “sell-out” [section 983]. The section reads as follows:

395 Power and duty to acquire shares of shareholders dissenting from scheme or contract approved by majority.—

- (1) Where a scheme or contract involving the transfer of shares or any class of shares in a company (in this section referred to as “the transferor company”) to another company (in this section referred to as “the transferee company”), has within four months after the making of the offer in that behalf by the transferee company, been approved by the holders of not less than nine-tenths in value of the shares whose transfer is involved (other than shares already held at the date of the offer by, or by a nominee for, the transferee company or its subsidiary), the transferee company may, at any time within two months after the expiry of the said four months, give notice in the prescribed manner to any dissenting shareholder, that it desires to acquire his shares; and when such a notice is given, the transferee company shall, unless, on an application made by the dissenting shareholder within one month from the date on which notice was given, the Tribunal thinks fit to order otherwise, be entitled and bound to acquire those shares on the terms on which, under the scheme or contract, the shares of the approving shareholders are to be transferred to the transferee company:

Provided that where shares in the transferor company of the same class as the shares whose transfer is involved are already held as aforesaid to a value greater than one-tenth of the aggregate of the values of all the shares in the company of such class, the foregoing provisions of this subsection shall not apply, unless—

- (a) the transferee company offers the same terms to all holders of the shares of that class (other than those already held as aforesaid) whose transfer is involved; and
 - (b) the holders who approve the scheme or contract, besides holding not less than nine-tenths in value of the shares (other than those already held as aforesaid) whose transfer is involved, are not less than three-fourths in number of the holders of those shares.
- (2) Where, in pursuance of any such scheme or contract as aforesaid, shares, or shares of any class, in a company are transferred to another company or its nominee, and those shares together with any other shares or any other shares of the same class, as the case may be, in the first-mentioned company held at the date of the transfer by, or by a nominee for, the transferee company or its subsidiary comprise nine-tenths in value of the shares, or the shares of that class, as the case may be, in the first-mentioned company, then,—
 - (a) the transferee company shall, within one month from the date of the transfer (unless on a previous transfer in pursuance of the scheme or contract it has already complied with this requirement), give notice of that fact in the prescribed manner to the holders of the remaining shares or of the remaining shares of that class, as the case may be, who have not assented to the scheme or contract; and
 - (b) any such holder may, within three months from the giving of the notice to him, require the transferee company to acquire the shares of question;
and where a shareholder gives notice under clause (b) with respect to any shares, the transferee company shall be entitled and bound to acquire those shares on the terms on which, under

the scheme or contract, the shares of the approving shareholders were transferred to it, or on such other terms as may be agreed, or as the Tribunal on the application of either the transferee company or the shareholder thinks fit to order.

- (3) Where a notice has been given by the transferee company under sub-section (1) and the Tribunal has not, on an application made by the dissenting shareholder, made an order to the contrary, the transferee company shall, on the expiry of one month from the date on which the notice has been given, or, if an application to the Tribunal by the dissenting shareholder is then pending, after that application has been disposed of, transmit a copy of the notice to the transferor company together with an instrument of transfer executed on behalf of the shareholder by any person appointed by the transferee company and on its own behalf by the transferee company, and pay or transfer to the transferor company the amount or other consideration representing the price payable by the transferee company for the shares which, by virtue of this section, that company is entitled to acquire; and the transferor company shall-

- (a) thereupon register the transferee company as the holder of those shares, and
- (b) within one month of the date of such registration, inform the dissenting shareholders of the fact of such registration, and of receipt of the amount or other consideration representing the price payable to them by the transferee company :

Provided that an instrument of transfer shall not be required for any share for which a share warrant is for the time being outstanding.

- (4) Any sums received by the transferor company under this section shall be paid into a separate bank account, and any such sums and any other consideration so received shall be held by that company in trust for the several persons entitled to the shares in respect of which the said sums or other consideration were respectively received.
- (4A) (a) The following provisions shall apply in relation to every offer of a scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company, namely :—
- (i) every such offer or every circular containing such offer or every recommendation to the members of the transferor company by its directors to accept such offer shall be accompanied by such information as may be prescribed;
 - (ii) every such offer shall contain a statement by or on behalf of the transferee company, disclosing the steps it has taken to ensure that necessary cash will be available;
 - (iii) every circular containing, or recommending acceptance of, such offer shall be presented to the Registrar for registration and no such circular shall be issued until it is so registered;
 - (iv) the Registrar may refuse to register any such circular which does not contain the information required to be given under sub-clause (i) or which sets out such information in a manner likely to give a false impression; and
 - (v) an appeal shall lie to the Tribunal against an order of the Registrar refusing to register any such circular.
- (b) whoever issues a circular referred to in sub-clause (iii) of clause (a), which has not been registered, shall be punishable with fine which may extend to five thousand rupees.
- (5) In this section—
- (a) "dissenting shareholder" includes a shareholder who has not assented to the scheme or contract and any shareholder who has failed or refused to transfer his shares to the transferee company in accordance with the scheme or contract;



(b) "transferor company" and "transferee company" shall have the same meaning as in section 394.

(6)

Section 395 of the Companies Act stands alone and covers a case of purchase of shares of dissentient shareholders of a company (transferor company) by another company (transferee company) based on a scheme or contract. It is not clear as to whether the scheme of contract is to be between the two companies or between the purchaser company and the shareholders having controlling interest of the company whose shares are offered to be bought. 'In either case it contemplates approval by the shareholders of the transferor company prior to such purchase. It does not cover a case of buy back of shares by a company, though in a case where the persons controlling the transferor company might resort to buy back before accepting the offer' from the transferee company. It presupposes the- existence of a scheme (not necessarily a scheme under section 391 of the Companies Act, for, the definition of the term "arrangement" in section 390 is applicable only to sections 391 to 393. or a contract between two companies, one company (transferee company) contracting to purchase the shares of another company (transferor company).

A summary of the provisions is as under:

- (a) a scheme or contract exists under which a transferee company agrees to purchase the shares (not necessarily the whole of the shares) of the transferor company;
- (b) the scheme or contract must be in relation to the transfer of shares or any class of shares of the transferor company to the transferee company;
- (c) the proposed transfer of shares by the transferor company must have the approval of nine-tenths in value of the shares (other than shares already held at the date of the offer by, or by a nominee for, the transferee company or its subsidiary) whose transfer is involved and this approval should be obtained within four months of the offer being floated;
- (d) the transferee company may give notice, within two months of the aforesaid four months, to the dissenting shareholders, in the prescribed manner (form 35 of the General Rules and Forms), for acquisition of their shares;
- (e) unless the dissentient shareholders, within one month of the above notice, obtain Court Orders to the contrary or stipulating certain other conditions, the transferee company is entitled and bound to acquire the shares on the terms as stated in the scheme or contract;
- (f) if the shares transferred to the transferee company together with shares held by or by a nominee of the transferee company or by its subsidiary exceeds 9/10^{ths} in value of the shares or the shares of that class of the transferor company, then the transferee company must give notice of the fact of such holding to the remaining persons who have not assented to the scheme or contract;
- (g) upon receipt of the notice the remaining shareholders may, within three months from the giving of the notice require the transferee to acquire the shares on same terms as per scheme or contract, unless the Tribunal on an application made by the transferee company or the shareholder directs otherwise.
- (h) If within one month of the notice no order to the contrary is passed by the Tribunal, then the transferee company within one month from the end of the notice period may approach the transferor company along with the duly executed transfer deed and pay the transfer consideration to the transferor company and where upon the transferor company is required to register the transfer and within one month inform the dissentient shareholders of this fact.
- (i) If the shares transferred under the scheme or contract together with the shares already held by or by a nominee of the transferor company or by its subsidiary comprise of 9/10th in value of the shares or the shares of that class then the transferee company shall within one month from the date of transfer give notice of that fact in the prescribed manner;

- (j) the dissentient shareholders may within three months of receipt of the notice require the transferee company to acquire the shares in question and the transferee company is entitled and bound to purchase the shares of the dissentient shareholders on same terms as the scheme or contract.
- (k) In cases where the dissentient shareholders had approached the Tribunal and the Tribunal gives direction in the matter the transferee company is bound to adhere to the Tribunal's directions.

Every offer or scheme to purchase shares of another company must comply, apart from the above, with the requirements of sub-section (4A). The requirements are:

- (1) every such offer or every circular containing such offer or every recommendation to the members of the transferor company by its directors to accept such offer shall be accompanied by the following prescribed information:
 - (a) Name of the company making the offer or issuing any circular in connection with the offer;
 - (b) Management structure of the transferee company (composition of Board of Directors and particulars regarding managers, managing director, if any);
 - (c) Capital structure of the transferee company.
 - (d) The extent of shareholdings of the directors, manager, managing director, or other associates in the transferor company;
 - (e) The extent of shareholdings of the directors, manager, managing directors or their associates of the transferee company in the transferor company.
 - (f) In case the offer is made by another person on behalf of the transferee company the extent of such person's holding in the transferee company.
 - (g) A summary of the financial position of the company to be given separately in the proforma prescribed (see Appendix to the form 35A).
 - (h) The price or consideration offered. If consideration is other than cash, full particulars thereof. If the consideration is by way of allotment of shares in the transferee company, full particulars of the shares and rights attached thereto. The basis of valuation of the shares to be allotted.
 - (i) Sources from which the transferee company proposes to pay for the acquisition if the consideration is cash.
 - (j) The basis of valuation of the shares of the transferor company;
 - (k) Name of the transferor company;
 - (l) Management structure of the transferor company (composition of Board of Directors and particulars regarding managers, managing director, if any
 - (m) Capital structure of the transferor company;
 - (n) The extent of shareholdings of the directors, manager, managing director or their associates, if any, of the transferor company in the transferor and transferee companies;
 - (o) Details of transfer of shares in the transferor company by its directors, manager, managing directors, or their associates in the two years preceding the offer;
 - (p) The reasons for which the offer has been recommended for acceptance by the members of the transferor company by its directors, showing the interest of the directors, manager, managing directors or their associates in the transferee company; and
 - (q) A certificate from the auditors of the transferee company that the information contained in the offer/recommendation is correct,
- 2) Every such offer shall contain a statement by or on behalf of the transferee company, disclosing



the steps it has taken to ensure that necessary cash will be available.

- 3) Every circular containing, or recommending acceptance of, such offer shall be presented to the Registrar of Companies for registration and no such circular shall be issued until it is so registered. The Registrar may refuse to register any such circular which does not contain the information as in (1) above which are required to be given or if the circular issued sets out such information in a manner likely to give a false impression. Failure to present to the Registrar is punishable with fine.
- 4) An appeal shall lie to the Tribunal against an order of the Registrar refusing to register any such circular.

Obligation not to seek compensation

It is provided that in certain specified cases of transfer of shares by a transferor company to a transferee company, no director of the transferor company shall receive any payment by way of compensation for loss of office, or as consideration for retirement from office or in connection with such loss or retirement from a transferor company or except as provided in the Companies Act from the transferee company or any other person, [section 320(1)]. The specified cases are:

Transfer to any persons all or any of the shares of the company being a transfer resulting from:

- (i) an offer made to the general body of shareholders;
- (ii) an offer made by or on behalf of some other body corporate with a view to the company becoming a subsidiary of such body corporate or a subsidiary of its holding company;
- (iii) an offer made by or on behalf of an individual with a view to his obtaining the right to exercise, or control the exercise of, not less than one-third of the total voting power at any general meeting of the company; or
- (iv) any other offer which is conditional on acceptance to a given extent.

In the case of receipt of compensation from the transferee company or any other person, the director concerned must ensure that particulars with respect to the payment proposed to be made by the transferees or other person (including the amount thereof) are included in, or sent with, any notice of the offer made for their shares which is given to any shareholders. [section 320(2)].

If there is default in the above, any sum received by the director on account of the payment shall be deemed to have been received by him in trust for any persons who have sold their shares as a result of the offer made, and the expenses incurred by him in distributing that sum amongst those persons shall be borne by him and not retained out of that sum.

This is very similar to the prohibition from payment of compensation for loss of office in case of transfer of whole or substantially whole of the undertaking of a company as provided in section 319 of the Companies Act.

Procedure

Rule 12 of the Company (Central Government's) General Rules and Forms, 1956 provides the manner in which notice under sub-section (1) or 2(a) of section 395 are to be issued. The Rule reads as follows:

12. (1) The notice required to be given by a transferee company—

- (a) to any dissenting shareholder of the transferor company in pursuance of section 395, sub-section (1); or
- (b) to any shareholder of the transferor company who has not assented to the scheme or contract

in pursuance of section 395, sub-section (2), clause (a),
shall be given in the manner provided in section 53 for the service of a document by a company on a member thereof.

- (2) While making any offer or issuing any circular containing any recommendation to the members of the transferor company by its directors to accept such offer, the company shall furnish the prescribed information in addition to the statement referred to in sub-clause (ii) of clause (a) of the said section.

Section 53 of Companies Act provides as follows:

The form of notice to dissenting shareholders should be in form 35.

FORM NO. 35

Registration No. of Transferee Company

No., if any, of Transferor Company

The Companies Act, 1956

Notice to dissenting shareholders

[Pursuant to section 395]

Limited/Private Limited [hereinafter called "the transferor company"]

Notice by Limited/Private Limited [hereinafter called "the transferee company"]

To

Whereas on the day of the transferee company made an offer to all the holders of shares in the transferor company [state shortly the nature of the offer].

and

Whereas up to the day of being a date within four months of the date of the making thereof such offer was approved by the holders of not less than nine-tenths in value of the said shares, other than shares already held at the date of the offer by or by a nominee for the transferee company or its subsidiary.

Now, therefore, the transferee company in pursuance of the provisions of section 395(1) of the Companies Act, 1956, hereby gives you notice that it desires to acquire the shares held by you in the transferor company.

And further take notice that unless, upon application made to the Court by you the said, on or before the day of, being one month from the date of this notice, the Court thinks fit to order otherwise, the transferee company will be entitled and bound to acquire the shares held by you in the transferor company on the terms of the above-mentioned offer, approved by the approving shareholders in the said company.

Dated the day of

Signature for

Designation

1. Name of transferor company:
2. Name of transferee company:
3. Name(s) and address(es) of dissenting shareholder(s):
4. If the offer is limited to a certain class or classes of shareholders, state description of that class or those classes:
5. State whether director, managing director, manager or secretary.



Takeover of Control and Management by secured creditors

Another method of takeover of a company is envisaged by the Securitization and Reconstruction of Finance Assets and Enforcement of Security Interest Act, 2002 (SRFAESIA). Under the aforesaid Act, as part of measures for asset reconstruction by securitization company or reconstruction company, such a company could take over the management of the business of a borrower. At the outset, it should be pointed out that such a measure is possible only in terms of guidelines to be framed by the Reserve Bank of India, and till date no such guidelines have been prescribed.

In this regard, section 9 of SRFAESIA *inter alia* provides that —

Without prejudice to the provisions contained in any other law for the time being in force, a securitization company or reconstruction company may, for the purposes of asset reconstruction, having regard to the guidelines framed by the Reserve Bank in this behalf, provide for any one or more of the following measures, namely :—

- (a) the proper management of the business of the borrower, by change in, or take over of, the management of the business of the borrower;

If, and when a securitization company or a reconstruction company takes over the management of a borrower, it is provided in section 15 of SRFAESIA the manner and effect of such take over of management. The said section reads as follows:

Manner and effect of take over of management.

15. (1) When the management of business of a borrower is taken over by a secured creditor, the secured creditor may, by publishing a notice in a newspaper published in English language and in a newspaper published in on Indian language in circulation in the place where the principal office of the borrower is situated, appoint as many persons as it thinks fit—
 - (a) in a case in which the borrower is a company as defined in the Companies Act, 1956 (1 of 1956), to be the directors of that borrower in accordance with the provisions of that Act; or
 - (b) in any other case, to be the administrator of the business of the borrower.
- (2) On publication of a notice under sub-section (1),—
 - (a) in any case where the borrower is a company as defined in the Companies Act, 1956 (1 of 1956), all persons holding office as directors of the company and in any other case, all persons holding any office having power of superintendence, direction and control of the business of the borrower immediately before the publication of the notice under sub-section (1), shall be deemed to have vacated their offices as such;
 - (b) any contract of management between the borrower and any director or manager thereof holding office as such immediately before publication of the notice under sub-section (1), shall be deemed to be terminated;
 - (c) the directors or the administrators appointed under this section shall take such steps as may be necessary to take into their custody or under their control all the property, effects and actionable claims to which the business of the borrower is, or appears to be, entitled and all the property and effects of the business of the borrower shall be deemed to be in the custody of the directors or administrators, as the case may be, as from the date of the publication of the notice;
 - (d) the directors appointed under this section shall, for all purposes, be the directors of the company of the borrower and such directors or as the case may be, the administrators appointed under this section, shall alone be entitled to exercise all the powers of the directors or as the case may be, of the persons exercising powers of superintendence, direction and control, of the business of the borrower whether such powers are derived from the memorandum or articles of association of the company of the borrower or from any other source whatsoever.

- (3) Where the management of the business of a borrower, being a company as defined in the Companies Act, 1956 (1 of 1956), is taken over by the secured creditor, then, notwithstanding anything contained in the said Act or in the Memorandum or Articles of Association of such borrower,—
 - (a) it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company;
 - (b) no resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;
 - (c) no proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court, except with the consent of the secured creditor.
- (4) Where the management of the business of a borrower had been taken over by the secured creditor, the secured creditor shall, on realization of his debt in full, restore the management of the business of the borrower to him.

From the above it would be seen a strong signal is sent to borrowing companies that default in repayment of loan to banks or financial institutions might result in change of management. The takeover if and when effected in terms of the above section is valid only till the debt in question has been realized in full. In this sense it is only a temporary takeover of the management of a company.

By a Circular No. DNBS. PD.CC.I/SCRC/10.30/2002-2003 dated April 23, 2003, the Reserve Bank had stated that "The Bank is in the process of framing a set of standard guidelines in the matter of takeover of the management, sale or lease of whole or part of the business of the borrower. Securitization Companies and Reconstruction Companies are, therefore, advised to refrain from exercising the measures of takeover of management, sale or lease of the borrowers' business as provided for in Section 9 of the Act, until guidelines in this regard are notified by the Reserve Bank of India," As stated earlier, no such guidelines have been issued till date.

In this regard, it must be noted that section 35 of SRFAESIA provides that the provisions of the SRFAESIA shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law. Further section 37 provides that the provisions of SRFAESIA shall be in addition to, and not in derogation of, the Companies Act, 1956 (1 of 1956), the Securities Contracts (Regulation) Act, 1956 (42 of 1956), the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993) or any other law for the time being in force.

In the light of the above, a takeover by a secured creditor under the SRFAESIA will also be subject to Takeover Regulations and the Companies Act, 1956 provisions.

TAKEOVER REGULATIONS
SECURITIES AND EXCHANGE BOARD OF INDIA
(SUBSTANTIAL ACQUISITION OF SHARES AND
TAKEOVERS) REGULATIONS, 1997

Preliminary

The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1994, ("Takeover Code 1994") was a maiden attempt in India to regulate in an organized manner 'takeover' of a quoted company. It was found to have certain deficiencies. Within two years of its working a need was felt to improve the regulations. Substantial modifications were made and the entire regulation was recast in 1997 and the new regulations - Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, (Takeover Code 1997 or the Regulations) - was announced by Securities and Exchange Board of India (SEBI) after receiving the report of a high powered Committee under the Chairmanship of Justice P. N. Bhagwati, former Chief



Justice of India ("Justice Bhagwati Committee"). Since 1997 further changes were made based on the recommendations of the Review Committee again chaired by Justice P. N. Bhagwati. Presently there is a move to overhaul the entire Takeover Code and SEBI constituted a Takeover Regulations Advisory Committee under the Chairmanship of Shri C. Achuthan. This Committee submitted its recommendations in July 2010, including a draft text of the proposed takeover regulations in part III of the Report. The proposed Code is yet to be adopted. Apart from this the Competition Commission of India has circulated a draft of Competition of India (Procedure in regard to the transactions of business relating to combination) Regulations.

The Takeover Code 1997 underwent several amendments. The latest one being SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2013.

Applicability

The objectives of the Takeover Code 1997 are to regulate substantial acquisition of shares and takeover of companies whose shares are listed on a stock exchange i.e. listed company. They also apply in a limited sense to an unlisted company including a body corporate incorporated outside India, so long as such acquisitions give indirect control over or substantial voting rights in, a listed company. The other enactments which have a bearing, on such substantial acquisition are Companies Act 1956, Securities Contracts Regulation Act (SCR Act), the Securities and Exchange Board of India Act (SEBI Act) and various Regulations made there under, the Foreign Exchange Management Act, 1999 ("FEMA") and the Competition Act, 2002, Industrial policy, and other governmental policy and procedures, as also other legislations affecting an industry.

The Takeover Code 1997 deals with an acquirer's —

- (a) substantial acquisition of shares of a target company or
- (b) substantial acquisition of voting rights of a target company or
- (c) acquisition of control over a target company.

The provisions of the Regulations have been discussed in detail in study note 3.5. Please refer the same.

Joint Ventures (JVs)

Introduction

One form of business reorganization carried out to achieve economic growth based on the strengths of an enterprise - commercial, financial, technical, managerial, manufacturing, marketing or research skills or a combination of one or more of these skills - is the profitable exploitation of such skills by combining its strengths with another enterprise. This is generally achieved by entering into agreements between the enterprises. Such an agreement could be any one or more of the following types:

- (a) Traditional joint venture
 - (i) Technical collaboration agreement
 - (ii) Financial collaboration agreement
 - (iii) Licensing agreement for use of Intellectual Properties
 - (iv) Licensing manufacturing operations
- (b) Franchising arrangement
- (c) Outsourcing
 - (i) Business Process Outsourcing agreement
 - (ii) Business Process Off shoring agreement

(iii) Knowledge Process Outsourcing agreement

A joint venture, being an entity founded on mutual belief and faith, would call for certain sacrifices or reconciliation. If the parties do not fully understand the objectives - benefit for both parties - for which they have come together then such a joint venture would be a failure.

Joint Venture- Definition

A joint venture is an arrangement generally between two or more persons coming together with a view to co-operate with each other to carry on a business. The agreement could be a written agreement or even an oral arrangement, though the former is preferred. The expression "joint venture" has not been defined in the Companies Act 1956, but under one of the Accounting Standards prescribed under the Companies Act viz the Accounting Standards (AS) 27 - explains the concept of a joint venture. As we are concerned with the company law relating to joint ventures, we give below the explanations contained in the AS 27 to highlight the nature of a joint venture. There is also a reference to "joint venture" in other Accounting Standards such as AS 18, AS 21 and AS 23. A word of caution, in that, the explanations under the mandatory Accounting Standards AS 27, covers only joint ventures which have joint control of operations or joint control of assets or joint control of entities. There could be other joint ventures which are in the nature of co-operation without having joint control, in relation to which AS 27 does not apply. However, the characteristics enumerated in AS 27 do have a bearing to other joint ventures as well.

In New Horizons Ltd vs. Union of India [1995 (1) SCC 478] it was held:

"The expression "joint venture" is more frequently used in the United States. It connotes a legal entity in the nature of a partnership engaged in the joint undertaking of a particular transaction for mutual profit or an association of persons or companies jointly undertaking some commercial enterprise wherein all contribute assets and share risks. It requires a community of interest in the performance of the subject matter, a right to direct and govern the policy in connection therewith, and duty, which may be altered by agreement, to share both in profit and losses. According to Words and Phrases, Permanent Edition, a joint venture is an association of two or more persons to carry out a single business enterprise for profit."

Further, one may also refer to the following definition of a joint venture:

"A joint venture is to be distinguished from a relationship of independent contractor, the latter being one who, exercising an independent employment, contracts to do work according to his own methods and without being subject to the control of his employer except as to the result of the work, while a joint venture is a special combination of two or more persons where, in some specific venture, a profit is jointly sought without any actual partnership or corporate designation."

Forms of Joint Venture covered by the AS 27

This Standard identifies three broad types — jointly controlled operations, jointly controlled assets and jointly controlled entities — which are commonly described as, and meet the definition of, joint ventures. The following characteristics are common to all joint ventures:

- (a) two or more venturers are bound by a contractual arrangement; and
- (b) the contractual arrangement establishes joint control.

The expression "joint venture" is defined to mean "a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control"; the expression "Joint control" is defined as "the contractually agreed sharing of control over an economic activity" and the expression "Control" means "the power to govern the financial and operating policies of an economic activity so as to obtain benefits from it".



Contractual Arrangement

The existence of a contractual arrangement distinguishes interests which involve joint control from investments in associates in which the investor has significant influence i.e. holding of 20% and more of equity. Activities which have no contractual arrangement to establish joint control are not joint ventures for the purposes of this Standard. The contractual arrangement may be evidenced in a number of ways, for example by a contract between the venturers or minutes of discussions between the venturers. In some cases, the arrangement is incorporated in the articles or other by-laws of the joint venture.

Whatever its form, the contractual arrangement is normally in writing and deals with such matters as:

- (a) the activity, duration and reporting obligations of the joint venture;
- (b) the appointment of the board of directors or equivalent governing body of the joint venture and the voting rights of the venturers;
- (c) capital contributions by the venturers; and
- (d) the sharing by the venturers of the output, income, expenses or results of the joint venture.

The contractual arrangement establishes joint control over the joint venture. Such an arrangement ensures that no single venturer is in a position to unilaterally control the activity. The arrangement identifies those decisions in areas essential to the goals of the joint venture which require the consent of all the venturers and those decisions which may require the consent of a specified majority of the venturers. The contractual arrangement may identify one venturer as the operator or manager of the joint venture. The operator does not control the joint venture but acts within the financial and operating policies which have been agreed to by the venturers in accordance with the contractual arrangement and delegated to the operator.

Jointly Controlled Operations

The operation of some joint ventures involves the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer uses its own fixed assets and carries its own inventories. It also incurs its own expenses and liabilities and raises its own finance, which represent its own obligations. The joint venture's activities may be carried out by the venturer's employees alongside the venturer's similar activities. The joint venture agreement usually provides means by which the revenue from the jointly controlled operations and any expenses incurred in common are shared among the venturers.

An example of a jointly controlled operation is when two or more venturers combine their operations, resources and expertise in order to manufacture, market and distribute, jointly, a particular product, such as an aircraft. Different parts of the manufacturing process are carried out by each of the venturers. Each venturer bears its own costs and takes a share of the revenue from the sale of the aircraft, such share being determined in accordance with the contractual arrangement.

Jointly Controlled Assets

Some joint ventures involve the joint control, and often the joint ownership, by the venturers of one or more assets contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture. The assets are used to obtain economic benefits for the venturers. Each venturer may take a share of the output from the assets and each bears an agreed share of the expenses incurred.

These joint ventures do not involve the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer has control over its share of future economic benefits through its share in the jointly controlled asset.

An example of a jointly controlled asset is an oil pipeline jointly controlled and operated by a number

of oil production companies. Each venturer uses the pipeline to transport its own product in return for which it bears an agreed proportion of the expenses of operating the pipeline. Another example of a jointly controlled asset is when two enterprises jointly control a property, each taking a share of the rents received and bearing a share of the expenses.

Jointly Controlled Entities

A jointly controlled entity is a joint venture which involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other enterprises, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity.

A jointly controlled entity controls the assets of the joint venture, incurs liabilities and expenses and earns income. It may enter into contracts in its own name and raise finance for the purposes of the joint venture activity. Each venturer is entitled to a share of the results of the jointly controlled entity, although some jointly controlled entities also involve a sharing of the output of the joint venture.

An example of a jointly controlled entity is when two enterprises combine their activities in a particular line of business by transferring the relevant assets and liabilities into a jointly controlled entity. Another example is when an enterprise commences a business in a foreign country in conjunction with the Government or other agency in that country, by establishing a separate entity which is jointly controlled by the enterprise and the Government or agency.

Many jointly controlled entities are similar to those joint ventures referred to as jointly controlled operations or jointly controlled assets. For example, the venturers may transfer a jointly controlled asset, such as an oil pipeline, into a jointly controlled entity. Similarly, the venturers may contribute, into a jointly controlled entity, assets which will be operated jointly. Some jointly controlled operations also involve the establishment of a jointly controlled entity to deal with particular aspects of the activity, for example, the design, marketing, distribution or after-sales service of the product.

A jointly controlled entity maintains its own accounting records and prepares and presents financial statements in the same way as other enterprises in conformity with the requirements applicable to that jointly controlled entity.

Legal form of a joint venture

A joint venture could take any one of the following legal forms:

- (a) A joint venture company - Generally a private limited company, with or without joint control;
- (b) A Registered Partnership - with or without limited liability;
- (c) Contractual - a mutual agreement for a specific job outlining the rights and obligations of each party.

The Indian party to a joint venture agreement could be a private limited company or a public limited company. Generally for new joint ventures for large projects a Special Purpose Vehicle (SPV) in the form a private limited company is preferred, especially as it is possible to record the private arrangement for joint control in the Articles of the company. If, however, the Indian party, being a public limited company, admits a joint venture partner into it, then care should be taken to amend the Articles of the company. It is necessary that the laws in India should not pre-empt the decision as to what structure is appropriate for controlling businesses. Such prescriptions will make the environment rigid and put Indian companies at a disadvantage vis-a-vis their competitors internationally. Such restrictions would also not facilitate sound corporate planning, formation of joint ventures, international operations or restructuring of companies. Doubts have been raised as to certain restrictions for transfer of shares as it may conflict with the provisions of Section 111A. Further, in view of the specific provisions of Section 9 of Companies Act 1956, the Articles will have to be consistent with the Companies Act 1956 as otherwise the Articles will not be enforceable.



Contents of a joint venture agreement

Given below are some of the suggested contents of a joint venture agreement:

- (a) Objective of joint venture;
- (b) Conditions precedent, if any, to be complied by the parties;
- (c) Form or structure of the joint venture - company, partnership, other association etc.;
- (d) Capital structure and equity participation;
- (e) Financing options;
- (f) Management - day-to-day as well as overall;
- (g) Auditors;
- (h) Operational issues;
- (i) Distribution policy;
- (j) Intellectual property rights;
- (k) Dispute resolution method;
- (l) Disclosures and warranties;
- (m) Confidentiality provisions;
- (n) Preemptive rights;
- (o) Events of default;
- (p) Defaults and termination;
- (q) Non-assignment;
- (r) Mode of communication;
- (s) Effect of variation, if any;
- (t) Jurisdiction of Courts;
- (u) Interpretation of the Agreement; and
- (v) Supplementary agreements relating to licensing of trade mark, territory, technical know-how and non-competition.

Types of joint venture

As stated earlier a joint venture agreement is entered into or joint ventures are formed between:

- (a) an entity which possesses modern technology, technical skill, knowledge and financial strengths joins hands with an entity which does not possess or has a dearth of such technology, skills and finance but possesses certain other strengths and skills which the first entity does not possess or has a dearth of it - **traditional joint venture**;
- (b) an entity which has trade mark, trade name and the marketing skills gets its products manufactured by another entity who has only manufacturing capacity but no product, trade name or trade mark or marketing strength but enjoys certain concessions - **loan licensing or product outsourcing**;
- (c) an entity which has the market (ready customers) but needs to get the services done more economically from another entity who has no access to such market or have no ready customer but has ability to render the services more economically or in a globalised economy has the advantage of time difference - **Business Process Outsourcing or Off shoring (BPOs)**;

- (d) an entity which has the management skills for marketing products, and gives such skills to another entity who does not possess such skills but has presence in the market concerned - **Franchising; etc.**

We now deal broadly with each of the above types of joint ventures.

(a) Traditional joint venture

The traditional joint venture envisages an agreement for the transfer of technology or a combination of transfer of technology and trade mark. In certain cases these transfers include financial participation by the joint venture partners.

Prior to the opening up of Indian economy to foreign investment there were restrictions on such joint venture agreements under the Foreign Exchange Regulation Act (FERA). Such joint venture needed prior approval of the RBI and the Central Government. There were severe restrictions on allotment of shares in the Indian company to foreign entities, payment of royalty, use of trade mark etc.

Under the liberalized foreign investment policy foreign collaboration has been permitted under automatic investment route with far less control than what was prevailing earlier. Further with foreign direct investment allowed with least hassle such agreements have become a thing of the past as the foreign entities could set up their own subsidiaries in all fields except a few strategic industries affecting the country's sovereignty and security as also in cases covered by Press Note 1 of 2005.

We quote the relevant portion of Press Note 1 of 2005:

"The Government has reviewed the guidelines notified vide Press Note 18 (1998 series) which stipulated approval of the Government for new proposals for foreign investment/technical collaboration where the foreign investor has or had any previous joint venture or technology transfer trademark agreement in the same or allied field in India.

New proposals for foreign investment/technical collaboration would henceforth be allowed -under the automatic route, subject to sectoral policies, as per the following guidelines:

- (i) Prior approval of the Government would be required only in cases where the foreign investor has an existing joint venture or technology transfer/trademark agreement in the 'same' field. The onus to provide requisite justification as also proof to the satisfaction of the Government that the new proposal would or would not in any way jeopardize the interests of the existing joint venture or technology/trademark partner or other stakeholders would lay equally on the foreign investor/technology supplier and the Indian partner.
- (ii) Even in cases where the foreign investor has a joint venture or technology transfer/trademark agreement in the 'same' field prior approval of the Government will not be required in the following cases:
 - (a) Investments to be made by Venture Capital Funds registered with the Security and Exchange Board of India (SEBI); or
 - (b) where in the existing joint-venture investment by either of the parties is less than 3%; or
 - (c) where the existing venture/collaboration is defunct or sick.

In so far as joint ventures to be entered into after the date of this Press Note are concerned, the joint venture agreement may embody a 'conflict of interest' clause to safeguard the interests of joint venture partners in the event of one of the partners desiring to set up another joint venture or a wholly owned subsidiary in the 'same' field of economic activity."

Since the Indian industry has also grown there are possibilities of traditional joint ventures with other Indian entities. Further, under the liberalized policy for encouraging Indian investment abroad, there are specific provisions for investing in joint ventures abroad and also setting up wholly owned subsidiaries abroad.

(b) Loan Licensing or business product outsourcing arrangements

One form of reorganization of a business, within India, is to effect economies in cost of manufacture, and source the products at cheaper costs. This could be achieved by supplying the base raw materials and getting the products manufactured by one or more entities whose cost of manufacturing is low. Further such small entities may be able to take advantage of incentives given by governments and thus reduce cost of manufacturing. This type sourcing of products can be achieved by entering into a licence agreement, popularly known as 'loan licensing' or business product outsourcing.

This form of licensing is rampant in India especially adopted by the various automobile, pharmaceutical and electrical manufacturing companies. Readers would be aware of special incentives and benefits granted to small scale and medium scale industries in India. The large scale industries are at a disadvantage due to its size as compared to small scale and medium scale industries. At the same time the latter do not have the funding available to carry out manufacturing and marketing of their products. They are unable to spend large funds for creating a market for their products. Again there are investment restrictions in small scale industries viz. FDI is not allowed without prior FIPB approval beyond 24% and the value of plant and machinery could not be more than Rs. 5 crores. Hence it suited both the large scale manufacturer who have the financial and technical strengths for marketing the products and the small scale and medium scale manufacturers who lack such facilities. These small scale and medium scale manufacturers have manufacturing facilities with smaller capacity, and hence fewer labour issues and at the same time they get various tax incentives and concessional loan from banks and other financial institutions. By entering into such arrangements both parties benefit.

In this type of reorganization the licensor sources his products from one or more manufacturers to whom the licensor pays a fee. Often the raw materials are procured by the licensor and remain in their custody at the premises of the licensee. The licensor provides know how and retains with itself the quality control in respect of the products. The licensee utilizes its man power (labour), facility and factory management skills. It gets an advance payment towards these costs and thus financing is indirectly done by the licensor. The packaged goods will bear the name of the manufacturer with specific mention that it is manufactured under licence from the licensor, and the trade marks etc. of the product remains with the licensor only. The agreement is generally drafted in such a manner that it avoids the concept of labour contract, but a licence to manufacture and thus, as far as possible, the licensor is relieved from onerous labour problems. All the licences for manufacturing, premises etc. remains with the licensee only.

(c) Business Process Outsourcing and or Off shoring

We have seen that as a cost saving measure companies enter into loan licensing or business product outsourcing agreements, While the outsourcing involving a manufacturing activity is referred to as a business product outsourcing, the activity involving services is called business process outsourcing. When this type of outsourcing takes place between an entity in one country and another entity in another country it is sometimes referred to as business process offshore outsourcing or off shoring. When the services are dependent computer software it is often referred to as Information Technology Enabled Services (ITES). Examples of BPO services include Customer Support, Technical Support, Telemarketing, Insurance Processing, legal services, medical services, Data Processing, Internet/ Online/Web Research and so on.

Thus by BPO we refer to contracting of a specific task, generally a non-core activity, with a third party service provider within the same country or outside a country. Usually, BPO is implemented as a cost-saving measure. Sometimes it is done to take advantage of time difference between countries so as to give a 24 hours and 7 days a week (24/7) services. BPO may consist of back office jobs such as billing or purchasing etc. or front office tasks such as marketing or technical support. Without being offensive, in a crude sense BPO services involve a 'slave trade' except that the 'slaves' are often educated and qualified professionals and in certain cases take business risks as well.

Before entering into a BPO arrangement the company outsourcing must undertake the following steps:

- (a) evaluate the company's philosophy on the role of outsourcing its activities;
- (b) to select appropriate outsourcing project;
- (c) evaluate the profitability of outsourcing;
- (d) to decide on the appropriate outsourcing location;
- (e) to identify the appropriate service provider;
- (f) to decide on the legal, pricing and service level agreement terms; and
- (g) to determine the management and governance issues.

There are instances where the BPO acts as a 'virtual office' of the person for whom the services are rendered. This happens where the service provider in India develops the BPO through a special purpose vehicle (SPV) wholly owned by the provider, but render services for one specific person and manages and run the SPV during the initial days of operation and after attaining a specific performance level the person to whom the services are rendered will take over the SPV at either a pre-determined price or a negotiated price. During the period of the agreement the SPV cannot render any service to any other person and thus the SPV act as the 'virtual office' of the person to whom the services are provided. In this type of joint venture there is risk and finance of the service provider involved and the other party gets services done from the provider and unless the service level reaches certain level of performance the SPV will remain with the service provider. In case the level of service does not reach the desired level, the BPO contract will get terminated. In this type of business reorganization the company which is providing the service will need to take greater care as its investments are involved.

(d) Franchising

One form of successfully exploiting one's success of an established business, trade name, acceptability of products, services and management support systems is to license these valuable assets to another person for a fee and thus utilize these self generated assets for profit. This type of licensing relating to goods and services is referred to as 'franchising'.

When you finance the growth of your business through franchising it allows the existing shareholders to maintain a greater share of equity within the firm. This means that going forward they can run the business in a way that they see fit, and capitalize on opportunities when they arise.

The term "franchising" is defined in the Code issued by the Franchising Association of India, as "a system of marketing goods and/or services and/or technology, which is based upon a close and ongoing collaboration between legally and financially separate and independent undertakings, the Franchisor and its Individual Franchisees whereby the Franchisor grants its Individual Franchisees the right, and imposes the obligation, to conduct a business in accordance with the Franchisor's concept. The right entitles and compels the individual Franchisee, in exchange for a direct or indirect financial consideration, to use the Franchisor's trade name, and/or trade mark and/or service mark, know-how, business and technical methods, procedural system, and other industrial and/or intellectual property rights, supported by continuing provision of commercial and technical assistance, within the framework and for the term of a written franchise agreement, concluded between parties for this purpose".

By franchising brand equity, and technology of one person - generally a foreign brand owner - could be combined with another person - generally a domestic entity - by providing finances, building, equipment etc. Under such a licence the franchisee is required to follow standards of quality, service, value, formula and specifications in respect of goods or products or services of the franchisor. The franchisee is also required by the agreement to adhere to business ethics of the franchisor and to protect the goodwill, trademarks and technology of the franchisor.

For exploiting the above said assets of the franchisor, the franchisee may be required to pay an initial



fee, ongoing management fees, a percentage of the turnover of the business carried on under the franchise or a combination of these. In certain cases the franchisee is required to purchase goods and products from the franchiser at fixed price.

A franchise business can take different legal forms - sole traders, partnerships or limited companies. Whatever the structure, the franchisee's freedom to manage the business is limited by the terms of the franchise agreement.

Franchise agreements usually set out how the franchised business should be run, although they may allow some flexibility. Franchisers usually provide management help and training to franchisees.

The advantage of such a form of business reorganization is to take advantage of:

- Some one else's tested products and or services;
- Build a profitable organization riding on the back of large, well-organized franchisor who normally carries out advertisement campaigns;
- Take advantage of comprehensive training programmes and marketing skills of the franchisor; and
- Instant good will created with customers that the products or services supplied are best value for money and these are provided under the 'supervision' of established business house.

Successful examples of franchises run are the Hotel chains, eateries like McDonald, Pizza Hut, Kentucky Chicken etc. The recent entry of Wal Mart into India through Bharti group as a new venture in retail trading.

The FAI's Code, which is binding on its members, enumerates the following issues should be covered in any franchise agreement:

- Requiring the parties to comply with the Code;
- the rights of the Franchisor;
- the rights granted to the Individual Franchisee;
- the goods and/or services to be provided to the Individual Franchisee;
- the obligations of the Franchisor;
- the obligations of the Individual Franchisee;
- the terms of payment by the Individual Franchisee;
- the duration of the agreement;
- the basis for any renewal of the agreement;
- the terms upon which the Individual Franchisee may sell or transfer the franchised business and the Franchisor's possible preemption rights in this respect;
- provisions relevant to the use by the individual Franchisee of the Franchisor's distinctive signs, trade name, trade mark, service mark, store sign, logo or other distinguishing identification;
- the Franchisor's right to adapt the franchise system to new or changed methods;
- provisions for termination of the agreement;
- provisions for surrendering promptly upon termination of the franchise agreement any tangible and intangible property belonging to the Franchisor or other owner thereof.

The agreement must reflect the interests of the members of the franchised network in protecting the Franchisor's industrial and intellectual property rights and in maintaining the common identity and reputation of the franchised network. All agreements and all contractual arrangements in connection

with the franchise relationship should be written in or translated by a sworn translator into the official language of the country the Individual Franchisee is established in, and signed agreements shall be given immediately to the Individual Franchisee.

Joint Venture between private sector and public sector

Many infrastructure projects involve very large financial resources apart from leaning towards social responsibility. Apart from infrastructure, as a policy to diversify industry in the country the governments -both Central and State, through public financial institutions owned by it, encourage setting up of industry in joint sector - a sector which is a joint venture between private and public sectors. In such cases the government and the private sector participant enter into a joint venture agreement under which both the parties participate in the equity while the private sector participant is vested with the management powers. The government also grants certain specific incentives to the joint venture entity. At some point of time later the government will reduce its stake or even sell out their stake to the private participant or to the public.

Infrastructure projects, we have pointed out earlier, has leanings towards social responsibility of the government. The government has the basic requirement of land and has the ability to acquire land for public good. Private sector with profit motive has less incentive to undertake infrastructure projects as they have long gestation period and involves large capital outlay. The government has the social responsibility to develop infrastructure and profit is not necessarily its sole motive. Hence joint venture in respect of infrastructure projects relating to national highways, airports, transport, oil exploration and the like take the shape of what is called build- operate-transfer (BOT) in which the government provides the land for the project and the private sector develops the project with certain concessions from the government and get its return on capital by operating the project for a fixed period. At the end of the fixed period the entire project is transferred to the government. In this regard the recent development of airport modernization, extension of national highways and development of motorways in India are examples. Normally BOT arrangements are adopted for greenfield projects.

There are many possible variations of the BOT model. Some of them are:

- (a) build-operate-own (BOO) arrangements, in which the assets remain indefinitely with the private sector participant;
- (b) design-build-operate (DBO) arrangements, in which the public and private sectors share responsibility for capital investments;
- (c) build-transfer-lease (BTL) arrangements under which the private sector takes back on lease land and other immovable assets and take on lease the project for management at some fixed remuneration;
- (d) build-own-operate-transfer (BOOT) arrangements where a certain part of the project is owned by the private sector while after realizing reasonable return by operating it and then transfer it back to the public sector;

A slight variation of the above arrangements could possibly be adopted as a model for revival and rehabilitation of sick industries where a model of design-build-finance-operate (DBFO) could be adopted and where the ownership continues to remain with the company.

Dispute Resolution

One aspect of any contract or agreement is the possibility of 'dispute' or 'differences' between the parties. Consequently all agreements must contain some provision for resolution of any dispute or difference arising between the parties, in the course of giving effect to the terms of the agreement. This is more pronounced in case of joint venture agreement as it is generally a contract under which joint control of the entity is envisaged. The disputes could be relating to financing the joint venture, day-to-day running of the business, managerial: control, policy matters relating to raising of capital, distribution of dividends and the like, non-disclosure, breach of warranty and such other matters.



Most agreements provide that if any dispute arises as to any matters contained in the agreement or in the interpretation of the different clauses in the agreement, the parties would endeavour to resolve the same amicably and if the dispute is remediable, a time frame is given for remedying the defect or action which resulted in the dispute. Failing this personal touch of the parties, normally the matter is resolved through arbitration proceedings. If the dispute does not get resolved through arbitration, the matters will have to be decided by the Court. Care should be taken to choose the law as applicable to arbitration and decide the courts which would have jurisdiction to resolve disputes.

Tax treatment of Joint Ventures

The tax treatment of joint ventures under the Income-tax Act, 1961, depends on the legal form the joint venture takes place. If it is through a separate corporate entity, no specific advantage exists. The new corporate entity would be subject to tax in the normal course. Under the present law any technical know-how fee or royalty for trade mark would be subject to tax in the hands of the foreign joint venture partner at specified tax rates. Dividend to the extent it suffers tax in the hands of the distributing company would not be subject to tax in the hands of the recipient.

If joint venture takes the shape of a partnership firm, then such entity would be subject to tax as any other partnership firm. The partners would not be subjected to tax on their share of income, once the liability is raised against the firm. Depending upon the provisions of Agreement between the countries of residence of the foreign collaborator benefit of tax credit for the tax paid by the firm would be available under the related agreement between the two countries for avoidance of double taxation. At the same the provisions relating to transfer pricing - a measure to curb tax avoidance - would also be applicable in such cases. This can happen irrespective of the legal entity is a company or a firm or an AOP.

If the joint venture is a one off arrangement then such a joint venture would be treated as an Association of Persons (AOP) for tax purposes and its income taxed accordingly, and the joint venture partners would not be subjected to tax on their share of income. The rate of tax is similar to a resident individual. However, as stated above the provisions of transfer pricing would be applicable in the respective country of residence of the joint venture partners.

If the joint venture in special cases such as exploration of mineral oils, business of civil construction in case of turnkey power projects, the non-resident joint venture partner would be charged to tax under provisions of sections 44BB and 44BBB.

One other issue which needs to be in mind is the determination of residential status of the joint venture entity. In this regard Section 6(3) of ITA 1961, provides that

- (3) A company is said to be resident in India in any previous year, if
- (i) it is an Indian company ; or
 - (ii) during that year, the control and management of its affairs is situated wholly in India.

Hence if the joint venture company is incorporated in India, it will be a resident for tax purposes in India. However, if it were a company incorporated outside India and even if there is joint control, such a company will not be resident of India for tax purposes as the control is not "wholly in India".

As against this legal form, if the joint venture is a partnership or AOP then in terms of section 6(4) of ITA 1961, such a joint venture would be treated as a resident for Indian tax purposes. Section 6(4) reads as follows:

- (4) Every other person is said to be resident in India in any previous year in every case, except where during that year the control and management of his affairs is situated wholly outside India.

This in a joint venture as there would be a joint control, some part of the control would vest in India and consequently the joint venture firm or AOP will be treated as a resident.

One should also consider the provisions of section 6(5) of ITA 1961, which reads as under:

- (5) If a person is resident in India in a previous year relevant to an assessment year in respect of any source of income, he shall be deemed to be resident in India in the previous year relevant to the assessment year in respect of each of his other sources of income.

Hence care should be taken to decide which legal form a joint venture should take keeping in view the effect of such a decision under the tax laws of India.

Joint Ventures provisions under FEMA

Since India has strict foreign exchange control regulations, any investment outside India by Indian companies is governed by Foreign Exchange Management (Transfer or issue of any foreign security) Regulations, 2000. This regulation was first notified by Notification No. FEMA 19/RB -2000 dated 3rd May 2000, later this was replaced by Notification 120/RB-2004 dated July 7, 2004. This Notification is modified from time to time and every year the Reserve Bank of India issues a Master Circular on the subject, incorporating the modifications made.

We give below the salient aspect contained in the Master Circular No.11/2012-13 which relate to joint ventures abroad (JV):

Introduction

- (1) Overseas investments in Joint Ventures (JV) and Wholly Owned Subsidiaries (WOS) have been recognised as important avenues for promoting global business by Indian entrepreneurs. Joint Ventures are perceived as a medium of economic and business co-operation between India and other countries. Transfer of technology and skill, sharing of results of R&D, access to wider global market, promotion of brand image, generation of employment and utilisation of raw materials available in India and in the host country are other significant benefits arising out of such overseas investments. They are also important drivers of foreign trade through increased exports of plant and machinery and goods and services from India and also a source of foreign exchange earnings by way of dividend earnings, royalty, technical know-how fee and other entitlements on such investments.
- (2) In keeping with the spirit of liberalisation, which has become the hallmark of economic policy in general, and Foreign Exchange regulations in particular, the Reserve Bank has been progressively relaxing the rules and simplifying the procedures both for current account as well as capital account transactions.

Statutory basis

- (1) Section 6 of the Foreign Exchange Management Act, 1999 provides powers to the Reserve Bank to specify, in consultation with the Government of India the classes of permissible capital account transactions and limits up to which foreign exchange is admissible for such transactions. Section 6(3) of the aforesaid Act provides powers to the Reserve Bank to prohibit, restrict or regulate various transactions referred to in the sub-clauses of that sub-section, by making Regulations.
- (2) In exercise of the above powers conferred under the Act, the Reserve Bank has in supersession of the earlier Notification No.FEMA19/RB-2000 dated 3rd May 2000 and subsequent amendments thereto, issued Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 vide Notification No. FEMA 120/RB-2004 dated July 7, 2004. The Notification seeks to regulate acquisition and transfer of a foreign security by a person resident in India i.e. investment by Indian entities in overseas joint ventures and wholly owned subsidiaries as also investment by a person resident in India in shares and securities issued outside India. Overseas Investment can be made under two routes viz. (i) Automatic Route and (ii) Approval Route.

Prohibitions

Indian parties are prohibited from making investment in a foreign entity engaged in real estate (meaning buying and selling of real estate or trading in Transferable Development Rights (TDRs) but does not include development of townships, construction of residential/commercial premises, roads or



bridges) or banking business, without the prior approval of the Reserve Bank.

General Permission

In terms of Regulation 4 of the Notification, general permission has been granted to persons residents in India for purchase / acquisition of securities in the following manner :

- a. out of the funds held in RFC account;
- b. as bonus shares on existing holding of foreign currency shares; and
- c. when not permanently resident in India, out of their foreign currency resources outside India.

General permission is also available to sell the shares so purchased or acquired.

Automatic Route

- (1) In terms of Regulation 6 of the Notification, an Indian party has been permitted to make investment in overseas Joint Ventures (JV) / Wholly Owned Subsidiaries (WOS), not exceeding 400 per cent of the net worth as on the date of last audited balance sheet of the Indian party, i.e. a company incorporated in India or a body created under an Act of Parliament or a partnership firm registered under the Indian Partnership Act, 1932, making investment in a JV/WOS abroad and includes any other entity in India excluding individuals as may be notified by the Reserve Bank.
- (2) The ceiling of 400 per cent of net worth will not be applicable where the investment is made out of balances held in Exchange Earners' Foreign Currency account of the Indian party or out of funds raised through ADRs/GDRs. The Indian party should approach an Authorised Dealer Category - I bank with an application in Form ODI (Annex A) and prescribed enclosures / documents for effecting remittances towards such investments.
- (3) The total financial commitment of the Indian party, in all the Joint Ventures / Wholly Owned Subsidiaries put together, shall not exceed 400% of the net worth of the Indian party as on the date of the last audited balance sheet. For the purpose of determining the 'total financial commitment' within the limit of 400% as specified above, the following shall be reckoned, namely:
 - a. 100% of the amount of equity shares;
 - b. 100% of the amount of compulsorily and mandatorily convertible preference shares;
 - c. 100% of the amount of other preference shares;
 - d. 100% of the amount of loan;
 - e. 100% of the amount of guarantee (other than performance guarantee) issued by the Indian party;
 - f. 100% of the amount of bank guarantee issued by a resident bank on behalf of JV or WOS of the Indian party provided the bank guarantee is backed by a counter guarantee / collateral by the Indian party.
 - g. 50% of the amount of performance guarantee issued by the Indian party provided that the outflow on account of invocation of performance guarantee results in the breach of the limit of the financial commitment in force, prior permission of the Reserve Bank is to be obtained before executing remittance beyond the limit prescribed for the financial commitment.

The investments are subject to the following conditions:

- a) The Indian party / entity may extend loan / guarantee only to an overseas JV/ WOS in which it has equity participation. Proposals from the Indian party for undertaking financial commitment without equity contribution in JV / WOS may be considered by the Reserve Bank under the approval route. AD banks may forward the proposals from their constituents after ensuring that the laws of the host country permit incorporation of a company without equity participation by the Indian party.

Indian entities may offer any form of guarantee - corporate or personal (including the personal

guarantee by the indirect resident individual promoters of the Indian Party)/ primary or collateral / guarantee by the promoter company / guarantee by group company, sister concern or associate company in India provided that:

- i. All financial commitments including all forms of guarantees are within the overall ceiling prescribed for overseas investment by the Indian party i.e. currently within 400 per cent of the net worth as on the date of the last audited balance sheet of the Indian party.
- ii. No guarantee should be 'open ended' i.e. the amount and period of the guarantee should be specified upfront. In the case of performance guarantee, time specified for the completion of the contract shall be the validity period of the related performance guarantee.
- iii. In cases where invocation of the performance guarantees breach the ceiling for the financial exposure of 400 per cent of the net worth of the Indian Party, the Indian Party shall seek the prior approval of the Reserve Bank before remitting funds from India, on account of such invocation.
- iv. As in the case of corporate guarantees, all guarantees (including performance guarantees and Bank Guarantees / SBLC) are required to be reported to the Reserve Bank, in Form ODI-Part II. Guarantees issued by banks in India in favour of WOSs / JVs outside India, and would be subject to prudential norms, issued by the Reserve Bank (DBOD) from time to time.

Foot note: Compulsorily Convertible Preference Shares (CCPS) shall be treated at par with equity shares

Note: Specific approval of the Reserve Bank will be required for creating charge on immovable/ moveable property and other financial assets (except pledge of shares of overseas JV/WOS) of the Indian parent/ group companies in favour of a non-resident entity within the overall limit fixed (presently 400%) for financial commitment subject to submission of a 'No Objection' by the Indian Party and their Group companies from their Indian lenders.

- b) The Indian party should not be on the Reserve Bank's Exporters' caution list / list of defaulters to the banking system circulated by the Reserve Bank / Credit Information Bureau (India) Ltd. (CIBIL) / or any other credit information company as approved by the Reserve Bank or under investigation by any investigation / enforcement agency or regulatory body.
- c) All transactions relating to a JV / WOS should be routed through one branch of an Authorised Dealer bank to be designated by the Indian party.
- d) In case of partial / full acquisition of an existing foreign company, where the investment is more than USD 5 million, valuation of the shares of the company shall be made by a Category I Merchant Banker registered with SEBI or an Investment Banker / Merchant Banker outside India registered with the appropriate regulatory authority in the host country; and, in all other cases by a Chartered Accountant or a Certified Public Accountant.
- e) In cases of investment by way of swap of shares, irrespective of the amount, valuation of the shares will have to be made by a Category I Merchant Banker registered with SEBI or an Investment Banker outside India registered with the appropriate regulatory authority in the host country. Approval of the Foreign Investment Promotion Board (FIPB) will also be a prerequisite for investment by swap of shares.
- f) In case of investment in overseas JV / WOS abroad by a registered Partnership firm, where the entire funding for such investment is done by the firm, it will be in order for individual partners to hold shares for and on behalf of the firm in the overseas JV / WOS if the host country regulations or operational requirements warrant such holdings.
- g) An Indian party may acquire shares of a foreign company engaged in a bonafide business activity, in exchange of ADRs/GDRs issued to the latter in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism)



Scheme, 1993, and the guidelines issued there under from time to time by the Government of India, provided:

- (i) ADRs/GDRs are listed on any stock exchange outside India;
 - (ii) The ADR and/or GDR issued for the purpose of acquisition is backed by underlying fresh equity shares issued by the Indian party;
 - (iii) The total holding in the Indian entity by persons resident outside India in the expanded capital base, after the new ADR and/or GDR issue, does not exceed the sectoral cap prescribed under the relevant regulations for such investment under FDI;
 - (iv) Valuation of the shares of the foreign company shall be:
 - (a) as per the recommendations of the Investment Banker if the shares are not listed on any recognized stock exchange; or
 - (b) based on the current market capitalisation of the foreign company arrived at on the basis of monthly average price on any stock exchange abroad for the three months preceding the month in which the acquisition is committed and over and above, the premium, if any, as recommended by the Investment Banker in its due diligence report in other cases.
- (4) The Indian Party is required to report such acquisition in form ODI to the AD Bank for submission to the Reserve Bank within a period of 30 days from the date of the transaction.

Note: Investments in Nepal are permitted only in Indian Rupees. Investments in Bhutan are permitted in Indian Rupees as well as in freely convertible currencies. All dues receivable on investments made in freely convertible currencies, as well as their sale / winding up proceeds are required to be repatriated to India in freely convertible currencies only. *Investments in Pakistan by Indian Parties are permissible under the approval route.*

Issue of guarantee by an Indian Party to step down subsidiary of JV /WOS

- (a) Indian Parties are permitted to issue corporate guarantees on behalf of their first level step down operating JV /WOS set up by their JV / WOS operating as a Special Purpose Vehicle (SPV) under the Automatic Route, subject to the condition that the financial commitment of the Indian Party is within the extant limit for overseas direct investment. It has been decided that irrespective of whether the direct subsidiary is an operating company or a SPV, the Indian promoter entity may extend corporate guarantee on behalf of the first generation step down operating company under the Automatic Route, within the prevailing limit for overseas direct investment. Such guarantees will have to be reported to the Reserve Bank in Form ODI, as hitherto, through the designated AD Category – I bank concerned.
- (b) Further, the issuance of corporate guarantee on behalf of second generation or subsequent level step down operating subsidiaries will be considered under the Approval Route, provided the Indian Party directly or indirectly holds 51 per cent or more stake in the overseas subsidiary for which such guarantee is intended to be issued.

Investment through Special Purpose Vehicle (SPV) under Automatic Route

- (i) Investments in JV/WOS abroad by Indian parties through the medium of a Special Purpose Vehicle (SPV) are also permitted under the Automatic Route in terms of Regulation 6 of the Notification, subject to the conditions that the Indian party is not included in the Reserve Bank's caution list or is under investigation by the Directorate of Enforcement or included in the list of defaulters to the banking system circulated by the Reserve Bank/any other Credit Information company as approved by the Reserve Bank. Indian parties whose names appear in the Defaulters' list require prior approval of the Reserve Bank for the investment.
- (ii) Setting up of an SPV under the Automatic Route is permitted for the purpose of making a investment

in JV/WOS overseas.

Investment in unincorporated entities overseas under the Automatic Route

- (1) Investments in unincorporated entities overseas in the oil sector (i.e. for exploration and drilling for oil and natural gas, etc.) by Navaratna PSUs, ONGC Videsh Ltd.(OVL) and Oil India Ltd.(OIL) may be permitted by AD Category - I banks, without any limit, provided such investments are approved by the competent authority.
- (2) Other Indian companies are also permitted under the Automatic Route to invest in unincorporated entities overseas in the oil sector up to 400 per cent of their net worth provided the proposal has been approved by the competent authority and is duly supported by certified copy of the Board resolution approving such investment. Investment in excess of 400 per cent of the net worth of an Indian company shall require prior approval of the Reserve Bank.
- (3) Indian companies are also permitted to participate in a consortium with other international operators to construct and maintain submarine cable systems on co-ownership basis under the automatic route. Accordingly, AD Category - I banks may allow remittances by Indian companies for overseas direct investment, after ensuring that the Indian company has obtained necessary licence from the Department of Telecommunication, Ministry of Telecommunication & Information Technology, Government of India to establish, install, operate and maintain International Long Distance Services and also by obtaining a certified copy of the Board Resolution approving such investment.

Accordingly, these transactions may be reported by the Indian entities investing in the consortium to the AD Category - I banks in form ODI for enabling on-line submission of the same by the AD Category -I banks to the Reserve Bank for allotment of Unique Identification Number.

Method of Funding

- (1) Investment in an overseas JV / WOS may be funded out of one or more of the following sources:
 - i. drawal of foreign exchange from an AD bank in India;
 - ii. capitalisation of exports;
 - iii. swap of shares (valuation as mentioned in para B.1 (e) above);
 - iv. proceeds of External Commercial Borrowings (ECBs) / Foreign Currency Convertible Bonds (FCCBs);
 - v. in exchange of ADRs/GDRs issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinar Shares (through Depository Receipt Mechanism) Scheme, 1993, and the guidelines issued thereunder from time to time by the Government of India;
 - vi. balances held in EEFC account of the Indian party; and
 - vii. proceeds of foreign currency funds raised through ADR / GDR issues.

In respect of (vi) and (vii) above, the ceiling of 400 per cent of the net worth will not apply. However, all investments made in the financial sector will be subject to compliance with Regulation 7 of the Notification, irrespective of the method of funding.

"Wherever, the host country Regulations stipulate that the investments into the country is required to be routed through a designated account, an Indian party will be allowed to open, hold and maintain Foreign Currency Account (FCA) abroad for the purpose of overseas direct investments subject to certain terms and conditions".

- (2) General permission has been granted to persons resident in India for purchase / acquisition of securities in the following manner :



- (i) out of funds held in RFC account;
- (ii) as bonus shares on existing holding of foreign currency shares; and
- (iii) when not permanently resident in India, out of their foreign currency resources outside India (para A.4 above)

Capitalisation of exports and other dues

- (1) Indian party is permitted to capitalise the payments due from the foreign entity towards exports, fees, royalties or any other dues from the foreign entity for supply of technical know-how, consultancy, managerial and other services within the ceilings applicable. Capitalisation of export proceeds remaining unrealised beyond the prescribed period of realization will require prior approval of the Reserve Bank.
- (2) Indian software exporters are permitted to receive 25 per cent of the value of their exports to an overseas software start-up company in the form of shares without entering into Joint Venture Agreements, with prior approval of the Reserve Bank.

Investments in Financial Services Sector

- (1) In terms of Regulation 7 of the Notification, an Indian party seeking to make investment in an entity outside India, which is engaged in the financial sector, should fulfill the following additional conditions:
 - i. be registered with the regulatory authority in India for conducting the financial sector activities;
 - ii. has earned net profit during the preceding three financial years from the financial services activities;
 - iii. has obtained approval from the regulatory authorities concerned both in India and abroad for venturing into such financial sector activity; and
 - iv. has fulfilled the prudential norms relating to capital adequacy as prescribed by the concerned regulatory authority in India.
- (2) Any additional investment by an existing JV/WOS or its step down subsidiary in the financial services sector is also required to comply with the above conditions.
- (3) Regulated entities in the financial sector making investments in any activity overseas are required to comply with the above guidelines. Unregulated entities in the financial services sector in India may invest in non financial sector activities subject to compliance with the provisions of Regulation 6 of the Notification. Trading in Commodities Exchanges overseas and setting up JV/ WOS for trading in overseas exchanges will be reckoned as financial services activity and require clearance from the Forward Markets Commission.

Investment in Equity of Companies Registered Overseas / Rated Debt Instruments

- (1) (i) Portfolio Investments by listed Indian companies

Listed Indian companies are permitted to invest up to 50 per cent of their net worth as on the date of the last audited balance sheet in (i) shares and (ii) bonds / fixed income securities, rated not below investment grade by accredited / registered credit rating agencies, issued by listed overseas companies.
- (ii) Investment by Mutual Funds

Indian Mutual Funds registered with SEBI are permitted to invest within an overall cap of USD 7 billion in :

 - i) ADRs / GDRs of the Indian and foreign companies;

- ii) equity of overseas companies listed on recognised stock exchanges overseas ;
 - iii) initial and follow on public offerings for listing at recognized stock exchanges overseas;
 - iv) foreign debt securities in the countries with fully convertible currencies, short- term as well as long-term debt instruments with rating not below investment grade by accredited/ registered credit agencies;
 - v) money market instruments rated not below investment grade;
 - vi) repos in the form of investment, where the counterparty is rated not below investment grade. The repos should not, however, involve any borrowing of funds by mutual funds;
 - vii) government securities where the countries are rated notbelow investment grade;
 - viii) derivatives traded on recognized stock exchanges overseasonly for hedging and portfolio balancing with underlying as securities;
 - ix) short-term deposits with banks overseas where the issuer is rated not below investment grade; and
 - x) units / securities issued by overseas Mutual Funds or Unit Trusts registered with overseas regulators and investing in (a) aforesaid securities, (b) Real Estate Investment Trusts (REITS) listed on recognized stock exchanges overseas, or (c) unlisted overseas securities (not exceeding 10 per cent of their net assets).
- (2) A limited number of qualified Indian Mutual Funds, are permitted to invest cumulatively up to USD 1 billion in overseas Exchange Traded Funds as may be permitted by SEBI.
- (3) Domestic Venture Capital Funds registered with SEBI may invest in equity and equity linked instruments of off-shore Venture Capital Undertakings, subject to an overall limit of USD 500 million. Accordingly, Mutual Funds / Venture Capital Funds desirous of availing of this facility may approach SEBI for necessary permission.
- (4) General permission is available to the above categories of investors for sale of securities so acquired.

Approval of the Reserve Bank

- (1) Prior approval of the Reserve Bank would be required in all other cases of direct investment abroad. For this purpose, application together with necessary documents should be submitted in Form ODI through their Authorised Dealer Category – I banks.
- (2) Reserve Bank would, inter alia, take into account the following factors while considering such applications:
- a. Prima facie viability of the JV / WOS outside India;
 - b. Contribution to external trade and other benefits which will accrue to India through such investment;
 - c. Financial position and business track record of the Indian party and the foreign entity; and
 - d. Expertise and experience of the Indian party in the same or related line of activity as of the JV / WOS outside India.

Investments in energy and natural resources sector

Reserve Bank will consider applications for investment in JV/WOS overseas in the energy and natural resources sectors (e.g. oil, gas, coal and mineral ores) in excess of 400 per cent of the net worth of the Indian companies as on the date of the last audited balance sheet. AD Category - I banks may forward such applications from their constituents to the Reserve Bank as per the laid down procedure.



Overseas Investments by Proprietorship Concerns

- (1) With a view to enabling recognized star exporters with a proven track record and a consistently high export performance to reap the benefits of globalization and liberalization, proprietorship concerns and unregistered partnership firms are allowed to set up JVs / WOS outside India with the prior approval of the Reserve Bank subject to satisfying certain eligibility criteria. An application in form ODI may be made to the Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Overseas Investment Division, Central Office, Amar Building, 5th Floor, Fort, Mumbai 400 001, through the AD Category - I bank. AD Category - I banks may forward the applications to the Reserve Bank along with their comments and recommendations, for consideration.
- (2) Investments by established proprietorship or unregistered partnership exporter firms will be subject to the following conditions:
 - i) The Partnership / Proprietorship firm is a DGFT recognized Star Export House.
 - ii) The AD Category – I bank is satisfied that the exporter is KYC (Know Your Customer) compliant and is engaged in the proposed business and meets the requirement as indicated at i) above.
 - iii) Exporter has proven track record i.e. overdue exports do not exceed 10 per cent of the average export realization of preceding three financial years.
 - iv) The exporter has not come under adverse notice of any Government agency like Directorate of Enforcement, CBI and does not appear in the exporters' caution list of the Reserve Bank or in the list of defaulters to the banking system in India.
 - v) The amount of investment outside India does not exceed 10 per cent of the average export realization of the preceding three financial years or 200 per cent of the net owned funds of the firm, whichever is lower.

Overseas investment by Registered Trust / Society

Registered Trusts and Societies engaged in manufacturing / educational / hospital sector are allowed to make investment in the same sector(s) in a JV/WOS outside India, with the prior approval of the Reserve Bank. Trusts / Societies satisfying the eligibility criteria, as indicated below, may submit the application/s in Form ODI-Part I, through their AD Category - I bank/s, to the Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Overseas Investment Division, Central Office, Amar Building, 5th Floor, Fort, Mumbai 400 001, for consideration.

Eligibility Criteria:

(a) Trust

- i) The Trust should be registered under the Indian Trust Act, 1882;
- ii) The Trust deed permits the proposed investment overseas;
- iii) The proposed investment should be approved by the trustee/s;
- iv) The AD Category – I bank is satisfied that the Trust is KYC (Know Your Customer) compliant and is engaged in a bonafide activity;
- v) The Trust has been in existence at least for a period of three years;
- vi) The Trust has not come under the adverse notice of any Regulatory / Enforcement agency like

the Directorate of Enforcement, Central Bureau of Investigation (CBI), etc.

(b) Society

- i) The Society should be registered under the Societies Registration Act, 1860.
- ii) The Memorandum of Association and rules and regulations permit the Society to make the proposed investment which should also be approved by the governing body / council or a managing / executive committee.
- iii) The AD Category - I bank is satisfied that the Society is KYC (Know Your Customer) compliant and is engaged in a bonafide activity;
- iv) The Society has been in existence at least for a period of three years;
- v) The Society has not come under the adverse notice of any Regulatory / Enforcement agency like the Directorate of Enforcement, CBI etc.

In addition to the registration, the AD Category – I bank should ensure that the special license / permission has been obtained by the applicant in case the activities require special license / permission either from the Ministry of Home Affairs, Government of India or from the relevant local authority, as the case may be.

Post investment changes / additional investment in existing JV / WOS

A JV / WOS set up by the Indian party as per the Regulations may diversify its activities / set up step down subsidiary / alter the shareholding pattern in the overseas entity (subject to compliance of Regulation 7 of the Notification in the case of financial services sector companies). The Indian party should report to the Reserve Bank through the AD Category - I bank, the details of such decisions within 30 days of the approval of those decisions by the competent authority of the JV / WOS concerned in terms of local laws of the host country and include the same in the Annual Performance Report (APR—Part III of form ODI) required to be forwarded to the AD Category-I bank.

Restructuring of the balance sheet of the overseas entity involving write- off of capital and receivables

In order to provide more operational flexibility to the Indian corporates, the Indian promoters who have set up WOS abroad or have at least 51 per cent stake in an overseas JV, may write off capital (equity / preference shares) or other receivables, such as, loans, royalty, technical knowhow fees and management fees in respect of the JV /WOS, even while such JV /WOS continues to function as under:

- (i) Listed Indian companies are permitted to write off capital and other receivables up to 25 per cent of the equity investment in the JV /WOS under the Automatic Route; and
- (ii) Unlisted companies are permitted to write off capital and other receivables up to 25 per cent of the equity investment in the JV /WOS under the Approval Route.

The write-off / restructuring have to be reported to the Reserve Bank through the designated AD Category-I bank within 30 days of write-off/ restructuring. The write-off / restructuring is subject to the condition that the Indian Party should submit the following documents for scrutiny along with the applications to the designated AD Category –I bank under the Automatic as well as the Approval Routes:

- a) A certified copy of the balance sheet showing the loss in the overseas WOS/JV set up by the Indian Party; and
- b) Projections for the next five years indicating benefit accruing to the Indian company consequent to such write off / restructuring.

Acquisition of a foreign company through bidding or tender procedure



An Indian party may remit earnest money deposit or issue a bid bond guarantee for acquisition of a foreign company through bidding and tender procedure and also make subsequent remittances through an AD Category - I bank, in accordance with the provisions of Regulation 14 of the Notification.

Obligations of Indian Entity

- (1) An Indian party which has made direct investment abroad is under obligation to (a) receive share certificate or any other document as an evidence of investment, (b) repatriate to India the dues receivable from foreign entity, and (c) submit the documents / Annual Performance Report to the Reserve Bank, in accordance with the provisions specified in Regulation 15 of the Notification. The share certificate or any other document as evidence of investment has to be submitted to and retained by the designated AD Category - I bank, who is required to monitor the receipt of such documents and satisfy themselves about the bonafides of the documents. A certificate to this effect should be submitted by the designated AD category – I bank to the Reserve Bank along with the APR (Part III of Form ODI).
- (2) Reporting requirements including submission of Annual Performance Report are also applicable for investors in unincorporated entities in the oil sector.
- (3) Where the law of the host country does not mandatorily require auditing of the books of accounts of JV / WOS, the Annual Performance Report (APR) may be submitted by the Indian party based on the un-audited annual accounts of the JV / WOS provided:
 - a. The Statutory Auditors of the Indian party certify that 'The un-audited annual accounts of the JV / WOS reflect the true and fair picture of the affairs of the JV / WOS' and
 - b. That the un-audited annual accounts of the JV / WOS has been adopted and ratified by the Board of the Indian party.

Transfer by way of sale of shares of a JV / WOS

1. An Indian Party without prior approval of the Reserve Bank may transfer by way of sale to another Indian Party which complies with the provisions of Regulation 6 of FEMA Notification 120/RB-2004 dated July 7, 2004 or to a person resident outside India, any share or security held by it in a JV or WOS outside India subject to the following conditions:
 - (i) the sale does not result in any write off of the investment made.
 - (ii) the sale is effected through a stock exchange where the shares of the overseas JV/ WOS are listed;
 - (iii) if the shares are not listed on the stock exchange and the shares are disinvested by a private arrangement, the share price is not less than the value certified by a Chartered Accountant / Certified Public Accountant as the fair value of the shares based on the latest audited financial statements of the JV / WOS;
 - (iv) the Indian party does not have any outstanding dues by way of dividend, technical know-how fees, royalty, consultancy, commission or other entitlements and / or export proceeds from the JV or WOS;
 - (v) the overseas concern has been in operation for at least one full year and the Annual Performance Report together with the audited accounts for that year has been submitted to the Reserve Bank;
 - (vi) the Indian party is not under investigation by CBI / DoE/ SEBI / IRDA or any other regulatory authority in India.
2. The Indian entity is required to submit details of such disinvestment through its designated AD category-I bank within 30 days from the date of disinvestment.

Transfer by way of sale of shares of a JV / WOS involving Write off of the investment

- (1) Indian Parties may disinvest, without prior approval of the Reserve Bank, in any of the under noted cases where the amount repatriated after disinvestment is less than the original amount invested:
 - i. in case where the JV / WOS is listed in the overseas stock exchange;
 - ii. in cases where the Indian Party is listed on a stock exchange in India and has a net worth of not less than Rs.100 crore;
 - iii. where the Indian Party is an unlisted company and the investment in the overseas venture does not exceed USD 10 million. and
 - iv. where the Indian Party is a listed company with net worth of less than Rs.100 crore but investment in an overseas JV/WOS does not exceed USD 10 million.
- (2) Such disinvestments shall be subject to the conditions listed under transfer by way of sale of shares items 1(ii) to (vi) and 2.
- (3) An Indian Party, which does not satisfy the conditions laid down above for undertaking any disinvestment in its JV/WOS abroad, shall have to apply to the Reserve Bank for prior permission.

Pledge of Shares of JV/WOS

An Indian party may pledge the shares of JV / WOS to an AD Category – I bank or a public financial institution in India for availing of any credit facility for itself or for the JV / WOS abroad in terms of Regulation 18 of the Notification. Indian party may also transfer by way of pledge, the shares held in overseas JV/WOS, to an overseas lender, provided the lender is regulated and supervised as a bank and the total financial commitments of the Indian party remain within the limit stipulated by the Reserve Bank for overseas investments, from time to time.

Hedging of Overseas Direct Investments

- (1) Resident entities having overseas direct investments are permitted to hedge the foreign exchange rate risk arising out of such investments. AD Category - I banks may enter into forward / option contracts with resident entities who wish to hedge their overseas direct investments (in equity and loan), subject to verification of such exposure. Cancellation of such forward contracts may be permitted by AD Category - I banks and 50 per cent of such cancelled contracts may be allowed to be rebooked.
- (2) If a hedge becomes naked in part or full owing to shrinking of the market value of the overseas direct investment, the hedge may continue to the original maturity. Rollovers on the due date are permitted up to the extent of market value as on that date.

Other Investments in Foreign Securities

Permission for purchase/ acquisition of foreign securities in certain cases

General permission has been granted to a person resident in India who is an individual –

- a. to acquire foreign securities as a gift from any person resident outside India;
- b. to acquire shares under cashless Employees Stock Option Programme (ESOP) issued by a company outside India, provided it does not involve any remittance from India;
- c. to acquire shares by way of inheritance from a person whether resident in or outside India;
- d. to purchase equity shares offered by a foreign company under its ESOP Schemes, if he is an employee, or, a director of an Indian office or branch of a foreign company, or, of a subsidiary in



India of a foreign company, or, an Indian company in which foreign equity holding, either direct or through a holding company/Special Purpose Vehicle (SPV) irrespective of the percentage of the direct or indirect equity stake in the Indian company. AD Category – I banks are permitted to allow remittances for purchase of shares by eligible persons under this provision irrespective of the method of operationalisation of the scheme i.e where the shares under the scheme are offered directly by the issuing company or indirectly through a trust / a Special Purpose Vehicle (SPV) / step down subsidiary, provided (i) the shares under the ESOP Scheme are offered by the issuing company globally on a uniform basis, and (ii) an Annual Return (Annex B) is submitted by the Indian company to the Reserve Bank through the AD Category – I bank giving details of remittances / beneficiaries, etc.

A person resident in India may transfer by way of sale the shares acquired as stated above provided that the proceeds thereof are repatriated immediately on receipt thereof and in any case not later than 90 days from the date of sale of such securities

- e. Foreign companies are permitted to repurchase the shares issued to residents in India under any ESOP Scheme provided (i) the shares were issued in accordance with the Rules / Regulations framed under Foreign Exchange Management Act, 1999, (ii) the shares are being repurchased in terms of the initial offer document, and (iii) an annual return is submitted through the AD Category – I bank giving details of remittances / beneficiaries, etc.
- f. In all other cases, not covered by general or special permission, approval of the Reserve Bank is required to be obtained before acquisition of a foreign security.

Pledge of a foreign security by a person resident in India

The shares acquired by persons resident in India in accordance with the provisions of Foreign Exchange Management Act, 1999 or Rules or Regulations made thereunder are allowed to be pledged for obtaining credit facilities in India from an AD Category – I bank / Public Financial Institution.

General permission in certain cases

Residents are permitted to acquire a foreign security, if it represents –

- a. “qualification shares for becoming a director of a company outside India to the extent prescribed as per the law of the host country where the company is located provided it does not exceed the limit prescribed for the resident individuals under the Liberalized Remittance Scheme (LRS) in force at the time of acquisition;
- b. “part / full consideration of professional services rendered to the foreign company or in lieu of Director's remuneration. The limit of acquiring such shares in terms of value is restricted to the overall ceiling prescribed for the resident individuals under the Liberalized Remittance Scheme (LRS) in force at the time of acquisition;
- c. rights shares provided that the rights shares are being issued by virtue of holding shares in accordance with the provisions of law for the time being in force;
- d. purchase of shares of a JV / WOS abroad of the Indian promoter company by the employees/ directors of Indian promoter company which is engaged in the field of software where the consideration for purchase does not exceed USD 10,000 or its equivalent per employee in a block of five calendar years; the shares so acquired do not exceed 5 per cent of the paid-up capital of the JV / WOS outside India; and after allotment of such shares, the percentage of shares held by the Indian promoter company, together with shares allotted to its employees is not less than the percentage of shares held by the Indian promoter company prior to such allotment; and
- e. purchase of foreign securities under ADR / GDR linked stock option schemes by resident employees of Indian companies in the knowledge based sectors, including working directors provided purchase consideration does not exceed USD 50,000 or its equivalent in a block of five calendar years.

LIMITED LIABILITY PARTNERSHIP

Preliminary

Limited Liability Partnership ("LLP") is a body corporate having a legal personality and perpetual succession and any change in the partners will not affect its existence, rights or liabilities. Though LLP is a body corporate it is governed, not by the Companies Act, but by the special LLP Act.

The question of LLP has been debated since 1972 by various expert committees including the Abid Hussain Committee 1997 and the Naresh Chandra Committee on Private Companies and Partnerships 2003. The Expert Committee on Company Law under the Chairmanship of Dr.J.J. Irani, had, while dealing with need to have provisions exempting small companies from the rigors of compliance under the Companies Act recommended "enabling of new vehicles for business, such as Limited Liability Partnerships, through separate legislation, if necessary" should be done. In the light of these recommendations the LLP Act has been enacted.

LLP format "is an alternative corporate business vehicle that provides the benefits of limited liability of a company but allows its members the flexibility of organizing their internal management on the basis of a mutually arrived agreement, as is the case in a partnership firm. This format would be quite useful for small and medium enterprises in general and for the enterprises in services, sector in particular, Internationally, LLPs are the preferred vehicle of business particularly for service industry or for activities involving professionals." However, the LLP Act does not restrict the benefit of LLP structure to certain classes of professionals only but made applicable to any enterprise which fulfils the requirements of the LLP Act. A specific provision is made that, unless otherwise specified, the provisions of the Indian Partnership Act, 1932 shall not apply to a LLP,

Advantages of a LLP

In the words of the Nareshchandra Committee, a LLP is "a hybrid entity between the partnership simpliciter, or general partnership, and a private limited company." "Such an entity would provide the flexibility of a partnership (allowing the owners to adopt whatever form of internal organization they prefer), and limiting at the same time, the owner's liability with respect to the LLP." Following are some of the advantages of a LLP as for vehicle for carrying out a business:

- (a) It is a partnership but has a legal entity of its own any property in its own name and can sue and be sued in its name;
- (b) It has perpetual existence as any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the limited liability partnership;
- (c) Though a partnership, the liability of its members i.e. partners is limited to the respective capital contributed by them similar to the case of a company where members have limited liability;
- (d) Its internal management is not prescribed by law, but is governed by the terms of the partnership agreement entered into and hence is flexible; any change in the terms require compliance but not a cumbersome procedure;
- (e) One partner may act as agent of another partner, but he is not liable for acts of another partner while all partners can bind the partnership; the partnership alone is liable for- all lawful, acts of the partners;
- (f) The compliance cost of a LLP is far less than that of a company be it a private limited company or otherwise;
- (g) Relieves the partnership from the requirement of CA 1956 which restricts the number of persons who could form an association or partnership unless such association or partnership is registered as a company.

LLP- Definition



Section 2(1)(n) defines the expression “limited liability partnership” to mean “a partnership formed and registered under this Act”. Unlike a partnership firm a LLP is a legal entity separate from that of its partners and has a perpetual succession. Section 3 of LLP Act reads as under;

3. (1) A limited liability partnership is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.

(2) A limited liability partnership shall have perpetual succession.

(3) Any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the limited liability partnership.

It is provided that a LLP is a body corporate. The term “body corporate” for the limited purposes of the LLP Act has been given a very wide meaning to include a company under the Companies Act or incorporated outside India and further includes a LLP whether incorporated under the LLP Act or incorporated outside India. This term is

defined in Section 2(1)(d) as under:

“body corporate” means—

a company as defined in section 3 of the Companies Act, 1956 and includes —

- (i) a limited liability partnership registered under this Act;
- (ii) a limited liability partnership incorporated outside India; and
- (iii) a company incorporated outside India,

but does not include —

- (i) a corporation sole;
- (ii) a co-operative society registered under any law for the time being in force
- (iii) any other body Corporate (not being a company as defined in section 3 of the Companies Act, 1956 or a limited liability partnership as defined in this Act), which the Central Government may, by notification in the Official Gazette specify in this behalf.

PRE-REQUISITES FOR FORMING A LLP

A. Application for name approval

Similar to formation of a company under the Companies Act 1956, before forming a LLP the concerned promoters need to apply for name approval. In terms of the Rule 18(5) of the Concept Rules, an application for reservation of name with which the proposed limited liability partnership is to be registered shall be made to the Registrar having jurisdiction over the proposed registered office in the prescribed Form 1. Rule 18(1) gives details as to what types of names which are prohibited and will not be approved. The name as approved by the Registrar will be valid for a period of three months from the date of intimation by the Registrar. Procedure has been given for seeking change of name. Every limited liability partnership shall have either the words “limited liability partnership” or the acronym “LLP” as the last words of its name [sec, 15(1)]. It is further provided that every limited liability partnership shall ensure that its invoices, official correspondence and publications bear the following, namely : —

- (a) the name, address of its registered office and registration number of the limited liability partnership; and
- (b) a statement that it is registered with limited liability.

B. Registered office

Section 13(1) of LLP Act states that “every limited liability partnership shall have a registered office to which all communications and notices may be addressed and where they shall be received”.

The choice of place for the Registered office is that of the promoters of the LLP. The application for registration will have to be sent to the Registrar having jurisdiction over the place chosen. For change of registered office simple procedure has been prescribed.

C. Who could be partners

It is made clear that the two 'persons' could be two individuals or bodies corporate or one or more partners individuals and others being bodies corporate. As we have seen the term 'bodies corporate' includes LLPs formed and registered outside India, and hence such foreign LLPs could also be a partner in a LLP. In the case of individual person he cannot be a partner if 'he is (a) he has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force or (b) he is an undischarged insolvent or (c) he has applied to be adjudicated as an insolvent and his application is pending. Similar to the case of a limited company under the Companies Act 1956, in the case of a LLP there must be a minimum of two partners, There is no maximum number prescribed.

D. Designated partner

However, there is a need to have two persons as "designated partners". If a body corporate is one of the partners and the other is an individual then a person nominated by the body corporate will be a designated partner. Further out of the two designated partners one must be a person 'resident' in India the term 'resident' means a person who has stayed in India for a period of not less than one hundred and eighty two days during the immediately preceding one year. There is also the requirement that each designated partner must have a Designated Partner Identification Number ("DPIN"). This would mean before making the application for registration the person proposing to act as a designated partner must have obtained the DPIN, In this regard the provisions of the CA 1956 relating to Director Identification Number ("DIN") would apply.

Section 2(1)(j) defines the expression "designated partner" as "any partner designated as such pursuant to section 7". Section 7 reads as follows:

7, Designated partners

- (1) Every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India :

Provided that in case of a limited liability partnership in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such limited liability partnership or -nominees of such bodies corporate shall act as designated partners,

Explanation.— For the purposes of this section, the term "resident in India" means a person who has stayed in India for a period of not less than one hundred and eighty-two days during the immediately preceding one year.

- (2) Subject to the provisions of sub-section (1),— (i) if the incorporation document-
 - (a) specifies who are to be designated partners, such persons shall be designated partners on incorporation; or
 - (b) states that each of the partners from time to time of limited liability partnership is to be designated partner, every partner shall be a designated partner;
- (ii) any partner may become a designated partner by and in accordance with the limited liability partnership agreement and a partner may cease to be a designated partner in accordance with limited liability partnership agreement.
- (3) An individual shall not become a designated partner in any limited liability partnership unless he has given his prior consent to act as such to the limited liability partnership in such form and manner as may be prescribed.



- (4) Every limited liability partnership shall file with the Registrar the particulars of every individual who has given his consent to act as designated partner in such form and manner as may be prescribed within thirty days of his appointment.
- (5) An individual eligible to be a designated partner shall satisfy such conditions and requirements as may be prescribed.
- (6) Every designated partner of a limited liability partnership shall obtain a Designated Partner Identification Number (DPIN) from the Central Government and the provisions of sections 266A to 266G (both inclusive) of the Companies Act, 1956 (1 of 1956) shall apply *mutatis mutandis* for the said purpose.

The importance of a 'designated partner' lies in the additional responsibilities and functions of the person so appointed. Section 8 of LLP Act provides that a designated partner shall be

- (a) responsible for doing of all acts, matters and things as are required to be done by the limited liability partnership in respect of compliance of the provisions of this Act including filing of any document, return, statement and the like report pursuant to the provisions of this Act and as may be specified in the limited liability partnership agreement; and
- (b) liable to all penalties imposed on the limited liability partnership for any contravention of those provisions.

E, Agreement between partners

Similar to the need to have a Memorandum and Articles in the case of a company under Companies Act 1956, for a LLP there is a need to have a written agreement between the partners detailing the terms under which the partnership will function. The expression "limited liability partnership agreement" has been defined in Section 2(1) to mean "any written agreement between the partners of the limited liability partnership or between the limited liability partnership and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to that limited liability partnership." Section 23(1) states "Save as otherwise provided by this Act, the mutual rights and duties of the partners of a limited liability partnership, and the mutual rights and duties of a limited liability partnership and its partners, shall be governed by the limited liability partnership agreement between the partners, or between the limited liability partnership and its partners." Hence a limited liability partnership agreement between the partners of a limited liability partnership is a pre-requisite for incorporating such a partnership.

Rule 21 of the Concept Rules provide that "every limited liability partnership shall file information with regard to the limited liability partnership agreement in Form 4 with the Registrar within 30 days from the date of agreement" and that "If the LLP agreement is silent on any of the matters contained in the First Schedule, the relevant provisions of the said schedule shall apply to that extent." The First Schedule is similar to Schedule A of the Companies Act 1956. Hence care should be taken to draft the limited liability partnership agreement. The following issues should be considered:

1. The name, duration of the partnership;
2. The place of registered office;
3. The extent of share of equity and profits and or loss of each partner; as failing this all the partners of a limited liability partnership are entitled to share equally in the capital, profits and losses of the limited liability partnership;
4. Clause providing for indemnify in respect of payments made and personal liabilities incurred by each partner in the ordinary and proper conduct of the business of the limited liability partnership; or in or about anything necessarily done for the preservation of the business or property of the limited liability partnership;
5. Clause that every partner shall indemnify the limited liability partnership for any loss caused to it by

his fraud in the conduct of the business of the limited liability partnership;

6. The person or persons in whom the day to day management of the limited liability partnership vest;
7. Drawing of partners;
8. Remuneration, if any, for any partner acting in the business or management of the limited liability partnership;
9. The terms on which a new partner could be join the partnership;
10. The basis on which issues relating to the limited liability partnership shall be decided i.e. whether a majority decision is acceptable or a consent of any specific partner is needed etc. and mention of matters which need consent of all partners apart from change in the nature of business for which consent of all partners must be taken;
11. Maintenance of minutes of decisions;
12. The rights a duties of each partner;
13. Matters relating to carrying on business in conflict with that of the partnership;
14. Power to expel any partner or accept resignation of a partner;
15. Financial Provisions on Death, Expulsion or Retirement;
16. Further Provisions Following Retirement or Expulsion;
17. Maintenance of bank accounts and its operation;
18. Appointment of auditors;
19. Financial year of the partnership for which accounts are to be maintained;
20. Provisions for winding up or dissolution of the partnership;
21. Dispute resolution;
22. Such other clauses which are relevant to the business of the partnership.

Incorporation and effect of incorporation of a LLP

In terms of Section 11 of LLP Act, for incorporating a LLP, following action is to be taken:

- (a) the persons (minimum two) intending to carry on a lawful business with a view to profit must subscribed their names to an incorporation document;
- (b) The incorporation document should be in the prescribed form - Form 2 of Concept Rules;
- (c) The Form 2 to be filed with the Registrar of the State in which the registered office of the LLP is to be situated;
- (d) Along with the Form 2, a statement in the prescribed form - Form 3, made by either an advocate, or a company secretary or a chartered accountant or a cost accountant, who is engaged in the formation of the limited liability partnership and by any one who subscribed his name to the incorporation document, shall be filed declaring that all the requirements of the LLP Act and the Rules made thereunder have been complied with, in respect of incorporation and matters precedent and incidental thereto;
- (e) The incorporation document must contain the following information:
 - (i) the name of the limited liability partnership; (ii) the proposed business of the limited liability partnership;
 - (iii) the address of the registered office of the limited liability partnership;



- (iv) the name and address of each of the persons who are to be partners of the limited liability partnership on incorporation;
- (v) the name and address of the persons who are to be designated partners of the limited liability partnership on incorporation;
- (vi) other information concerning the proposed limited liability partnership as per Form 2.

The Registrar, if he is satisfied that the requirements of Section 11 are complied, is required to register the incorporation document and issue a certificate of incorporation. The certificate issued shall be conclusive evidence that the limited liability partnership is incorporated by the name specified therein. Rules 11 to 20 of the LLP Concept Rules deal with the requirements relating to incorporation of a LLP.

Restructuring of a LLP

As stated earlier, we are mainly concerned with restructuring of corporate entities. LLP being a body corporate could also be restructured to meet the needs of the business. The restructuring of a LLP is considered under the following heads:

- (1) Compromise or arrangement of a limited liability partnership;
- (2) Amalgamation or reconstruction of a limited liability partnership;
- (3) Conversion of a partnership firm to a limited liability partnership;
- (4) Conversion of a private limited company to a limited liability partnership; and
- (5) Conversion of an unlisted public company to a limited liability partnership.

Compromise, arrangement or reconstruction of a limited liability partnership

The provisions relating to compromise or an arrangement between the limited liability partnership and its partners or between the limited liability partnership and its creditors are dealt with in Sections 60 and 61 of LLP Act and Rule 35 of the LLP Concept Rules. These provisions are very similar to sections 391 and 392 of the Companies Act 1956.

The procedure is explained below:

The application in respect of the proposed compromise or an arrangement is to be made to the Tribunal. The party who could make the application is either the limited liability partnership or its creditor or its partner. In the case of a LLP which is being wound up, the application could be made by the liquidator.

On the application made, the Tribunal may order a meeting of the creditors or of the partners to be called, held and conducted in such manner as is prescribed or as the Tribunal directs. Rule 35(1) of Concept LLP Rules provides that the application shall be by summons (Form 20) of the Tribunal supported by an affidavit (Form 21). A copy of the proposed compromise or arrangement shall be annexed to the affidavit as an exhibit thereto. Unless it is required to send notice to the limited liability partnership or to the liquidator, ordinarily the summons shall be moved *ex parte*. The notice of the meeting shall be advertised, if so decided by the Tribunal, in such newspapers and in such manner as the Tribunal may direct.

In terms of Rule 35(3), upon the hearing of the summons or any adjourned hearing thereof, the Tribunal shall, unless it thinks fit for any reason to dismiss the summons, give such directions as it may think necessary in respect of the following matters:

- (i) determining the class or classes of creditors and/or of partners whose meeting or meetings have to be held for considering the proposed compromise or arrangement;
- (ii) fixing the time and place of such meeting or meetings;
- (iii) appointing a chairman or chairmen for the meeting or meetings to be held, as the case may be;

- (iv) fixing the quorum and the procedure to be followed at the meeting or meetings, including voting by proxy;
- (v) determining the values of the creditors and/or the partners, as the case may be, whose meetings have to be held;
- (vi) notice to be given of the meeting or meetings and the advertisement, if any, of such notice;
- (vii) the time within which the Chairman of the meeting is to report to the Tribunal the result of the meeting; and
- (viii) such other matters as the Tribunal may deem necessary.

Every creditor or partner entitled to attend the meeting shall be furnished by the limited liability partnership, free of charge and within 24 hours of a requisition being made for the same, with a copy of the proposed compromise or arrangement stating any material interests of the designated partners, unless the same had been already furnished to such partner or creditor. [Rule 35(6)(1)]. Also an affidavit is required to be filed by the persons moving the application that all material facts relating to the LLP including the latest financial position of the LLP and all pending investigation proceedings in relation to the LLP.

The meeting shall be conducted in the manner the Tribunal directs. It is necessary that the scheme of compromise or arrangement must be approved by a majority representing three-fourths in value of the creditors, or partners, as the case may be.

The Tribunal, if it is satisfied that all material facts relating to the limited liability partnership, including the latest financial position of the LLP and the pendency of any investigation proceedings in relation to the LLP have been disclosed to all partners and or creditors, may pass an order sanctioning the scheme of compromise or arrangement. In this connection reference could be made to the decision of the Rajasthan High Court in the case of TCI Infrastructure Finance Ltd, In re: (2008) 146 Com Cas 133 (Raj). In that case it was found that material facts were not disclosed in that the application filed against the petitioner by one of the creditors before the Debt Recovery Tribunal and pending criminal cases under section 136 of the Negotiable Instruments Act against the managing director and other directors which were not disclosed in the Explanatory Statement. The Court rejected the scheme of arrangement with creditors. Though this case related to sections 391 and 393 of the CA 1956, it has relevance as to compromise or arrangement under the LLP Act as well, since the requirement of disclosing all material facts is also a requirement under the LLP Act.

An order passed by the Tribunal will be binding on all the creditors or all the partners, as the case may be, and also on the limited liability partnership, or in the case of a limited liability partnership which is being wound up, on the liquidator and contributories of the limited liability partnership.

The Tribunal has also the powers to stay the commencement or continuation of any suit or proceeding against the limited liability partnership on such terms as the Tribunal thinks fit until the final disposal of the application made to it.

The Tribunal has also the power to supervise the carrying out of the compromise or an arrangement in respect of a LLP. It has the powers to give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper working of the compromise or arrangement. It could also make an order for winding up of the LLP, in case it is satisfied that a compromise or arrangement cannot be worked satisfactorily with or without modification.

Amalgamation or reconstruction of a limited liability partnership

Section 62 of LLP Act deals with provisions relating to reconstruction and amalgamation of limited liability partnerships. These provisions are very similar to the provisions of Section 394 of the Companies Act 1956.



As in the case of reconstruction of companies, in the case of reconstruction of LLPs an application is to be made under section 60 of LLP Act to the Tribunal. The process of compromise or arrangement is to be first adopted. In an application to the Tribunal if the parties show that compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for -

- (a) the reconstruction of any limited liability partnership or limited liability partnerships, or ‘
- (b) the amalgamation of any two or more limited liability partnerships; and
- (c) the whole or any part of the undertaking, property or liabilities of any limited liability partnership concerned in the scheme (in this section referred to as a “transferor limited liability partnership”) is to be transferred to another limited liability partnership (in this section referred to as the “transferee limited liability partnership”),

and seek appropriate orders and directions under Section 62 [Rule 35(10)(1)] the Tribunal may, either by the order sanctioning the compromise or arrangement or by a subsequent order, make provisions for all or any of the following matters, namely: —

- (i) the transfer to the transferee limited liability partnership of the whole or any part of the undertaking, property (includes property, rights and powers of every description) or liabilities (includes duties of every description) of any transferor limited liability partnership;
- (ii) the continuation by or against the transferee limited liability partnership of any legal proceedings pending by or against any transferor limited liability partnership;
- (iii) the dissolution, without winding up, of any transferor limited liability partnership;
- (iv) the provision to be made for any person who, within such time and in such manner as the Tribunal directs, dissent from the compromise or arrangement; and
- (v) such incidental, consequential and supplemental matters as are necessary to secure that
 - (a) the reconstruction or
 - (b) the amalgamation

shall be fully and effectively carried out.

The above powers are exercisable by the Tribunal subject to the following:

- (a) in the case of a compromise or arrangement for the purposes of, or in connection with, a scheme for the amalgamation, which is being wound up, with any other limited liability partnership or limited liability partnerships, the Tribunal shall not sanction the scheme unless the Tribunal has received a report from the Registrar that the affairs of the limited liability partnership have not been conducted in a manner prejudicial to the interests of its partners or to public interest.
- (b) further an order permitting dissolution without winding up shall not be made unless the Official Liquidator has, on scrutiny of the books and papers of the limited liability partnership, made a report to the Tribunal that the affairs of the limited liability partnership have not been conducted in a manner prejudicial to the interests of its partners or to public interest.

The Tribunal has powers to pass an order transferring any property or liabilities free of any charge so long as the compromise or arrangement provisions provide for such discharge.

The limited liability partnership in relation to which the order is made shall file with the Registrar in the prescribed form - Form 22 - along with appropriate fee prescribed, for purposes of registration, a certified copy of such order within thirty days of the order.

As stated earlier the order of the Tribunal will be binding on all the parties. Powers of modification etc. as in the case of compromise or arrangement equally applies to cases under this section.

Conversion into a limited liability partnership

Sections 55, 56 and 57 of the LLP Act provide that a partnership firm ("firm") or a private limited company or an unlisted public company may convert itself into a limited liability partnership in accordance with the Second Schedule. Section 58 makes provisions for registration and consequential actions once the conversion becomes effective. The term "convert" is defined in all the three Schedules referred to above. This definition is in relation to a firm or a private limited company or an unlisted public company. The respective definition in each of the above referred Schedules is given below:

Clause 1(b) of the Second Schedule

"convert", in relation to a firm converting into a limited liability partnership, means a transfer of the property, assets, interests, rights, privileges, liabilities, obligations and the undertaking of the firm to the limited liability partnership in accordance with this Schedule.

Clause 1(b) of the Third Schedule

(b) "convert", in relation to a private company converting into a limited liability partnership, means a transfer of the property, assets, interests, rights, privileges, liabilities, obligations and the undertaking of the private company to the limited liability partnership in accordance with this Schedule,

Clause 1(b) of the Fourth Schedule

(b) "convert", in relation to a company converting into a limited liability partnership, means a transfer of the property, assets, interests, rights, privileges, liabilities, obligations and the undertaking of the company to the limited liability partnership in accordance with the provisions of this Schedule;

Hence conversion in this context refers to transfer of the whole of the undertaking i.e all the assets and all the liabilities, of a firm or a private company or an unlisted public company into a LLP, Thus conversion is a voluntary act and can be done by means of an agreement between all the partners of the firm. Such an agreement should in conformity with the LLP Act and the parties must comply with the requirements of the LLP Act.'

Conversion of a partnership firm to a limited liability partnership

The conversion can take place only if the partners of the proposed LLP comprise of ALL the partners of firm and NO ONE ELSE. Thus at the time of conversion the LLP will have no other person as a partner other than those who were partners of the erstwhile firm.

The application for conversion must be filed with the Registrar of LLPs having jurisdiction in which the registered office of the proposed LLP situate. The application shall be in the prescribed form - Form 17, and shall be accompanied by the prescribed fee. The particulars required are:

- (i) the name and registration number, if applicable, of the firm;
- (ii) the date on which the firm was registered under the Indian Partnership Act, 1932 or under any other law, if applicable, and
- (iii) incorporation document and statement referred to in section 11.

As we noted earlier, the incorporation document statement referred to in section 11 are as follows:

- (i) the name of the limited liability partnership;
- (ii) the proposed business of the limited liability partnership;
- (iii) the address of the registered office of the limited liability partnership;
- (iv) the name and address of each of the persons who are to be partners of the limited liability partnership on incorporation;
- (v) the name and address of the persons who are to be designated partners of the limited liability partnership on incorporation;



(vi) other information concerning the proposed limited liability partnership as per Form 2.

Each of the partners is required to give a statement in Form 17 [Rule 38(1) of LLP Concept Rules]. Since it is a requirement that statement referred to in Section 11 is also to be filed, it is necessary that in addition the statement in Form 17, a statement in the prescribed form - Form 3, made by either an advocate, or a company secretary or a chartered accountant or a cost accountant, who is engaged in the formation of the limited liability partnership and by any one who subscribed his name to the incorporation document, shall also be filed declaring that all the requirements of the LLP Act and the Rules made thereunder have been complied with, in respect of incorporation and matters precedent and incidental thereto.

Upon receipt of the above documents and statement, the Registrar is, if he is satisfied that all the particulars or other information as required by the LLP Act, has been furnished and is verified in the manner he requires, required to register the documents, and issue a certificate of registration in the prescribed form - Form 19 [Rule 38(2) of LLP Concept Rules]. The Registrar would specify the date on and from which the LLP is registered.

The LLP, shall within fifteen days of the date of registration, inform, the concerned Registrar of Firms with which it was registered about the conversion and of the particulars of the LLP in Form 3 [Rule 38(3) of LLP Concept Rules].

There is a right of appeal given to the LLP in case of refusal, for any reason, by the Registrar to register the conversion.

Effects of registration of the LLP upon conversion from a firm

Notwithstanding anything contained in any other law for the time being, on and from the date of registration specified in the certificate of registration issued by the Registrar of LLPs -

- (a) there shall be a limited liability partnership by the name specified in the certificate of registration registered under LLP Act;
- (b) all tangible (movable and immovable) property as well as intangible property vested in the firm] all assets, interests, rights, privileges, liabilities, obligations relating to the firm and the whole of the undertaking of the firm shall be transferred to and shall vest in the limited liability partnership without further assurance, act or deed;
- (c) the firm shall be deemed to be dissolved and if earlier registered under the Indian Partnership Act, 1932 removed from the records maintained under that Act;
- (d) All proceedings by or against the firm which are pending in any Court or Tribunal or before any authority on the date of registration may be continued, completed and enforced by or against the limited liability partnership;
- (e) Any conviction, ruling, order or judgment of any Court, Tribunal or other authority in favour of or against the firm may be enforced by or against the limited liability partnership;
- (f) Every agreement to which the firm was a party immediately before the date of registration, whether or not of such nature that the rights and liabilities thereunder could be assigned, shall have effect as from that date as if —
 - (i) the limited liability partnership were a party to such an agreement instead of the firm; and
 - (ii) for any reference to the firm, there were substituted in respect of anything to be done on or after the date of registration a reference to the limited liability partnership.
- (g) All deeds, contracts, schemes, bonds, agreements, applications, instruments and arrangements subsisting immediately before the date of registration relating to the firm or to which the firm is a party, shall continue in force on and after that date as if they relate to the limited liability partnership and shall be enforceable by or against the limited liability partnership as if the limited

liability partnership were named therein or were a party thereto instead of the firm;

- (h) Every contract of employment to which paragraph 11 or paragraph 12 of Second Schedule applies shall continue to be in force on or after the date of registration as if the limited liability partnership were the employer thereunder instead of the firm;
- (i) Every appointment of the firm in any role or capacity which is in force immediately before the date of registration shall take effect and operate from that date as if the limited liability partnership were appointed;
- (j) Any authority or power conferred on the firm which is in force immediately before the date of registration shall take effect and operate from that date as if it were conferred on the limited liability partnership; and
- (k) Any approval, permit or licence issued to the firm under any other Act which is in force immediately before the date of registration of the limited liability partnership, subject to the provisions of such other Act under which such approval, permit or licence has been issued, will stand transferred to the converted limited liability partnership;

Continuation of liability of the partners of the firm

Notwithstanding the effect of conversion referred to above, every partner of a firm that has converted into a limited liability partnership shall continue to be personally liable (jointly and severally with the limited liability partnership) for the liabilities and obligations of the firm which were incurred prior to the conversion or which arose from any contract entered into prior to the conversion. However, if any such partner discharges any liability or obligation of the erstwhile firm, he shall be entitled (subject to any agreement with the limited liability partnership to the contrary) to be fully indemnified by the limited liability partnership in respect of such liability or obligation.

Follow up action by the LLP and the firm

- (a) If any property referred above is registered with any authority, the limited liability partnership shall, as soon as practicable after the date of registration, take all necessary steps as required by the relevant authority to notify the authority of the conversion and of the particulars of the limited liability partnership in such medium and form as the authority may specify.
- (b) The limited liability partnership shall ensure that for a period of twelve months commencing not later than fourteen days after the date of registration, every official correspondence of the limited liability partnership bears a statement that it was, as from the date of registration, converted from a firm into a limited liability partnership; and the name and registration number, if applicable, of the firm from which it was converted.

Penal provisions

If the limited liability partnership contravenes the provisions above, it will be punished with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees and with a further fine which shall not be less than fifty rupees but which may extend to five hundred rupees for every day after the first day after which the default continues.

Conversion from private company into limited liability partnership

The conversion can take place only subject to the following two conditions:

- (a) there is no security interest in its assets subsisting or in force at the time of application; and
- (b) if the partners of the proposed LLP comprise of ALL the shareholders of the private company and NO ONE ELSE.

Thus at the time of conversion the LLP will have no other person as a partner other than those who were shareholders of the erstwhile private company.



The application for conversion must be filed with the Registrar of LLPs having jurisdiction in which the registered office of the proposed LLP situate. The application shall be in the prescribed form - Form 18, and shall be accompanied by the prescribed fee. The particulars required are:

- (i) the name and registration number, if applicable, of the company;
- (ii) the date on which the company was incorporated; and
- (iii) incorporation document and statement referred to in section 11.

As we noted earlier, the incorporation document statement referred to in section 11 are as follows:

- (i) the name of the limited liability partnership;
- (ii) the proposed business of the limited liability partnership;
- (iii) the address of the registered office of the limited liability partnership;
- (iv) the name and address of each of the persons who are to be partners of the limited liability partnership on incorporation;
- (v) the name and address of the persons who are to be designated partners of the limited liability partnership on incorporation;
- (vi) other information concerning the proposed limited liability partnership as per Form 2.

Each of the partners is required to give a statement in Form 18 [Rule 39(1) of LLP Concept Rules]. Since it is a requirement that statement referred to in Section 11 is also to be filed, it is necessary that in addition the statement in Form 18, a statement in the prescribed form - Form 3, made by either an advocate, or a company secretary or a chartered accountant or a cost accountant, who is engaged in the formation of the limited liability partnership and by anyone who subscribed his name to the incorporation document, shall also be filed declaring that all the requirements of the LLP Act and the Rules made thereunder have been complied with, in respect of incorporation and matters precedent and incidental thereto.

Upon receipt of the above documents and statement, the Registrar is, if he is satisfied that all the particulars or other information as required by the LLP Act has been furnished and is verified in the manner he requires, required to register the documents, and issue a certificate of registration in the prescribed form - Form 19 [Rule 39(3) of LLP Concept Rules], The Registrar would specify the date on and from which the LLP is registered.

The LLP, shall within fifteen days of the date of registration, inform, the concerned Registrar of Companies with which the private company was registered under the provisions of the Companies Act, 1956 about the conversion and of the particulars of the LLP in Form 14 [Rule 39(4) of LLP Concept Rules].

There is a right of appeal given to the LLP in case of refusal, for any reason, by the Registrar to register the conversion.

Effects of registration of the LLP upon conversion from a private company

Upon grant of certificate of registration by the Registrar of LLP the conversion of the private company to a LLP is complete and the shareholders of private company, the limited liability partnership to which such company has converted, and the partners of the limited liability partnership shall be bound by the provisions of the Third Schedule of the LLP Act.

Notwithstanding anything contained in any other law for the time being, the effects of the conversion on and from the date of registration specified in the certificate of registration shall be:

- (a) There shall be a limited liability partnership by the name specified in the certificate of registration registered under the LLP Act;

- (b) All tangible (movable or immovable) and intangible property vested in the company, all assets, interests, rights, privileges, liabilities, obligations relating to the company and the whole of the undertaking of the company shall be transferred to and shall vest in the limited liability partnership without further assurance, act or deed;
- (c) The company shall be deemed to be dissolved and removed from the records of the Registrar of Companies;
- (d) All proceedings by or against the company which are pending before any Court, Tribunal or other authority on the date of registration may be continued, completed and enforced by or against the limited liability partnership;
- (e) Any conviction, ruling, order or judgment of any Court, Tribunal or other authority in favour of or against the company may be enforced by or against the limited liability partnership;
- (f) Every agreement to which the company was a party immediately before the date of registration, whether or not of such nature that the rights and liabilities thereunder could be assigned, shall have effect as from that date as if —
 - (1) the limited liability partnership were a party to such an agreement instead of the company; and
 - (2) for any reference to the company, there were substituted in respect of anything to be done on or after the date of registration a reference to the limited liability partnership;
- (g) All deeds, contracts, schemes, bonds, agreements, applications, instruments and arrangements subsisting immediately before the date of registration relating to the company or to which the company is a party shall continue in force on and after that date as if they relate to the limited liability partnership and shall be enforceable by or against the limited liability partnership as if the limited liability partnership were named therein or were a party thereto instead of the company;
- (h) Every contract of employment to which paragraph 10 or paragraph 11 of Third Schedule applies shall continue in force on or after the date of registration as if the limited liability partnership were the employer thereunder instead of the company;
- (i) Every appointment of the company in any role or capacity which is in force immediately before the date of registration shall take effect and operate from that date as if the limited liability partnership were appointed;
- (j) Any authority or power conferred on the company which is in force immediately before the date of registration shall take effect and operate from that date as if it were conferred on the limited liability partnership; and
- (k) Any approval, permit or licence issued to the company under any other Act which is in force immediately before the date of registration of the limited liability partnership, subject to the provisions of such other Act under which such approval, permit or licence has been issued will stand transferred to the limited liability partnership.

Follow up action by the LLP and the company

- (a) In respect of any property referred above registered with any authority, the limited liability partnership shall, as soon as practicable, after the date of registration, take all necessary steps as required by the relevant authority to notify the authority of the conversion and of the particulars of the limited liability partnership in such form and manner as the authority may determine; and
- (b) The limited liability partnership shall ensure that for a period of twelve months commencing not later than fourteen days after the date of registration, every official correspondence of the limited liability partnership bears the following, namely:—
 - (a) a statement that it was, as from the date of registration, converted from a company into a limited liability partnership; and



- (b) the name and registration number of the company from which it was converted.

Penal provisions

Any limited liability partnership which contravenes the provisions of sub-paragraph (b) above shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees and with a further fine which shall not be less than fifty rupees but which may extend to five hundred rupees for every day after the first day after which the default continues.

Conversion from unlisted public company into limited liability partnership

The following definitions are relevant:

- (a) "company" means an unlisted public company;
- (c) "listed company" means a listed company as defined in the Securities Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000 issued by the Securities and Exchange Board of India under section 11 of the Securities and Exchange Board of India Act, 1992;
- (d) "unlisted public company" means a company which is not a listed company.

The Securities Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000, defines the expression "listed company" means

"a company which has any of its securities offered through an offer document v; listed on a recognised stock exchange and also includes Public Sector \

Undertakings whose securities are listed on a recognised stock exchange" [Clause 1.2.1.(xviii)].

The expression Securities is defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) (the "SCRA"), to include:

- (i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;
- (ia) derivative;
- (ib) units or any other instrument issued by any collective investment scheme to the investor in such schemes; i
- (ii) Government securities;
- (iia) such other instruments as may be declared by the Central Government to be securities; and
- (iii) rights or interests in securities.

The conversion can take place only subject to the following two conditions:

- (c) there is no security interest in its assets subsisting or in force at the time of application; and
- (d) if the partners of the proposed LLP comprise of ALL the shareholders of the unlisted public company and NO ONE ELSE.

Thus at the time of conversion the LLP will have no other person as a partner other than those who were shareholders of the erstwhile unlisted public company.

The application for conversion must be filed with the Registrar of LLPs having jurisdiction in which the registered office of the proposed LLP situate. The application shall be in the prescribed form - Form 18, and shall be accompanied by the prescribed fee. The particulars required are:

- (iv) the name and registration number, if applicable, of the company;
- (v) the date on which the company was incorporated; and (vi) incorporation document and statement referred to in section 11.

As we noted earlier, the incorporation document statement referred to in section 11 are as follows:

- (vii) the name of the limited liability partnership;
- (viii) the proposed business of the limited liability partnership;
- (ix) the address of the registered 'office of the limited liability partnership;
- (x) the name and address of each of the persons who are to be partners of the limited liability partnership on incorporation;
- (xi) the name and address of the persons who are to be designated partners of the limited liability partnership on incorporation;
- (xii) other information concerning the proposed limited liability partnership as per Form 2.

Each of the partners is required to give a statement in Form 18 [Rule 40(1) of LLP Concept Rules]. Since it is a requirement that statement referred to in Section 11 is also to be filed, it is necessary that in addition the statement in Form 18, a statement in the prescribed form - Form 3, made by either an advocate, or a company secretary or a chartered accountant or a cost accountant, who is engaged in the formation of the limited liability partnership and by anyone who subscribed his name to the incorporation document, shall also be filed declaring that all the requirements of the LLP Act and the Rules made thereunder have been complied with, in respect of incorporation and matters precedent and incidental thereto.

Upon receipt of the above documents and statement, the Registrar is, if he is satisfied that all the particulars or other information as required by the LLP Act has been furnished and is verified in the manner he requires, required to register the documents, and issue a certificate of registration in the prescribed form - Form 19 [Rule 40(3) of LLP Concept Rules]. The Registrar would specify the date on and from which the LLP is registered.

The LLP, shall within fifteen days of the date of registration, inform, the concerned Registrar of Companies with which the unlisted public company was registered under the provisions of the Companies Act, 1956 about the conversion and of the particulars of the LLP in Form 14 [Rule 40(4) of LLP Concept Rules].

There is a right of appeal given to the LLP in case of refusal, for any reason, by the Registrar to register the conversion.

Effect of registration of the LLP upon conversion from an unlisted public company

Upon grant of certificate of registration by the Registrar of LLP the conversion of the unlisted public company to a LLP is complete and the shareholders of the unlisted public company, the limited liability partnership to which such company has converted, and the partners of the limited liability partnership shall be bound by the provisions of the Fourth Schedule to LLP Act.

Notwithstanding anything contained in any other law for the time being, the effects of the conversion on and from the date of registration specified in the certificate of registration shall be:

- (a) There shall be a limited liability partnership by the name specified in the certificate of registration registered under this Act;
- (b) All tangible (movable or immovable) and intangible property vested in the unlisted public company, all assets, interests, rights, privileges, liabilities, obligations relating to the said company and the whole of the undertaking of the said company shall be transferred to and shall vest in the limited liability partnership without further assurance, act or deed; and
- (c) the unlisted public company shall be deemed to be dissolved and removed from the records of the Registrar of Companies;
- (d) All proceedings by or against the unlisted public company which are pending in any court or



Tribunal or before an authority on the date of registration may be continued, completed and enforced by or against the limited liability partnership;

- (e) Any conviction, ruling, order or judgment of any court, Tribunal or other authority in favour of or against the unlisted public company may be enforced by or against the limited liability partnership;
- (f) Every agreement to which the unlisted public company was a party immediately before the date of registration, whether or not of such nature that the rights and liabilities thereunder could be assigned, shall have effect as from that date as if —
 - (a) the limited liability partnership were a party to such an agreement instead of the unlisted public company; and
 - (b) for any reference to the unlisted public company, there were substituted in respect of anything to be done on or after the date of registration a reference to the limited liability partnership;
- (g) All deeds, contracts, schemes, bonds, agreements, applications, instruments and arrangements subsisting immediately before the date of registration relating to the unlisted public company or to which the said company is a party shall continue in force on and after that date as if they relate to the limited liability partnership and shall be enforceable by or against the limited liability partnership as if the limited liability partnership were named therein or were a party thereto instead of the said unlisted public company;
- (h) Every contract of employment to which paragraph (f) or paragraph (g) above applies shall continue in force on or after the date of registration as if the limited liability partnership were the employer thereunder instead of the unlisted public company;
- (i) Every appointment of the unlisted public company in any role or capacity which is in force immediately before the date of registration shall take effect and operate from that date as if the limited liability partnership were appointed;
- (j) Any authority or power conferred on the unlisted public company which is in force immediately before the date of registration shall take effect and operate from that date as if it were conferred on the limited liability partnership;
- (k) any approval, permit or licence issued to the unlisted public company under any other Act which is in force immediately before the date of registration of the limited liability partnership, subject to the provisions of such other Act under which such approval, permit or licence has been issued, will stand transferred to the limited liability partnership.

Follow up action by the LLP and the company

- (a) the limited liability partnership shall, within fifteen days of the date of registration, inform the concerned Registrar of Companies with which the unlisted public company was registered under the provisions of the Companies Act, 1956 about the conversion and of the particulars of the limited liability partnership in Form 14.
- (b) In respect of any property referred above registered with any authority, the limited liability partnership shall, as soon as practicable, after the date of registration, take all necessary steps as required by the relevant authority to notify the authority of the conversion and of the particulars of the limited liability partnership in such form and manner as the authority may determine; and
- (c) The limited liability partnership shall ensure that for a period of twelve months commencing not later than fourteen days after the date of registration, every official correspondence of the limited liability partnership bears the following, namely:-
 - (a) a statement that it was, as from the date of registration, converted from an unlisted public company into a limited liability partnership; and

(b) the name and registration number of the unlisted public company from which it was converted.

Penal provisions

Any limited liability partnership which contravenes the provisions of sub-paragraph (b) above shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees and with a further fine which shall not be less than fifty rupees but which may extend to five hundred rupees for every day after the first day after which the default continues.

Liquidation of LLPs

By a recent notification 'GSR 6(E) dated 6 January 2010, It is now provided that most of the provisions of the Companies Act 1956 relating to liquidation would apply to a LLP, with modifications of terms such as 'company', 'articles', 'member', etc,

Income-tax provisions

The Nareshchandra Committee recommended in its Report that "The LLPs should be governed by a taxation regime that taxes the partners as individuals, rather than taxing the LLP itself, i.e., the LLPs should be treated in the same manner as the firm under the tax laws." [Recommendation 3.6]

The above recommendation was accepted by the Government and the Finance (No. 2) Act, 2009, now provide that the expression 'firm' will include a LLP [sec.2(23)(i)], and the expression 'partner' will include a partner of a LLP [sec. 2(23)(ii)]. By this single change all the provisions of the ITA 1961 relating to general partnership firm applies equally to a LLP. The amendments are effective from assessment year 1st April 2010 i.e. for the accounting year starting on 1st April 2009.

We are primarily concerned with restructure of a partnership firm to a LLP, conversion of a limited liability company to a LLP, and conversion of unlisted public company to a LLP. There is no provision in the ITA 1961 to cover the latter two situations. However, as regards conversion of a partnership firm to a LLP is concerned the memorandum to the Finance (No, 2) Bill, 2009, states as follows:

"As an LLP and a general partnership is being treated as equivalent (except for recovery purposes) in the Act, the conversion from a general partnership firm to an LLP will have no tax implications if the rights and obligations of the partners remain the same after conversion and if there is no transfer of any asset or liability after conversion. If there is a violation of these conditions, the provisions of section 45 shall apply."

However, there does not appear to be a specific provision in this regard in the ITA 1961. Possibly if a general partnership firm converts itself to a LLP through a 'slump sale' some tax concession relating to capital gains may be available. Further there is no provision of exemption in respect of reverse conversion viz. conversion of a limited liability company to a LLP or an unlisted public limited company to a LLP.

The Finance Act 2010 has inserted new provisions for exempting, in a limited sense, capital gains arising on conversion of a private limited company or an unlisted public company to a LLP in terms of Sections 56 or 57 of the LLP Act, subject to the following conditions:

- (a) all the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the limited liability partnership;
- (b) all the shareholders of the company immediately before the conversion become the partners of the limited liability partnership and their capital contribution and profit sharing ratio in the limited liability partnership are in the same proportion as their shareholding in the company on the date of conversion;
- (c) the shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the limited liability partnership;



- (d) the aggregate of the profit sharing ratio of the share holders of the company in the limited liability partnership shall not be less than fifty per cent at any time during the period of five years from the date of conversion;
- (e) the total sales, turnover or gross receipts in business of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed sixty lakh rupees; and
- (f) no amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.

Thus the exemption is available only for certain small companies.

With the introduction of tax exemption for certain conversion of unlisted public companies or private companies, modifications have been made to sections 35DDA -amortisation of certain voluntary retirement payments, 43(6) — relating to depreciation of blocked assets, 72A — carry forward of loss, and 15JAA — Minimum Alternate Tax.

While the Finance Act 2010 provided that MAT will not be levied on an LLP, the Finance Act, 2011 has inserted a new Chapter XII-BA consisting of sections 115JC to 115JF to provide for levy of MAT at the rate of 18.5% on adjusted total income in case of LLPs. This will have a dampening effect on formation of LLPs.

Corporate Restructure

Reconstruction- Meaning

The term “reconstruction” is not specifically defined in the Companies Act. The Little Oxford dictionary gives the meaning of reconstruct as “construct again, repair, restore to former condition or appearance, construct a new in mind” and “reconstruction” is the noun form of reconstruct.

Webster's Dictionary, 2nd edition, explains the word “reconstruction” as “the act of constructing again”.

The Halsbury's Laws of England States as follows:

“Neither ‘reconstruction’ nor ‘amalgamation’ has a precise legal meaning. Where an undertaking is being carried by a company and is in substance transferred, not to an outsider, but to another company consisting substantially of the same shareholders with a view to its being continued by the transferee company, there is a reconstruction. It is none the less a reconstruction because all the assets do not pass to the new company, or all the shareholders in the transferee company are not shareholders of the transferor company, or the liabilities of the transferor company are not taken over by the transferee company. “

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, an Act to regulate one of the aspects of reconstruction viz. reconstruction of financial assets defines in section 2(1)(b) ‘asset reconstruction’ to mean “acquisition by any securitization company or reconstruction company of any right or interest of any bank or financial institution in any financial assistance for the purpose of realization of such financial assistance”.

Section 2(1)(k) defines “financial assistance” to mean any loan or advance guaranteed or any debentures or bonds subscribed or any guarantees given or letters of credit established or any other credit facility extended by any bank or financial institution.”

The said Act provides, among others, sale of financial assets by banks/Financial Institutions to Securitization Company/ Reconstruction Company. The above said Act has been enacted with a special emphasis on asset reconstruction activity, which mainly centres around impaired assets, the whole process of asset reconstruction and matters related thereto. The term financial asset is defined in section 2(1)(l) to mean debt or receivables and includes:

- (i) a claim to any debt or receivables or part thereof whether secured or unsecured;
- (ii) any debt or receivables secured by, mortgage of, or charge on, immovable property; or
- (iii) a mortgage, charge hypothecation or pledge of movable property; or
- (iv) any right or interest in the security, whether full or part underlying such debt or receivables; or
- (v) any beneficial interest in property whether movable or immovable, or in such debt, receivables, whether such interest is existing, future, accruing, conditional or contingent; or
- (vi) any financial assistance;

The term “property” is defined in section 2(1)(f) to mean—

- (i) immovable property;
- (ii) movable property;
- (iii) any debt or any right to receive payment of money whether secured or unsecured;
- (iv) receivables, whether existing or future;
- (v) intangible assets, being know-how patent, copyright, trademarks, license, franchise or any other business or commercial rights of similar nature;

Section 2(1)(v) defines “reconstruction company” means a company formed and registered under the Companies Act, 1956 for the purpose of asset reconstruction;

Thus under the above said Act, ‘reconstruction’ would refer to acquisition of financial assets which may be a debt - secured or unsecured, and/or an interest in fixed and/ or current assets and/or intangible assets, by a company formed under the Companies Act, 1956, having its main object - reconstruction activity and is registered under section 3(1) of the said Act with the Reserve Bank of India.

In the traditional sense, reconstruction refers to a company transferring its assets to a new company in consideration of the issue of the new company's shares to the first company's members, and if the first company's debentures are not paid off, in further consideration of the new company issuing debentures to the first company's debenture holders, The result of the transaction is that the new company has the same assets, members and debenture-holders as the old one, and the old company has no undertaking to manage and is therefore wound up.

Undertaking- Meaning

In the context of reconstruction of a corporate body it is necessary also to understand the meaning of the term “undertaking”, as reconstruction is carried out by sale of an undertaking or purchase or acquisition of an undertaking.

The word “undertaking” is not defined in the Companies Act. One has, therefore, necessarily to depend upon the dictionary meaning or such secondary meaning the term might have acquired by commercial usage or long practice governing the workings of and borrowings by companies.

Section 2(v) of the Monopolies and Restrictive Trade Practices Act, 1969 [54 of 1969]

(“MRTP Act”) defines “undertaking”

“means an enterprise which is or has been or is proposed to be engaged in “the production, storage, supply, distribution, acquisition or control of articles or goods or the provision of services of any kind either directly or through one or more of its units or divisions whether such unit or division is located at the same place where the undertaken is located or at a different place or at different places.

Explanation I.— In this clause —

- (a) “article” includes a new article and “service” includes a new service;
- (b) “unit” or “division” in relation to an undertaking includes —



- (i) a plant or factory established for the production, storage, supply, distribution, acquisition or control of any article or goods;
- (ii) any branch or office established for the provision of any service.

Explanation II.— For the purposes of this clause a body corporate which is or has been engaged only in the business of acquiring holding underwriting or dealing with shares, debentures or other securities of any other body corporate shall be deemed to be an undertaking.

Explanation III— For the removal of doubts it is hereby declared that an investment company shall be deemed for the purposes of this Act to be an undertaking."

Companies Act, 1956 provisions

Section 125 of Companies Act provides that charges creating security on the company's property or undertaking is void against the liquidator and any other creditor of the company unless it is registered with the Registrar of Companies in the prescribed manner. Section 125(4)(f) mentions "a floating charge on the undertaking or any property of the company" is one such charge.

Section 293 deals with restriction of the powers of the board of directors of a company. In this regard it is provided that in the case of a public limited company or a subsidiary of a public limited company, the board of directors cannot exercise power to "sell, lease or otherwise dispose of the whole, or substantially the whole, of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole, of any such undertaking" without the consent of the company in general meeting.

Section 394(1) of Companies Act deals with the powers of the National Company Law Tribunal ("Tribunal") in respect of an application is made under section 391 of Companies Act. If an application inter alia relates to a scheme of reconstruction of any company or companies, the Tribunal has powers to pass order on matters involving "the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company".

Corporate Restructure- Meaning

Corporate Restructuring is the process of redesigning one or more aspects of a company. The process of reorganizing a company may be implemented due to a number of different factors, such as positioning the company to be more competitive, surviving a currently adverse economic climate, or acting on the self-confidence of the corporation to move in an entirely new direction. Before restructuring there must be an existing structure which may have many limitations/ restrictions such as finance, legal, business and management which are to be kept in mind before restructuring. In other words, restructuring could be considered as making alterations to some extent to the existing structure.

Corporate Restructuring may have a single objective or multiple objectives; amongst them, there must be a dominant objective in addition to other important objectives for a successful corporate restructuring.

Hence, Corporate Restructuring is a comprehensive process by which a company can consolidate its business operations and strengthen its position for achieving its short-term and long-term corporate objectives. Corporate Restructuring is vital for the survival of a company in a competitive environment.

Process for Corporate Restructuring

While looking at the concept of Corporate restructuring, there is process to make it successful in achieving its stated objectives. For that a company must understand the objectives which are to be achieved and put forward the options or their opinions to achieve them. On selecting the appropriate option, a company can execute the same.

Objectives of Corporate Restructuring:

- Growth
- Technology
- Government policy
- To reduce dependency on others
- Economic stability

Needs of Corporate Restructuring:

- 1) To expand the business or operations of the company.
- 2) To carry on the business of the company more economically or more efficiently.
- 3) To focus on its core strength.
- 4) Cost Reduction, by deriving the benefits of economies of scale.
- 5) To obtain tax advantages by merging a loss-making company with a profit-making company.
- 6) To have access to better technology.
- 7) To improve the debt-equity ratio.
- 8) To have a better market share.
- 9) To overcome significant problems in a company.
- 10) To become globally competitive.
- 11) To eliminate competition between the companies.
- 12) To act in the public interest (by the Central Government in exercise of the powers conferred by section 396).

Corporate Restructuring Tools: In India, the concept has caught on like wildfire, with a merger or two reported frequently. The process of restructuring through mergers and amalgamations has been a regular feature in the developed and free economy nations like USA and European countries, more particularly in the UK, where hundreds of mergers take place every year. There are many tools and strategies by which or through which Corporate Restructuring can be processed such as amalgamations, mergers, demergers, reverse mergers, takeovers, acquisitions, joint ventures, disinvestments, buyback of shares etc.

- **By Amalgamation:**

It is the process of combining or uniting multiple entities into one form. The term amalgamation is not defined under the Companies' Act, 1956. Generally speaking, amalgamation is a legal process by which two or more companies are joined together to form a new entity or one or more companies are to be absorbed or blended with another. As a consequence, the amalgamating company loses its existence and its shareholder become the shareholder of the new or amalgamated company.

- **By Reverse Merger:**

It is when a private company purchases control of a public company and then carries out a merger with a private company. With a reverse merger, the private company shareholders receive most of the shares of the public company and control of the Board. A reverse merger is a quick way of going public with the time-table being only a couple of weeks. The reason a reverse merger is so quick is that the public company has already completed all the necessary paper-work and reviews in order to become public.

- **By Normal merger:**

Merger is an arrangement whereby the assets of two or more companies become vested in or under



the control of one company, which may or may not be one of the original two companies, which has as its shareholders, all or substantially all, the shareholders of the two companies.

- **By Demerger:**

The act of splitting off a part of an existing company to become a new company, which operates completely separately from the original company. Shareholders of the original company are usually given an equivalent stake of ownership in the new company. A demerger is often done to help each of the segments operate more smoothly, as they can now focus on a more specific task.

- **By Take-over:**

It is the purchase of one company by another. The term refers to the acquisition of a public company whose shares are listed on the Stock Exchange, in contrast to the acquisition of a private company.

- **By Joint Venture:**

Two parties, (individuals or companies), incorporate a company in India. The business of one party is transferred to the company and, as a consideration for such a transfer; shares are issued by the company and subscribed by that party. The other party subscribes to the shares in cash. The parties subscribe to the shares of the joint-venture company in agreed proportion, in cash, and start a new business.

- **By Disinvestment:**

It means to sell off certain assets, such as a manufacturing plant, a division or subsidiary, or product line.

- **By Buyback:**

The repurchase of outstanding shares by a company, in order to reduce the number of shares on the market. Companies will buy back shares either to increase the value of shares still available or to eliminate any threats by shareholders who may be looking for controlling powers. In other words, Buyback is the reverse of issue of shares by a company where it offers to take back its shares owned by the investors at a specified price; this offer can be binding or optional to the investors.

Reduction of entities

- By striking off of the name from the Register of Companies.
- By dissolution without winding up.
- By mergers or absorptions.

The restructuring usually takes place when a business is struggling and losing money. A third party will be brought in to assess the way that the business is being run, and then make recommendations based on what they found that will help make the business run more efficiently. A strong corporate restructuring firm will have experts in a wide variety of areas that can examine all aspects of a business to help find solutions. A good corporate restructuring firm will not just identify problems of where money is being lost, but also offer solutions that a company can implement in order to solve those problems. They will also help a company through the process of restructuring by developing forecasts of what to expect and making sure the company is able to secure the capital available to make those changes. Corporate restructuring can help restore, preserve and enhance the value of an organisation.

Financial Asset Reconstruction

Asset reconstruction refers to reconstruction process adopted by a Securitization or reconstruction company established under the Companies Act 1956 and registered with the Reserve Bank of India. The reconstruction would cover any right or interest of any bank or financial institution in respect of any financial assistance given by them to a company and to enable such bank or financial institution to realize its assets which have become a "non-performing asset". In this regard, elaborate rules have

been framed by the Reserve Bank of India. A non-performing asset refers to non-payment of any principal debt or interest thereon or any other amount payable by a borrower to any secured creditor, which is so treated in the books of a secured creditor as non-performing asset in accordance with the directions or guidance issued by the Reserve Bank.

In terms of section 9 of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SRFAESIA), a Securitization company or reconstruction company may, without prejudice, to the provisions contained in any other law for the time being in force, for the purposes of asset reconstruction, having regard to the guidelines framed by the Reserve Bank in this behalf, carry out reconstruction by providing, inter alia, one or more of the following measures, namely: —

- (a) the proper management of the business of the borrower, by change in, or takeover of, the management of the business of the borrower;
- (b) the sale or lease of a part or whole of the business of the borrower;
- (c) rescheduling of payment of debts payable by the borrower;
- (d) enforcement of security interest in accordance with the provisions of SRFAESIA;
- (e) settlement of dues payable by the borrower; and
- (f) taking possession of secured assets in accordance with the provisions of SRFAESIA.

For these purposes, in terms of section 2(zd) of SRFAESIA, means any bank or financial institution or any consortium or group of banks or financial institutions and includes —

- (i) debenture trustee appointed by any bank or financial institution; or
- (ii) securitization company or reconstruction company; or
- (iii) any other trustee holding securities on behalf of a bank or financial institution,

From the above it would be seen that reconstruction is to be carried out only for "realization of the debt by a bank or financial institution or groups of banks or financial institutions. It does not cover other private secured creditors who are not banks or financial institutions. This is the limitation of applicability of SRFAESIA.

In terms of section 38 of SRFAESIA, the rule making powers under SRFAESIA vests with the Central Government. So far no guidelines have been issued for 'reconstruction' though guidelines have been issued for sale of assets by the secured creditors. This area of the SRFAESIA remains still inactive.

Corporate Debt Restructuring (CDR) System

Considering the need to take a more practical view of recovery of debts by banks and or financial institutions, and with a view to reviving or rehabilitating companies through a scheme of debt restructuring, the Reserve Bank of India had announced for the first time in 2001, a scheme for Corporate Debt Restructuring System or popularly known as CDR System. This scheme was modified in 2003 and further modified in November, 2005, based on expert committees appointed by the Reserve Bank.

In the background note it was noted that "In spite of their best efforts and intentions, sometimes corporates find themselves in financial difficulty because of factors beyond their control and also due to certain internal reasons. For the revival of the corporates as well as for the safety of the money lent by the banks and FIs, timely support through restructuring in genuine cases is called for."

A. Objectives

"The objective of the Corporate Debt Restructuring (CDR) framework is to ensure timely and transparent mechanism for restructuring of the corporate debts of **viable entities facing problems, outside the purview of BIFR, DRT and other legal proceedings, for the benefit of all concerned**. In particular, the framework will aim at preserving viable corporates that are affected by certain internal and external factors and minimize the losses to the creditors and other stakeholders through an orderly and



coordinated restructuring programme."

B. Salient features of CDR

1. CDR will be a non-statutory mechanism;
2. CDR mechanism will be a voluntary system based on debtor-creditor agreement and inter-creditor agreement;
3. The scheme will not apply to accounts involving only one financial institution or one bank. The CDR mechanism will **cover only multiple banking accounts/syndication/consortium accounts with outstanding exposure of Rs.20 crore and above by banks and institutions**;
4. The CDR system will be applicable only to standard and sub-standard accounts. With a view to provide the necessary flexibility and facilitate timely intervention for debt restructuring exercise, the requests of any corporate indulging in wilful default or misfeasance will not be considered for restructuring under CDR;
5. Under the revised scheme in 2005, it was stated that while corporates indulging in frauds and malfeasance even in a single bank will continue to remain ineligible for restructuring under CDR mechanism as hitherto, the Core group may review the reasons for classification of the borrower as wilful defaulter specially in old cases where the manner of classification of a borrower as a wilful defaulter was not transparent and satisfy itself that the borrower is 'in a position to rectify the wilful default provided he is granted an opportunity under the CDR mechanism. Such exceptional cases may be admitted for restructuring with the approval of the Core Group only. The Core Group may ensure that cases involving frauds or diversion of funds with malafide intent are not covered.
6. The accounts where recovery suits have been filed by the creditors against the company, may be eligible for consideration under the CDR system provided, the initiative to resolve the case under the CDR system is taken by at least 75% of the creditors (by value) and 60% of creditors (by number).
7. BIFR cases are not eligible for restructuring under the CDR system. However, large value BIFR cases may be eligible for restructuring under the CDR system if specifically recommended by the CDR Core Group. The Core Group shall recommend exceptional BIFR cases on a case-to-case basis for consideration under the CDR system. It should be ensured that the lending institutions complete all the formalities in seeking the approval from BIFR before implementing the package.
8. There would be **no requirement of the account/company being sick, NPA or being in default for a specified period** before reference to the CDR Group. However, **potentially viable cases of NPAs will get priority**;
9. Reference to Corporate Debt Restructuring System could be triggered by
 - (i) any or more of the secured creditor who have minimum 20% share in either working capital or term finance, or
 - (ii) by the concerned corporate, if supported by a bank or financial institution having stake as in (i) above;
10. The legal basis to the CDR mechanism shall be provided by the **Debtor-Creditor Agreement (DCA)** and the **Inter-Creditor Agreement**. The debtors shall have to accede to the DCA, either at the time of original loan documentation (for future cases) or at the time of reference to Corporate Debt Restructuring Cell. Similarly, all participants in the CDR mechanism through their membership of the Standing Forum shall have to enter into a legally binding agreement, with necessary enforcement and penal clauses, to operate the System through laid-down

policies and guidelines;

11. Both the debtor and creditor(s) shall **agree to a legally binding 'standstill' whereby both the parties commit themselves not to taking recourse to any other legal action** during the 'standstill' period i.e. for 90 days or 180 days;
12. To be a binding agreement amongst all the secured creditors, the restructuring of debts must be approved by **75% of secured creditors by value**;
13. All references for corporate debt restructuring by creditors or borrowers will be made to the CDR Cell. It shall be the responsibility of the lead institution/major stakeholder to the corporate, to work out a preliminary restructuring plan in consultation with other stakeholders and submit to the CDR Cell within one month. The CDR Cell will prepare the restructuring plan in terms of the general policies and guidelines approved by the CDR Standing Forum and place for consideration of the Empowered Group within 30 days for decision.
14. Each case of debt restructuring will be examined and the viability and rehabilitation potential of the company would be ascertained before approval of the restructuring package within a specified time frame of 90 days or at best within 180 days of reference to the Empowered Group. The acceptable viability benchmark levels which may be applied on a case to case basis, based on the merits of each case. The following would be the parameters considered before recommending restructuring of debt:
 - Return on Capital Employed (ROCE);
 - Debt Service Coverage Ratio (DSCR);
 - Gap between the internal rate of return (IRR) and the cost of fund (COF);
 - Extent of sacrifice.
15. The CDR mechanism applies to category 1 cases, i.e., accounts classified as standard or sub-standard and category 2 cases, i.e., cases classified as doubtful in the books of the lenders. In the first category, the loans can be restructured and additional funds too provided by banks/ FIs. On the other hand, in the second category, the existing loans will only be restructured and additional financing for the restructuring will be firmed up by the promoters, with a new arrangement, either with the existing lenders individually or with new lenders;
16. Administratively the CDR system in the country will have a three-tier structure viz, CDR Standing Forum and its Core Group; CDR Empowered Group and CDR Cell. The CDR Standing Forum would be the representative general body of all financial institutions and banks participating in CDR system. The Forum will also provide an official platform for both the creditors and borrowers (by consultation) to amicably and collectively evolve policies and guidelines for working out debt restructuring plans in the interests of all concerned. A CDR Core Group will be carved out of the CDR Standing Forum to assist the Standing Forum in convening the meetings and taking decisions relating to policy, on behalf of the Standing Forum. The CDR Cell will make the initial scrutiny of the proposals received from borrowers/creditors, by calling for proposed rehabilitation plan and other information and put up the matter before the CDR Empowered Group; and
17. Certain accounting treatments to the restructured accounts have also been prescribed.

Debts Restructuring relating to Small and Medium Enterprises (SMEs)

By a Circular No. UBD. BPD. Cir. No. 36/9.9.001/05-06 dated March 9, 2006 the Reserve Bank of India had announced guidelines to be used for restructuring of debts of SMEs.

SMEs refers to a small enterprise or a medium enterprise. SMEs is defined as a small scale industrial unit is an undertaking in which investment in plant and machinery does not exceed Rs.1 crore, except in respect of certain specified items under hosiery, hand tools, drugs and pharmaceutical, stationery items



and sports goods, where this investment limit has been enhanced to Rs. 5 crore. Units with investment in plant and machinery in excess of SSI limit and up to Rs. 10 crore may be treated as Medium Enterprises (MEs).

A. Applicability

These guidelines would be applicable to —

- (i) the following entities, which are **viable or potentially viable** :
 - (a) All non-corporate SMEs irrespective of the level of dues to banks;
 - (b) All corporate SMEs, which are enjoying banking facilities from a single bank, irrespective of the level of dues to the bank;
 - (c) All corporate SMEs, which have funded and non-funded outstanding up to Rs.10 crore under multiple/consortium banking arrangement.
- (ii) As in the case of other CDR Systems, accounts involving wilful default, fraud and malfeasance will not be eligible for restructuring under these guidelines;
- (iii) Accounts classified by banks as “Loss Assets” will not be eligible for restructuring;
- (iv) In respect of BIFR cases, banks should ensure completion of all formalities in seeking approval from BIFR before implementing the package.

B. Viability criteria

Banks may decide on the acceptable viability benchmark, consistent with the unit becoming viable in 7 years and the repayment period for restructured debt not exceeding 10 years.

C. Procedure

- (i) Based on these guidelines, banks registered under the State Acts may formulate, with the approval of the concerned Registrar of the Cooperative Societies, a debt restructuring scheme for SMEs. However, in the case of Multi-State Co-operative Banks, the above guidelines may be formulated with the approval of the Board of Directors.
- (ii) The restructuring would follow a receipt of a request to that effect from the borrowing units.
- (iii) In case of eligible SMEs which are under consortium/multiple banking arrangements, the bank with the maximum outstanding may work out the restructuring package, along with the bank having the second largest share.

D. Time frame

Banks should work out the restructuring package and implement the same within a maximum period of 60 days from date of receipt of requests.

E. Review

Banks may review the progress in rehabilitation and restructuring of SME accounts on a quarterly basis and keep the Board and the concerned RCS informed.

F. Disclosure

It may be ensured that the scheme formulated in this regard is brought to the notice of all beneficiaries. The bank may place the scheme on its website and give adequate publicity through other means. A copy may also be forwarded to SIDBI and the concerned Regional Offices of Reserve Bank of India.

Banks should also disclose in their published annual Balance Sheets, under “Notes on Accounts”, the following information in respect of restructuring

undertaken during the year for SME accounts:

- (a) Total amount of assets of SMEs subjected to restructuring, [(a) = (b) + (c) + (d)]
 - (b) The amount of standard assets of SMEs subjected to restructuring.
 - (c) The amount of sub-standard assets of SMEs subjected to restructuring.
 - (d) The amount of doubtful assets of SMEs subjected to restructuring
7. Certain accounting norms have been prescribed.

Accounting issues relating to Corporate Debt Restructuring (CDR system)

In the context of restructuring of the accounts, the following stages at which the restructuring/ rescheduling/renegotiation of the terms of loan agreement could take place, can be identified:

- (a) before commencement of commercial production;
- (b) after commencement of commercial production but before the asset has been classified as sub-standard, and after commencement of commercial production and after the asset has been classified as sub-standard.

In each of the foregoing three stages, the rescheduling, etc., of principal and/or of interest could take place, with or without sacrifice, as part of the restructuring package evolved.

A. Types of accounts

Standard accounts and sub-standard accounts. A sub-standard account is one which has sub-standard assets. A sub-standard asset was one, which was classified as NPA for a period not exceeding eighteen months. However, the asset classification under CDR would continue to be bank-specific based on record of recovery of each bank, as per the existing prudential norms applicable to banks.

B. Treatment of Restructured Standard Accounts

A rescheduling of the instalments of principal alone, at any of the aforesaid first two stages would not cause a standard asset to be classified in the sub-standard category provided the loan/credit facility is fully secured.

A rescheduling of interest element at any of the foregoing first two stages would not cause an asset to be downgraded to sub-standard category subject to the condition that the amount of sacrifice, if any, in the element of interest, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved. For the purpose, the future interest due as per the original loan agreement in respect of an account should be discounted to the present value at a rate appropriate to the risk category of the borrower (i.e., current PLR+ the appropriate credit risk premium for the borrower-category) and compared with the present value of the dues expected to be received under the restructuring package, discounted on the same basis.

In case there is a sacrifice involved in the amount of interest in present value terms, as at (b) above, the amount of sacrifice should either be written off or provision made to the extent of the sacrifice involved.

C. Treatment of restructured sub-standard accounts

A rescheduling of the instalments of principal alone, would render a substandard asset eligible to be continued in the sub-standard category for the specified period, provided the loan/credit facility is fully secured.

A rescheduling of interest element would render a sub-standard asset eligible to be continued to be classified in sub-standard category for the specified period subject to the condition that the amount of sacrifice, if any, in the element of interest, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved. For the purpose, the future interest due as per the original loan agreement in respect of an account should be discounted to the present value at a rate appropriate to the risk category of the borrower (i.e., current PLR + the appropriate credit risk



premium for the borrower-category) and compared with the present value of the dues expected to be received under the restructuring package, discounted on the same basis.

In case there is a sacrifice involved in the amount of interest in present value terms, as at (b) above, the amount of sacrifice should either be written off or provision made to the extent of the sacrifice involved. Even in cases where the sacrifice is by way of write off of the past interest dues, the asset should continue to be treated as sub-standard.

D. Upgradation of restructured accounts

The sub-standard accounts which have been subjected to restructuring etc., whether in respect of principal instalment or interest amount, by whatever modality, would be eligible to be upgraded to the standard category only after the specified period i.e., a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due, subject to satisfactory performance during the period. The amount of provision made earlier, net of the amount provided for the sacrifice in the interest amount in present value terms as aforesaid, could also be reversed after the one year period. During this one year period, the sub-standard asset will not deteriorate in its classification if satisfactory performance of the account is demonstrated during the period. In case, however, the satisfactory performance during the one year period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule.

In case of SMEs

1. Treatment of accounts

- (i) Treatment of 'standard' accounts subjected to restructuring
 - (a) A rescheduling of the instalments of principal alone, would not cause a standard asset to be classified in the sub-standard category, provided the borrower's outstanding is fully covered by tangible security.
 - (b) A rescheduling of interest element would not cause an asset to be downgraded to sub-standard category subject to the condition that the amount of sacrifice, if any, in the element of interest, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved.
- (ii) Treatment of 'sub-standard'/'doubtful' accounts subjected to restructuring
 - (a) A rescheduling of the instalments of principal alone, would render a 'sub-standard'/'doubtful' asset eligible to continue in the 'sub-standard'/'doubtful' category for the specified period, provided the borrower's outstanding is fully covered by tangible security.
 - (b) A rescheduling of interest element would render a sub-standard/'doubtful' asset eligible to be continued to be classified in sub-standard/'doubtful' category for the specified period subject to the condition that the amount of sacrifice, if any, in the element of interest, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved,
 - (c) Even in cases where the sacrifice is by way of write off of the past interest dues, the asset should continue to be treated as sub-standard/'doubtful'.
- (iii) Treatment of Provision
 - (a) Provision made towards interest sacrifice should be created by debit to Profit & Loss account and held in a distinct account. For this purpose, the future interest due as per the current BPLR in respect of an account should be discounted to the present value at a rate appropriate to the risk category of the borrower (i.e., current PLR + the appropriate term premium and credit risk premium for the borrower category) and compared with

the present value of the dues expected to be received under the restructuring package, discounted on the same basis.

- (b) Sacrifice may be re-computed on each balance sheet date till satisfactory completion of all repayment obligations and full repayment of the outstanding in the account, so as to capture the changes in the fair value on account of changes in BPLR, term premium and the credit category of the borrower. Consequently, banks may provide for the shortfall in provision or reverse the amount of excess provision held in the distinct account.
- (c) The amount of provision made for NPA, may be reversed when the account is re-classified as a 'standard asset'.

2. Additional finance

Additional finance, if any, may be treated as 'standard asset' in all accounts viz; standard, sub-standard, and doubtful accounts, up to a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due under the approved restructuring package. If the restructured asset does not qualify for upgradation at the end of the above period, additional finance shall be placed in the same asset classification category as the restructured debt.

3. Upgradation of restructured accounts

The sub-standard/doubtful accounts at para 1(ii)(a) & (b) above, which have been subjected to restructuring, whether in respect of principal instalment or interest, by whatever modality, would be eligible to be upgraded to the standard category after the specified period, i.e., a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms, subject to satisfactory performance during the period.

4. Asset classification status

During the specified one-year period, the asset classification status of rescheduled accounts will not deteriorate if satisfactory performance of the account is demonstrated during the period. In case, however, the satisfactory performance during the one year period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule. The asset classification would be bank-specific based on record of recovery of each bank, as per the existing prudential norms applicable to banks.

5. Repeated restructuring

The special dispensation for asset classification as available shall be available only when the account is restructured for the first time.

DEMERGER

The term "demerger" refers to a corporate restructuring procedure as opposed to "merger" i.e. it is a separation or spin-off or hiving-off of one or more undertakings carried on by a company into a separate company so as to either dispose such newly formed company or dispose off the undertaking or undertakings in question to the transferee company. Though the term has relevance to corporate law, the Companies Act, 1956 does not contain a definition of the term.

Demerger is a corporate business decision and not a step taken by companies as part of a tax planning or tax avoidance scheme. However, any concession or removable disabilities under the tax laws would assist an entrepreneur in taking a business decision for demerging an undertaking. Demerger as a method of corporate restructure has assumed greater importance in India consequent to removal of certain tax disabilities arising due to such restructuring and thus encourage this type of restructuring as part of its growth plans by companies or take steps leading to addition to the shareholder's value.



Companies Act, 1956, provisions

As we observed the term “demerger” is not defined under the Companies Act, 1956. Demerger could be achieved either by:

- (a) sale of the whole or substantially whole of an undertaking in terms of section 293(1)(a) of the Companies Act; or
- (b) as a part of a scheme of compromise or an arrangement in terms of sections 391 to 393 of the Companies Act, 1956.

Briefly stated:

- (a) sale of the whole or substantially whole of an undertaking of a company could be achieved by
 - (i) approval by the board of directors of the transferor company
 - (ii) further obtaining approval of its shareholders, at a general meeting of the company, by passing a special resolution.

The resulting company need to ensure that its objects include the carrying of the business of the undertaking proposed to be acquired.

Relevant portion of sections 293 is given below:

Sec.293. (1) The Board of directors of a public company, or of a private company which is a subsidiary of a public company, shall not, except with the consent of such public company or subsidiary in general meeting,—

- (a) sell, lease or otherwise dispose of the whole, or substantially the whole, of the undertaking of the company, or where the company owns more than one undertaking, of the whole, or substantially the whole, of any such undertaking;
- (2) Nothing contained in clause (a) of sub-section (1) shall affect-
 - (a) the title of a buyer or other person who buys or takes a lease of any such undertaking as is referred to in that clause, in good faith and after exercising due care and caution; or
 - (b) the selling or leasing of any property of the company where the ordinary business of the company consists of, or comprises, such selling or leasing.
- (3) Any resolution passed by the company permitting any transaction such as is referred to in clause (a) of sub-section (1) may attach such conditions to the permission as may be specified in the resolution, including conditions regarding the use, disposal or investment of the sale proceeds which may result from the transaction;
 - (b) approval under a scheme of compromise or an arrangement by adopting following the following procedure:
 - (i) approval of the board of a scheme of compromise or an arrangement;
 - (ii) presenting the scheme to the Tribunal;
 - (iii) holding of a general meeting of the concerned persons under the supervision of the Tribunal;
 - (iv) obtaining approval of the general meeting of persons holding not less than $\frac{3}{4}$ th of the voting power;
 - (v) obtaining the consent of the Tribunal; and
 - (vi) implementing the scheme as approved at the general meeting and as consented by the Tribunal,

The word 'arrangement', though not defined specifically, has a wide range and ambit.

It held that demerger would be considered as an "arrangement" under section 391 to section 394 of Companies Act. [Larsen & Toubro Ltd, In re. [2004] 44 SCL 461 (Bom)]

INCOME-TAX ACT, 1961 (IT ACT)

'Demerger'- Definition

The term "demerger" has been defined in the Income-tax Act, 1961. The definition of the term under the IT Act refers back to the provisions of sections 391 to 394 of the Companies Act, 1956, though an exception has been made in case of foreign companies. We know by now that the said sections 391 to 394 deal with a scheme of compromise or/and arrangement duly approved by the company or companies in question and further approved by the Tribunal.

Thus by demerger we refer to a compromise or arrangement by which one or more undertakings of a company is transferred to another company, often a subsidiary of the demerging company or a company having the same shareholders as the demerging company. The sale of an undertaking or transfer of some of the assets and liabilities of an undertaking under section 293(1)(a) of the Companies Act would not be treated as a "demerger" under the Income-tax Act.

The IT Act has made provisions removing certain tax disabilities, often referred to, inappropriately in our view, as tax incentives for demerger, to the companies 'involved in a demerger and to their shareholders. To avoid some of the disabilities under the Income-tax Act, it is essential that a demerger squarely falls within the definition of the term "demerger" under section 2(19AA) of the IT Act.

Section 2(19AA) reads as follows:

"Demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956 (1 of 1956), by a demerged company of its one or more undertakings to any resulting company in such a manner that —

- (i) All the property of the undertaking, being transferred by the demerged company, immediately before the demerger becomes the property of the resulting company by virtue of the demerger;
- (ii) All the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger becomes the liabilities of the resulting company by -virtue of the demerger;
- (iii) The property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;
- (iv) The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis;
- (v) The shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;
- (vi) The transfer of the undertaking is on a going concern basis;
- (vii) The demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

Explanation I.- For the purposes of this clause "undertaking" shall include any part of an undertaking or a unit or division of an undertaking or a business activity taken as a whole but does not include individual assets or liabilities or any combination thereof not constituting a business activity.



Explanation 2.- For the purposes of this clause the liabilities referred to in sub-clause (ii) shall include—

- (a) the liabilities which arise out of the activities or operations of the undertaking;
- (b) the specific loans or borrowings (including debentures) raised, incurred and utilised solely for the activities or operations of the undertaking; and
- (c) in cases, other than those referred to in clause (a) or clause (b), so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger.

Explanation 3.- For determining the value of the property referred to in sub-clause (iii), any change in the value of assets consequent to their revaluation shall be ignored.

Explanation 4.- For the purposes of this clause, the splitting up or the reconstruction of any authority or a body constituted or established under a Central, State or Provincial Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfils such conditions as may be notified in the Official Gazette by the Central Government.

Notification No. S.O. 1159(E), dated December 26, 2000

In exercise of the powers conferred under Explanation 4 to clause (19AA) of section 2 of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby specifies that where the split-up or the reconstructed authority or body, constituted or established under a Central, State or Provincial Act, is an entity engaged in the generation or transmission or distribution of electrical power, or in all of these activities, such splitting up or reconstruction shall be deemed to be a demerger if the following conditions are fulfilled, namely :—

- (i) splitting up or reconstruction is effected through a notification in the Official Gazette by the Central or the State Government; and
- (ii) assets of the split-up or reconstructed authority or body, are transferred to one or more resulting companies on a going concern basis.

Other related definitions:

'Demerged company' - Definition

Section 2(19AAA) "demerged company" means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company;

'Resulting company' Definition

Section 2(41A) "resulting company" means one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.

Conditions for a demerger

From the above it would be seen that a demerger for purposes of the Income-tax Act, has to fulfil the following conditions:

- (a) the demerger must be a transfer by the transferor company to a transferee company of one or more undertakings belonging to the transferor company;
- (b) this transfer should be achieved pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956;

- (c) all the property and related liabilities of the undertaking transferred, immediately before the demerger, must become the property of the transferee company by virtue of the demerger, and not by virtue of sale or otherwise as a result of the acquisition of the property or assets of the transferor company or any undertaking thereof by the transferee company;
- (d) the property and the liabilities transferred must be transferred at values appearing in the books of account of the transferor company immediately before the demerger. Revaluation of assets must be ignored;
- (e) the consideration to be paid by the transferee company should be paid to the shareholders of the transferor company and not to the transferor company. Such payment must be in the form of the shares of the transferee company. The consideration should not be in cash or otherwise. Further such allotment to the shareholders of the transferor company must be in proportion to the shares held by them in the transferor company;
- (f) the shareholders holding not less than three-fourths in value of the shares in the transferor company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) must become shareholders of the transferee company or companies by virtue of the demerger;
- (g) the transfer of the undertaking is on a going concern basis;
- (h) and the demerger must be in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

Difference of 'demerger' between Companies Act and Income-tax Act

	Companies Act, 1956	Income-tax Act, 1961
1	Demerger could be achieved either as part of a scheme of arrangement under sections 391 to 394 or By a process of sale of an undertaking.	Demerger must be only through a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956 and not otherwise. Sale of undertaking is specifically excluded.
2	The scheme of arrangement could envisage payment of consideration to the transferor company or could be in consideration for settlement of certain debts as part of a scheme of compromise.	The consideration cannot be paid to the transferor company but only the shareholders of the transferor company.
3	It is not necessary that all the property and the related liabilities need to be transferred to the transferee company.	It is necessary that all the property and all the related liabilities must be transferred to the transferee company.
4	The property and/or liabilities transferred could be at values agreed and revaluation values could also be part of the values transferred.	The property and the liabilities must be at the values appearing in the books of account of the transferor company immediately prior to demerger and revaluation of assets or liabilities must be ignored.



5	The transferee company may or may not consist of the shareholders of the transferor company.	The transferee company must have as shareholders persons holding not less than three-fourths in value of the shares in the transferor company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary).
6	The transfer need not be of a running concern i.e. the undertaking transferred need not be carrying on business at the time of transfer .	The transfer must be of a running concern and the transfer must be as a going concern basis.
7	There is no need to comply with any directions given under section 72A of the Income-tax Act, 1961.	The demerger must comply with the directions issued by the Central Government under section 72A of the Income-tax Act, 1961.

Removable of disabilities (or concessions) under the Income-tax Act

But for the specific provisions made in the Income-tax Act, by the Finance Act, 1999, removing some of the disabilities consequent to demerger, a transfer of an undertaking could result in:

- (a) liability to tax on the gains arising on the transfer (sale) of an undertaking in the hands of the transferor company (demerged company);
- (b) the non-availability of certain type of expenses which are allowed against taxable income or deductions of income in computing taxable income of such undertakings transferred resulting from the change in the ownership of the undertaking to the transferee company (resulting company)
- (c) the non-availability of the benefit of carry forward of unabsorbed losses and/or unabsorbed depreciation related to the undertaking transferred in the hands of the transferee company (resulting company)
- (d) possible liability to tax on the gains arising due to allotment or issue of shares in the transferee company as a distribution of dividend in the hands of the shareholders of the transferor company.

To avoid the harshness of the Income-tax Act provisions consequent to transfer of an undertaking, the demerger must satisfy the following conditions:

- (a) the demerger must be under sections 391 to 394 of the Companies Act, 1956, subject to exception in relation to foreign companies;
- (b) the undertaking demerged must be carrying on a business activity as a whole;
- (c) the transfer of the -undertaking must be as a going concern;
- (d) the entity to which the undertaking is transferred ("resulting company") must be a company under the Companies Act;
- (e) all the assets and liabilities immediately before the demerger of the undertaking which is being demerged must be transferred to the new entity;
- (f) the values at which the assets are transferred should be at book values immediately prior to demerger after ignoring any increase or decrease on account of revaluation;
- (g) the values of liabilities should be those which arose out of the operations of the undertakings or specific liabilities pertaining to the activities of the demerging undertaking or must bear the same proportion which the value of the assets transferred in a demerger bears to the total value of the

assets of such demerged company immediately before the demerger;

- (h) the consideration for the transfer of the undertaking is payable to the shareholders of the transferor company ("demerged company") and not to the transferor company and that such consideration shall as far as possible be in shares of the transferee company (resulting company) so as to ensure that the shareholders holding not less than three-fourths in value of the shares in the transferor company (other than shares already held therein immediately before the demerger, or by a nominee for, the transferee company or, its subsidiary) become shareholders of the transferee company or companies (resulting company or companies) by virtue of the demerger; and
- (i) The demerger is in accordance with the conditions, if any, notified under subsection (5) of section 72A by the Central Government in this behalf.
- (j) demerger of a co-operative bank if it fulfils the requirements of section 72AB of IT Act, 1961.

The persons who can avail the above referred benefits under the tax laws for a demerger complying with the above-referred conditions are:

- (a) the transferor company (demerged company);
- (b) the transferee company (resulting company); and
- (c) the shareholders of the transferor company (demerged company).

Benefits to the transferor company (demerged company)

(i) Capital Gains

- Ø Transfer of capital asset by demerged company to resulting Indian company is exempt – Section 47(vib)
 - Ø Transfer to Indian company's shares by demerged foreign company to resulting foreign company is exempt if following conditions are satisfied – Section 47(vic)
 - (a) Shareholders holding not less than 3/4th in value of the shares of demerged foreign company remain shareholder of resulting foreign company
 - (b) Such transfer does not attract any capital gain in the country of demerged company
- Proviso – this exemption is not applicable in case of demerger as mentioned in Section 391 to 394 of the Companies Act, 1956
- (i.e., demerger of an Indian company to a foreign company)
- Ø Transfer or issue of shares by the resulting company in a scheme of demerged to the shareholders of the demerged company is exempt – Section 47(vid)

(ii) Depreciation allowance

For purposes of determination of written down value of the block of assets in the hands of the demerged company after the demerger the written down value of the assets transferred to the resulting company will be reduced from the written down value of the block of assets as existed immediately prior to such demerger-Explanation 2A to Section 43(6)

- (iii) **Amortisation of expenditure in case of demerger (Sec. 35DD):** Expenses by an Indian company incurred after 1-4-1999 for amalgamation or demerger of an undertaking, shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the amalgamation or demerger takes place.



BENEFITS TO THE TRANSFEREE COMPANY (RESULTING COMPANY)

(i) Carry forward & set off of accumulated losses & unabsorbed depreciation in case of demerger

- Ø Accumulated loss or unabsorbed depreciation, if directly relatable to an undertaking, which is transferred to a resulting company shall be allowed to be carried forward and set off in the hands of resulting company – Section 72A(4)(a)
- Ø If loss or unabsorbed depreciation is not directly relatable, the loss carried forward shall be apportioned between the demerged company and the resulting company in proportion to the assets of the undertaking retained by the demerged company and that transferred to the resulting company – Section 72A(4)(b)

(ii) Scientific research expenditure u/s 35(5)

(iii) Patent right/copyright expenditure u/s 35A(6)

(iv) Expenditure on know-how u/s 35AB(3)

(v) Expenditure for licence to operate telecommunication services u/s 35ABB(6 & 7)

(vi) Amortization of preliminary expenses u/s 35D(5)

(vii) Expenditure on prospecting etc. u/s. 35E(7)

(viii) Chapter VI-A deductions u/s 80-IA(12) & 80-IB(12)

(ix) Tax holiday u/s 10A(7A) & 10B(7A)

Benefits to the shareholders of the demerged (transferor) company

(i) Deemed dividend

Section 2(22) has been amended by inserting a new clause (v) to provide that no dividend income shall arise in the hands of shareholders of demerged company on demerger.

(ii) Determination of cost of acquisition of shares allotted by resulting company

Normally when shares are acquired for which no cost is incurred the cost for purposes of determining any chargeable capital gains under section 45 would have been treated as Nil. However, in the case of demerger it is provided that the cost of acquisition of the shares in the resulting company allotted consequent to demerger shall be the amount which bears to the cost of acquisition of shares held by the concerned shareholder in the demerged company in the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger. "Net worth" for this purposes is the aggregate of the paid-up share capital and general reserves as appearing in the books of account of the demerged company immediately, 'before the demerger [section 49(2C) of IT Act].

(iii) Re-determination of cost of acquisition of shares in the demerged (transferor) company.

Consequent to determination of cost of the shares allotted in the resulting company consequent to demerger, it is provided that the cost of acquisition of the original shares held by the shareholder in the demerged company, on the basis of which the shares are allotted by the resulting company, shall be deemed to have been reduced by the amount determined as cost of acquisition of shares allotted by the resulting company, referred to earlier, [section 49(2D) of IT Act].

Effect of demerger of a company under tonnage tax scheme

Section 115VZ deals with the effect of demerger of a company which had opted to be assessed to tax under the tonnage tax scheme. This section reads as follows:

115VZ. Where in a scheme of demerger, the demerged company transfers its business to the resulting company before the expiry of the option for tonnage tax scheme, then, subject to the other provisions

of this Chapter, the tonnage tax scheme shall, as far as may be, apply to the resulting company for the unexpired period if it is a qualifying company.

Provided that the option for tonnage tax scheme in respect of the demerged company shall remain in force for the unexpired period of the tonnage tax scheme if it continues to be a qualifying company.

The effect of demerger would not affect the resulting company in respect of the option exercised by the demerged qualifying shipping company. The resulting company must also be a qualifying company under the said scheme.

Special provisions in respect of newly established Units in Special Economic Zones It is provided in section 10AA(5) that where any undertaking being the Unit which is entitled to the deduction is transferred, before the expiry of the period specified in section 10AA(1) viz. 15 years, to another undertaking, being the Unit in a scheme of demerger,—

- (a) no deduction shall be admissible to the demerged Unit, being the company for the previous year in which the demerger takes place; and
- (b) the provisions of that section shall, as they would have applied to the demerged Unit being the company as if the demerger had not taken place.

Compliance with SEBI Regulations

The SEBI (Disclosures & Investors Protection) Guidelines do provide certain disclosures needed for protecting the investors. Consequent to coming into force of ICDR Regulations, the DIP Guidelines have been rescinded. No specific guidelines are presently there. However, it has been proposed by SEBI that it proposes to enforce appropriate disclosures in case of demergers as in the case of amalgamation. [SEBI Press Release 311-2003 dated 17 December, 2003]. This the SEBI intends to enforce through amendment to the Listing Agreement. Hence this would apply, as in case of other SEBI regulations, only to a listed company. The disclosures which are likely to be made compulsory are:

Details about the companies: |

1. Names & registered offices of the companies. |
2. The extent to/manner in which the companies are related to each other.
3. Capital structure of the companies.
4. Shareholding pattern clearly indicating the shares held by the promoters and by persons other than promoters.
5. Line of business.
6. Dates of agreement, if any, with the other companies which are parties to the scheme of arrangement.
7. Names and Profile of the promoters and directors - viz. age, educational qualifications, experience, personal addresses etc of the companies.
8. Names of subsidiary/group companies and companies with which the promoters of the resultant company are associated.
9. Indicate whether there would be a change in control in the resultant company viz the issuing company.
10. Capital Structure and Shareholding pattern, before (of issuing company) and after (of resultant company) the proposed scheme of arrangement, and the management's views on the change in the public holding on how it would affect the shareholders at large.
11. Audited Financial statements of the companies for the last 3 years including the latest audited



financial statement (not more than 6 months' old) and material development after balance-sheet date (as per the format given in clause 49 of Listing agreement).

Details about the scheme:

1. Basis of valuation.
2. Nature of consideration, if any, payable/receivable under the scheme.
3. Mode of payment/receipt.
4. Manner of surrender/receipt of shares or securities.
5. The time schedule within which the shares/securities are to be surrendered/ received and payments to be made/received.
6. Tentative date by which the scheme would become effective under the provisions of the Companies Act.
7. Details of approvals obtained/to be obtained/sought from creditors, authorities like stock exchanges/authorities under Companies Act etc.
8. Dates of Board Meeting when the proposal was considered/approved.
9. Any other details which deemed necessary for information to shareholders enabling them to make an informed decision about the proposed scheme, including those required under Section 393 of the Companies Act, 1956.

For the above purposes:

1. The terms "company/companies" mean the companies which are parties to the terms of arrangement of merger/demerger/amalgamation specified under Sections 391 to 394 of the Companies Act, 1956.
2. The term "resultant company" shall mean the company which comes into existence as a result of the scheme of arrangement for merger/demerger/ amalgamation.
3. The term "issuing company" shall mean the listed company which is seeking approval of shareholders for the scheme of arrangement for merger/demerger/ amalgamation.

Compliance with Stock Exchange requirements

Under Clause 36 of the Listing Agreement it is provided that the company will also immediately inform the Exchange of all the events which will have bearing on the performance/operations of the company as well as price sensitive information, *Inter alia* one of the material events is the change in the general character or nature of business. In this regard it is provided that:

"Without prejudice to the generality of Clause 29 of the Listing Agreement, the Company will promptly notify the Exchange of any material change in the general character or nature of its business where such change is brought about by the Company entering into or proposing to enter into any arrangement for technical, manufacturing, marketing or financial tie-up or by reason of the company, selling or disposing of or agreeing to sell or dispose of any unit or division or by the company, enlarging, restricting or closing the operations of any unit or division or proposing to enlarge, restrict or close the operations of any unit or division or otherwise."

Further, under Clause 31 of the Listing Agreement it is provided that the company shall promptly report the following:

(c) three copies of all the notices, call letters or any other circulars including notices of meetings convened u/s 391 or section 394 read with section 391 of the Companies Act, 1956 together with Annexures thereto, at the same time as they are sent to the shareholders, debenture holders or creditors or any class of them or advertised in the Press.

- (d) copy of the proceedings at all Annual and Extraordinary General Meetings of the company;
- (e) three copies of all notices, circulars, etc., issued or advertised in the press either by the company, or by any company which the company proposes to absorb or with which the company proposes to merge or amalgamate, or under orders of the Court or any other statutory authority in connection with any merger, amalgamation, re-construction, reduction of capital, scheme or arrangement, including notices, circulars, etc. issued or advertised in the press in regard to meetings of shareholders or debenture holders or creditors or any class of them and copies of the proceedings at all such meetings.

Procedure

The procedure for demerger is the same as in case of a scheme of arrangement.

REORGANISATION THROUGH COMPROMISE OR AN ARRANGEMENT

The provisions of Companies Act, 1956 regarding scheme of 'Compromise' or 'Arrangement' are mainly applicable to those companies which are liable to be wound up under the act [Sec.390(a)]. By providing these provisions, the law intends to provide a kind of substitute for winding up and thereby save a company from going into liquidation.

Compromise-Meaning

Though the term 'arrangement' has been defined in section 390, the term 'compromise' has not been defined in the Companies Act. Hence, we need to look for the general meaning of this term. The Oxford Little Dictionary *inter alia* gives the meaning as "agreement attained by mutual concession; adjust by mutual concession."

Thus compromise implies existence of a dispute which needs to be resolved through a give and take action by the parties concerned. In contrast to this an arrangement could exist whether there is a dispute or not.

Section 391 envisages existence of a proposal for a compromise or an arrangement between a company on the one side and either the members or a class of them or the creditors or a class of them on the other side. The proposal could be in the form of a scheme prepared in this regard. The scheme could be to cover all the creditors or all the members or any class of creditors or any class of members.

Arrangement-Meaning

'Arrangement' is defined to include-

"a reorganization of the share capital of the company by the consolidation of shares of different classes, or by the division of shares into shares of different classes or, by both those methods";

In this regard one may refer to section 94(1) of the Companies Act which *inter alia* deals with power of a company to:

"(b) consolidate and divide all or any of its share capital into shares of larger amount than its existing shares;

(d) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived."

The definition of the term "arrangement" is an inclusive definition. The word "arrangement" should not be limited to something analogous in some sense to 'compromise'. The courts have construed "arrangement" as a word of very wide import covering almost every type of legal transaction so long as there is some element of give and take and has the approval of the company concerned, either through its board or through the members in general meeting.



Sections 390 to 393 of the Companies Act, deal with the procedure for giving effect to compromise or an arrangement. Sections 100 to 105 deal with reduction of capital, sections 106 and 107 deal with variation of shareholders' rights, and sections 94 and 95 deal with consolidation of share capital where there is increase in capital.

Sections 390 to 393 read as follows:

390. In sections 391 and 393

- (a) the expression "company" means any company liable to be wound up under this Act;
- (b) the expression "arrangement" includes a reorganization of the share capital of the company by the consolidation of shares of different classes, or by the division of shares into shares of different classes or, by both those methods; and
- (c) unsecured creditors who may have filed suits or obtained decrees shall be deemed to be of the same class as other unsecured creditors.

391. Power to compromise or make arrangements with creditors and members

- (1) Where a compromise or arrangement is proposed-

- (a) between a company and its creditors or any class of them; or
 - (b) between a company and its members or any class of them;

the Court* may, on the application of the company or of any creditor or member of the company, or, in the case of a company, which is being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Court* directs.

- (2) If a majority in number representing three- fourths in value of the creditors, or class of creditors, or members, or class of members as the case may be, present and voting either in person or, where proxies are allowed [under the rules made under section 643], by proxy, at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Court*, be binding on all the creditors, all the creditors of the class, all the members, or all the members of the class, as the case may be, and also on the company, or, in the case of a company which is being wound up, on the liquidator and contributories of the company:

Provided that no order sanctioning any compromise or arrangement shall be made by the Court* unless the Court* is satisfied that the company or any other person by whom an application has been made under sub- section (1) has disclosed to the Court*, by affidavit or otherwise, all material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company, the pendency of any investigation proceedings in relation to the company under sections 235 to 251, and the like.

- (3) An order made by the Court* under sub- section (2) shall have no effect until a certified copy of the order has been filed with the Registrar.
- (4) A copy of every such order shall be annexed to every copy of the memorandum of the company issued after the certified copy of the order has been filed as aforesaid, or in the case of a company not having a memorandum, to every copy so issued of the instrument constituting or defining the constitution of the company.
- (5) If default is made in complying with sub- section (4), the company, and every officer of the company who is in default, shall be punishable with fine which may extend to ten rupees for each copy in respect of which default is made.
- (6) The Court* may, at any time after an application has been made to it under this section, stay the commencement or continuation of any suit or proceeding against the company on such terms as the Court* thinks fit, until the application is finally disposed of.

- (7) ** An appeal shall lie from any order made by a Court* exercising original jurisdiction under this section to the Court* empowered to hear appeals from the decisions of that Court*, or if more than one Court* is so empowered, to the Court* of inferior jurisdiction. The provisions of sub-sections (3) to (6) shall apply in relation to the appellate order and the appeal as they apply in relation to the original order and the application."

*Tribunal- Substituted by the Companies (Second Amendment) Act, 2002, yet to come in effect.

** Sub-section (7) omitted by the Companies (Second Amendment) Act, 2002, yet to come in effect.

392. Power of High Court to enforce compromises and arrangements

- (1) Where a High Court* makes an order under section 391 sanctioning a compromise or an arrangement in respect of a company, it--
- (a) shall have power to supervise the carrying out of the compromise or arrangement; and
 - (b) may, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper working of the compromise or arrangement.
- (2) If the Court* aforesaid is satisfied that a compromise or an arrangement sanctioned under section 391 cannot be worked satisfactorily with or without modifications, it may, either on its own motion or on the application of any person interested in the affairs of the company, make an order winding up the company, and such an order shall be deemed to be an order made under section 433 of this Act.
- (3) **The provisions of this section shall, so far as may be, also apply to a company in respect of which an order has been made before the commencement of this Act under section 153 of the Indian Companies Act, 1913 , (7 of 1913) sanctioning a compromise or an arrangement.

*Tribunal- Substituted by the Companies (Second Amendment) Act, 2002, yet to come in effect.

** Sub-section (3) omitted by the Companies (Second Amendment) Act, 2002, yet to come in effect.

393. Information as to compromises or arrangements with creditors and members

- (1) Where a meeting of creditors or any class of creditors, or of members or any class of members, is called under section 391-
- (a) with every notice calling the meeting which is sent to a creditor or member, there shall be sent also a statement setting forth the terms of the compromise or arrangement and explaining its effect; and in particular, stating any material interests of the directors, managing director, managing agent, secretaries and treasurers or manager of the company, whether in their capacity as such or as members or creditors of the company or otherwise, and the effect on those interests, of the compromise or arrangement, if, and in so far as, it is different from the effect on the like interests of other persons; and
 - (b) in every notice calling the meeting which is given by advertisement, there shall be included either such a statement as aforesaid or a notification of the place at which and the manner in which creditors or members entitled to attend the meeting may obtain copies of such a statement as aforesaid.
- (2) Where the compromise or arrangement affects the rights of debenture holders of the company, the said statement shall give the like information and explanation as respects the trustees of any deed for securing the issue of the debentures as it is required to give as respects the company's directors.
- (3) Where a notice given by advertisement includes a notification that copies of a statement setting



forth the terms of the compromise or arrangement proposed and explaining its effect can be obtained by creditors or members entitled to attend the meeting, every creditor or member so entitled shall, on making an application in the manner indicated by the notice, be furnished by the company, free of charge, with a copy of the statement.

- (4) Where default is made in complying with any of the requirements of this section, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to five thousand rupees; and for the purpose of this sub-section any liquidator of the company and any trustee of a deed for securing the issue of debentures of the company shall be deemed to be an officer of the company:

Provided that a person shall not be punishable under this sub-section if he shows that the default was due to the refusal of any other person, being a director, managing director, managing agent, secretaries and treasurers, manager or trustee for debenture holders, to supply the necessary particulars as to his material interests.

- (5) Every director, managing director, managing agent, secretaries and treasurers or manager of the company, and every trustee for debenture holders of the company, shall give notice to the company of such matters relating to himself as may be necessary for the purposes of this section; and if he fails to do so, he shall be punishable with fine which may extend to five hundred rupees.

Scheme of compromise or arrangement

The law requires an applicant viz. the company, or a creditor or a member to present an application to the Tribunal. Generally, it is the company which prepares a scheme of arrangement or compromise after discussion with the members, creditors and its advisors. In case of a company in liquidation, the liquidator prepares the scheme based on the discussions he had with the company directors, the creditors, the members and his advisors. All the 'give and take' exercise between the parties would have normally taken place prior to the preparation of the scheme. The company or the liquidator then presents an application to the Tribunal. The Tribunal then orders a meeting of the creditors or class of creditors or members or class of members, as the case may be. The Tribunal also gives the direction as to the manner in which such meeting takes place. This does not bar any member or creditor to frame a scheme and seek approval of the company and the Tribunal. Under the Rules, the application under section 391(1) will have to be made as a petition to the Tribunal.

Procedure in respect of compromise or arrangement

Except for the preparation of an appropriate scheme and presentation of a petition to the Tribunal, all the rest of the procedure will be as prescribed by the Companies (Court) Rules, 1959 as applicable. An extract of the relevant Rules is given as under:

67. Summons for directions to convene a meeting-

An application u/s 391(1) for an order convening a meeting of creditors and/or members or any class of them shall be by a Judge's summons supported by an affidavit. A copy of the proposed compromise or arrangement shall be annexed to the affidavit as an exhibit thereto. Save as provided in rule 68 hereunder, the summons shall be moved *ex parte*. The summons shall be in Form No. 33, and the affidavit in support thereof in Form No. 34.

68. Service on company-

Where the company is not the applicant, a copy of the summons and of the affidavit shall be served on the company, or, where the company is being wound up on its liquidator, not less than 14 days before the date fixed for the hearing of the summons.

69. Directions at hearing of summons-

Upon the hearing of the summons or any adjourned hearing thereof, the Judge shall, unless he thinks fit for any reason to dismiss the summons, give such directions as he may think necessary in respect of

the following matters:

- (1) determining the class or classes of creditors and/or of members whose meeting or meetings have to be held for considering the proposed compromise or arrangement;
- (2) fixing the time and place of such meeting or meetings;
- (3) appointing a chairman or chairmen for the meeting or meetings to be held, as the case may be;
- (4) fixing the quorum and the procedure to be followed at the meeting or meetings, including voting by proxy;
- (5) determining the values of the creditors and/or the members, or the creditors or members of any class, as the case may be, whose meetings have to be held;
- (6) notice to be given of the meeting or meetings and the advertisement of such notice;
- (7) the time within which the Chairman of the meeting is to report to the Court the result of the meeting; and such other matters as the Court may deem necessary.

The order made on the summons shall be in Form No. 35 with such variations as may be necessary.

70. Proxies.—

- (1) Voting by proxy shall be permitted, provided a proxy in the prescribed form duly signed by the person entitled to attend and vote at the meeting is filed with the company at its registered office not later than 48 hours before the meeting.
- (2) Where a body corporate which is a member or creditor (including holder of debentures) of a company authorises any person to act as its representative at the meeting, of the members or creditors of the company, or of any class of them, as the case may be, a copy of the resolution of the Board of Directors or other governing body of such body corporate authorising such person to act as its representative at the meeting, and certified to be a true copy by a director, the manager, the secretary, or other authorised officer of such body corporate shall be lodged with the company at its registered office not later than 48 hours before the meeting.
- (3) Rules 227 to 229 of these rules relating to proxies shall also apply to proxies lodged under the rule.

71. Application for stay—

An application under sub-section (6) of section 391 for stay of the commencement or continuation of any suit or proceeding against the company may be moved by a Judge's summons *ex parte* provided that where a petition for winding-up the company or a petition under section 397 or section 398 is pending, notice of the application shall be given to the petitioner in such petition.

72. Application to vacate or vary order of stay.—

Where an order has been made staying the commencement or continuation of any suit or proceeding under sub-section (6) of section 391 any person aggrieved by such order may apply to the Court by a Judge's summons to vacate or vary such order. Notice of the application shall be given to the applicant at whose instance the order of stay was made and to such other persons as the Court may direct.

73. Notice of meeting.—

The notice of the meeting to be given to the creditors and/or members or the creditors or members of any class, as the case may be, shall be in Form No. 36. and shall be sent to them individually by the Chairman appointed for the meeting or if the Court so directs, by the company (or its liquidator), or any other person as the Court may direct, by post under certificate of posting to their last known address not less than 21 clear days before the date fixed for the meeting. It shall be accompanied by a copy of the proposed compromise or arrangement and the statement required to be furnished under section 393, and a form of proxy in Form No. 37.



74. Advertisement of the notice of meeting.—

The notice of the meeting shall be advertised in such newspapers and in such manner as the Judge may direct, not less than 21 clear days before the date fixed for the meeting. The advertisement shall be in Form No. 38.

75. Copy of compromise or arrangement to be furnished by the company.—

Every creditor or member entitled to attend the meeting shall be furnished by the company, free of charge and within 24 hours of a requisition being made for the same, with a copy of the proposed compromise or arrangement together with a copy of the statement required to be furnished under section 393, unless the same had been already furnished to such member or creditor.

76. Affidavit of service.—

The Chairman appointed for the meeting of the company or other person directed to issue the advertisement and the notices of the meeting shall file an affidavit not less than seven days before the date fixed for the holding of the meeting or the holding of the first of the meetings, as the case may be showing that the direction regarding the issue of notices and the advertisement have been duly complied with. In default thereof the summons shall be posted before the Judge for such orders as he may think fit to make.

77. Result of the meeting to be decided by poll.—

The decisions of the meeting or meetings held in pursuance of the order made under rule 69 on all resolutions shall be ascertained only by taking a poll.

78. Report of the result of the meeting.—

The Chairman of the meeting, (or where there are separate meetings, the Chairman of each meeting, shall, within the time fixed by the Judge, or where no time has been fixed, within seven days after the conclusion of the meeting, report the result thereof to the Court. The report shall state accurately the number of creditors or class of creditors or the number of members or class of members, as the case may be, who were present and who voted at the meeting either in person or by proxy, their individual values and the way they voted. The report shall be in Form No. 39.

79. Petition for confirming compromise or arrangement —

Where the proposed compromise or arrangement is agreed to, with or without modification, as provided by sub-section (2) of section 391, the company, (or its liquidator, as the case may be) shall within seven days of the filing of the report by the chairman, present a petition to the Court for confirmation of the compromise or arrangement. The petition shall be in Form No. 40.

Where a compromise or arrangement is proposed for the purposes of or in connection with a scheme for the reconstruction of any company or companies, or for the amalgamation of any two or more companies, the petition shall pray for appropriate orders and directions under section 394,

Where the company fails to present the petition for confirmation of the compromise or arrangement as aforesaid, it shall be open to any creditor or contributory as the case may be, with the leave of the Court, to present the petition and the company shall be liable for the cost thereof.

Where no petition for confirmation of the compromise or arrangement is presented, or where the compromise or arrangement has not been approved by the requisite majority under section 391(2) and consequently no petition for confirmation could be presented, the report of the chairman as to the result of the meeting made under the preceding rule shall be placed for consideration before the Judge for such orders as may be necessary,

80. Date and notice of hearing—

The Court shall fix a date for the hearing of the petition, and notice of the hearing shall be advertised

in the same papers as the Court may direct, not less than 10 days before the date fixed for the hearing.

81. Order on petition.—

Where the Court sanctions the compromise or arrangement, the order shall include such directions in regard to any matter and such modifications in the compromise or arrangements as the Judge may think fit to make for the proper working of the compromise or arrangement. The order shall direct that a certified copy of the same shall be filed with the Registrar of Companies within 14 days from the date of the order, or such other time as may be fixed by the Court. The order shall be in Form No. 41 with such variations as may be necessary.

82. Application for directions under section 394—

Where the compromise or arrangement has been proposed for the purposes of or in connection with a scheme for the reconstruction of any company or companies or the amalgamation of any two or more companies, and the matters involved cannot be dealt with adequately on the petition for sanction of the compromise or arrangement, an application shall be made to the Court under section 394 by a summons supported by affidavit, for directions of the Court as to the proceedings to be taken. Notice of the summons shall be given in such manner and to such persons as the Court may direct.

83. Direction at hearing of application—

Upon the hearing of the summons or upon any adjourned hearing thereof the Court may make such order or give such directions as it may think fit, as to the proceedings to be taken for the purpose of reconstruction or amalgamation, as the case may be including, where necessary, an inquiry as to the creditors of the transferor company and the securing of the debts and claims of any of the dissenting creditors in such manner as to the Court may seem just.

84. Order under section 394.—

An order made under section 394 shall be in Form No 42 with such variation as the circumstances may require.

85. Compromise or arrangement involving reduction of capital—

Where a proposed compromise or arrangement involves a reduction of capital of the company, the procedure prescribed by the Act and these rules relating to the reduction of capital, and the requirements of the Act and these rules in relation thereto, shall be complied with before the compromise or arrangement so far as it relates to reduction of capital is sanctioned.

86. Report on working of compromise or arrangement—

At any time after the passing of the order sanctioning the compromise or arrangement the Court may, either of its own motion or on the application of any person interested, make an order directing the company, or, where the company is being wound-up, the Liquidator, to submit to the Court within such time as the Court may fix, a report on the working of the said compromise or arrangement. On a consideration of the report, the Court may pass such orders or give such directions as it may think fit.

87. Liberty to apply.—

- (1) The company, or any creditor or member thereof or in case of a company which is being wound-up, the liquidator, may, at any time after the passing of the order sanctioning the compromise or arrangement, apply to the Court for the determination of any question relating to the working of the compromise or arrangement.
- (2) The application shall in the first instance be posted before the Court for directions as to the notices and the advertisement, if any, to issue, as the Court may direct.
- (3) The Court may, on such application, pass such orders and give such directions as it may think fit in regard to the matter, and may make such modifications in the compromise or arrangement as it



may consider necessary for the proper working thereof, or pass such other order as it may think fit in the circumstances of the case.

2.2. RECONSTRUCTION VS. AMALGAMATION

The term 'Reconstruction' implies the formation of a new company to take over the assets of an existing company with the idea that the persons interested and the nature of business substantially remains the same.

The term 'Amalgamation' is taken to mean as the union of two or more companies, so as to form a third entity or one company is absorbed into another company.

The difference between the two can be highlighted as under:

Particulars	Reconstruction	Amalgamation
1. Number of Companies	Used when one Company is involved, and the rights of its Creditors / Members are reorganized.	Used when two or more Companies are merged together to form a new entity, or one Company taking over another.
2. Nature	Internal Arrangement of rights of Members / Creditors or class thereof.	External in nature, as it involves arrangement with another Company / entity, and also Members / Creditors or class thereof.
3. Business	The same business is carried on by substantially the same persons. The Company continues to operate with its Members / Creditors, but with variation of their rights.	The Company may sell its undertaking to another Company, or takeover another Company as such.
4. Purposes	• To extend the objects of the Company. • To compound with Creditors and determine liabilities afresh. • To re-organize Share Capital. • To alter the rights of different classes of Share / Debenture holders. • To revive a sick unit.	• To avail tax concessions and benefits. • To diversify or expand business operations. • To revive a sick unit. • To eliminate competition, by takeover. • To make full use of unused capacity. • To achieve economies of scale. • To acquire fresh assets at discounted price.

5. Methods of achieving / effecting	• Sale of Company as per power contained in MOA. • Sale of undertaking of the Company [Sec.391 - 394]. • Acquiring Shares in another Company [Sec.395]. • Compulsory Amalgamation in public interest [Sec.396]. • Reconstruction under Members' Voluntary Winding up [Sec.494]. • Reconstruction under Creditors' Voluntary Winding up [Sec.507]. • Reconstruction by arranging with Creditors in Voluntary Winding up [Sec.517].	• Sale of undertaking of the Company [Sec.391 -394]. • Acquiring Shares in another Company [Sec.395]. • Compulsory Amalgamation in public interest [Sec.396].
6. Scope	General and wide term. Amalgamation is also a method of reconstruction.	Specific and restricted in scope. Amalgamation is one of the methods of "external" reconstruction.

2.3. SALE OF UNDERTAKING OF THE COMPANY [SEC.391-394]

The procedure for sale of undertaking of the Company is stated as under:

1. Parties [Sec.391(1)]: The Compromise or Arrangement may be proposed -

- (a) between a Company and its Creditors or any class of them, or
- (b) between a Company and its Members or any class of them.

Note: For Sec.391 & 393 purposes -

- Company means any Company liable to be wound up under the Act.
- Unsecured Creditors who may have filed suits or obtained decrees shall be deemed to be of the same class as other Unsecured Creditors.

2. Application to Court [Sec.391(1)]: An application shall be made to the Court u/s 391, describing the scheme of arrangement. Such application can be made by -

- (a) Company itself,
- (b) Any Creditor of the Company,
- (c) Any Member of the Company,
- (d) Liquidator of a Company which is being wound up.

Case Law: Where a Company is being wound up, not only the Liquidator, but also any Creditor or Member may also make an application for compromise or arrangement. Creditors/ Members' rights are not lost on the Company being wound-up.-

Rajendra Prasad Agarwal vs Official Liquidator 48 CC 476

3. Notice to Central Government [Sec.394A]: The Court shall give notice of every application made to it u/s 391 / 394 to the Central Government, and shall take into consideration the representations, if any, made to it by that Government before passing any order under any of these Sections.



[However, the Court is not bound by the representations made by the Central Government.]
(Note: Power of Central Government delegated to Regional Director. Refer Notification below)

Notification No. S.O.447(E), dated 28-2-2011 - The Central Government hereby delegates to the Regional Directors at Mumbai, Kolkata, Chennai, Noida and Ahmedabad, the powers and functions of the Central Government u/s 394A. (i.e., Notice of application u/s 391/394)

4. Directions for Meeting [Sec.391(1)]: The Court may order a meeting of the Creditors / Members or class of Creditors / Members, to be called, held and conducted in such manner as the Court directs,
5. Disclosure of interest by Director, etc.[Sec.393(5)]: Every Director, MD or Manager of the Company, and every Debenture Trustee, shall give notice to the Company of such matter relating to himself as may be necessary for Sec.393 purposes. Failure to do so will attract a fine upto ₹ 5,000.
6. Notice of Meeting [Sec.393(1) - (4)]: Notice of the meeting shall be sent to Members / Creditors, along with the following information -
 - (a) Terms of the compromise or arrangement,
 - (b) Explanatory Statement containing the effect of the compromise or arrangement,
 - (c) Details of any material interests of the Directors, MD or Manager of the Company, whether in their capacity as such or as Members / Creditors / otherwise, and the effect on those interests, in so far as, it is different from the effect on the like interests of other persons,
 - (d) Statement providing like information and explanation (as in (c) above) as respects the Debenture Trustees, where the compromise / arrangement affects the rights of Debentureholders,
 - (e) Notification of the place at which and the manner in which Creditors / Members entitled to attend the meeting may obtain copies of such Statements as aforesaid, where such Notice is given by way advertisement. [Note: In case of Notice by advertisement, every such Creditor / Member, on making an application in the manner indicated by the Notice, shall be furnished with a copy of the statement by the Company, free of charge].
7. Consequence of default: In case of default in complying with Sec.393, the Company, and every Officer in default (including Liquidator and Debenture Trustee), shall be punishable with fine upto ₹ 50,000. Such person can be relieved of punishment if he shows that the default was due to the refusal of any other person, being a Director, MD, Manager or Debenture Trustee, to supply the necessary particulars as to his material interests.
8. Approval of Scheme at the Meeting [Sec.391(2)]: At the meeting, the scheme of compromise / arrangement shall be approved by a majority in number representing 3/4th in value of Creditors / Members, or class of Creditors / Members,, present and voting, either in person or by proxy (where proxies are allowed under Rules made u/s 643).
9. **Court Sanction [Sec.391(2)]:**
 - (a) Mere approval by majority does not validate the compromise / arrangement..The scheme has to be sanctioned by the Court.
 - (b) The Court shall make an order sanctioning the compromise / arrangement only if the Court is satisfied that the Company / other applicant has disclosed to the Court/ by affidavit or otherwise, all material facts relating to the Company, e.g. - (i) latest financial position of the Company, (ii) latest Auditor's Re'port on the accounts of the Company, (iii) pendency of any investigation proceedings in relation to the Company u/s 235 to 251, etc.
 - (c) The Court may, at any time after an application is made u/s 391, stay the commencement or continuation of any suit or proceeding against the Company on such terms as the Court thinks fit, until the application is finally disposed of.

10. Filing Court Order with ROC [Sec.391(4) & (5)]:

- (a) An order made by the Court shall become effective only when a certified copy thereof has been filed with the ROC.
 - (b) A copy of every such order shall be annexed to every copy of the MOA or other instrument constituting or defining the constitution of the Company, issued after the certified copy of the order has been filed with the ROC.
 - (c) In case of default with the above, the Company, and every Officer in default, shall be punishable with fine upto ₹ 100 for each copy in respect of which default is made.
11. Effect of Court Order [Sec.391(2)]: Once the Court Order becomes effective, the compromise or arrangement shall be binding on - (a) all the Creditors / Members, or all the Creditors / Members of the class, (b) the Company, and (c) the Liquidator and Contributories in the case of a Company which is being wound-up.
12. Supervision & Modifications [Sec.392]: Where a Court makes a sanction order u/s 391, it -
- (a) shall have power to supervise the carrying out of the compromise or arrangement, and
 - (b) may, at the time of making the order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper working of the compromise or arrangement
13. Winding up Order: If the Court is satisfied that a compromise / arrangement sanctioned u/s 391 cannot be worked satisfactorily with or without modifications, it may, either on its own motion or' on the application of any person interested in the affairs of the Company, make an order winding up the Company. Such order shall be deemed to be an order made u/s 433 of the Act.

CASE LAW In SESA Industries Ltd. Vs. Krishna H. Bajaj 2011 (SC)

Supreme Court held the following in Connection with Section 394 –

- 1. Court before whom scheme of amalgamation is placed for sanction is not expected to put its seal of approval on scheme merely because majority of shareholders have voted in favour of scheme.
- 2. Scheme which gets sanctioned by Court would be binding on dissenting minority Shareholders or Creditors, Court is obliged to examine scheme in its proper prospective together with its various manifestations and ramifications with a view to find out whether scheme is fair, just and reasonable to concerned members and is not contrary to any law or public policy.
- 3. Existence of proceedings u/s 209A (Inspection) must be disclosed. Copies of inspection report to be sent as part of explanatory statement with individual notices.

Findings in report u/s 209A were placed before the court was justified in sanctioning scheme of amalgamation.

4.		

2.4. ACQUIRING SHARES IN ANOTHER COMPANY [SEC. 395]

The method of Amalgamation by take-over bid is quite common. A "take-over Bid" means an offer to acquire shares of company with a view to obtaining legal control of the company.

Section 395 provides for the compulsory acquisition of the shares of the dissenting minority.

The provisions of Sec.395 are as follows:

1. The offer of the transferee company to acquire the shares or any class of shares, must be placed before the shareholder of the transferor company.
2. The shareholders have the option to approve the offer within 4 months. Approval must be accorded by the holders of atleast 90 per cent in value of the shares whose transfer is involved (other than shares already held by transferee company at the date of the offer or by its nominees or by its subsidiary.)
3. If the scheme is so approved, the transferee company may, at any time, within two months, after the expiration of above four months, give notice to the dissenting shareholders.
4. The dissenting shareholders can, within one month of the receipt of such notice, apply to the court for annulling the scheme.
5. If the Court refuse to issue the order annulling the scheme of Amalgamation or if no application is made to the Court, the transferee company shall be entitled and bound to acquire the share of dissenting shareholders.
6. The transfer of shares pursuant to the notice given by the transferee company after the disposal of the appeal filed by the dissenting shareholders.
7. Any sums which so received by the transferee company must be paid into a bank account and this amount or any other consideration received must be held for dissenting shareholders.

2.5. COMPULSORY AMALGAMATION IN PUBLIC INTEREST [SEC. 396]

Under Sec.396 of the Act, the Central Government is given power to order Amalgamation of two or more companies in public interest.

The provisions are:

1. If the Central Government is satisfied that it is essential in public interest that two or more companies should be amalgamated.
2. The order aforesaid may provide for the continuation by or against the transferee company of any legal proceedings pending by transferee company.
3. Every Member, Debentureholder or any Creditors of the Amalgamation companies, continue to have the same interest in the new company.
4. No order under this section shall be made by the Central Govt. unless:
 - (a) A draft copy of the proposed order has been sent to each of the companies to file their objectives and suggestions.
 - (b) The time for preferring an appeal to CLB has expired.
 - (c) It has considered and made such modifications if any, in the draft order as may seem to it desirable in the light of any suggestions and objectives.
5. Copies of the order made by the govt. in this connection must, as soon as possible, be laid before both the House of Parliament.

Study Note - 3

SEBI LAWS AND REGULATIONS



This Study Note includes

- 3.1 The Securities and Exchange Board of India Act, 1992**
- 3.2 The Securities Contracts (Regulation) Act, 1956**
- 3.3 SEBI (Issue of Capital and Disclosure regulations), 2009**
- 3.4 Clause 49**
- 3.5 Substantial Acquisition of Shares and Takeover Regulations**

3.1 THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992

PRELIMINARY

Short title, extent & commencement (Section 1)

- (1) This Act may be called the Securities and Exchange Board of India Act, 1992.
- (2) It extends to the whole of India.
- (3) It shall be deemed to have come into force on the 30th day of January, 1992.

Definitions (Section 2)

- (1) In this Act, unless the context otherwise requires, -
 - (a) "Board" means the Securities and Exchange Board of India established under section 3;
 - (b) "Chairman" means the Chairman of the Board;
 - (ba) "collective investment scheme" means any scheme or arrangement which satisfies the conditions specified in Section 11AA;
 - (c) "existing Securities and Exchange Board" means the Securities and Exchange Board of India constituted under the Resolution of the Government of India in the Department of Economic Affairs No.1 (44)SE/86, dated the 12th day of April, 1988;
 - (d) "Fund" means the Fund constituted under Section 14;
 - (e) "member" means a member of the Board and includes the Chairman;
 - (f) "notification" means a notification published in the Official Gazette;
 - (g) "prescribed" means prescribed by rules made under this Act;
 - (h) "regulations" means the regulations made by the Board under this Act;
 - (ha) "Reserve Bank" means the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934;
 - (i) "securities" has the meaning assigned to it in section 2 of the Securities Contracts (Regulation) Act, 1956.
- (2) Words and expressions used and not defined in this Act, but defined in the Securities Contracts (Regulation) Act, 1956, [or the Depositories Act, 1996], shall have the meanings respectively assigned to them in that Act.

ESTABLISHMENT OF THE SECURITIES AND EXCHANGE BOARD OF INDIA

Establishment and incorporation of Board [Section 3]

- (1) With effect from such date as the Central Government may, by notification, appoint, there shall be established, for the purposes of this Act, a Board by the name of the Securities and Exchange Board of India.
- (2) The Board shall be a body corporate by the name aforesaid, having perpetual succession and a common seal, with power subject to the provisions of this Act, to acquire, hold and dispose of property, both movable and immovable, and to contract, and shall, by the said name, sue or be sued.
- (3) The head office of the Board shall be at Bombay.
- (4) The Board may establish offices at other places in India.

Management of the Board [Section 4]

- (1) The Board shall consist of the following members, namely:-
 - (a) a Chairman;
 - (b) two members from amongst the officials of the Ministry of the Central Government dealing with Finance and administration of the Companies Act, 1956;
 - (c) one member from amongst the officials of the Reserve Bank;
 - (d) five other members of whom at least three shall be the whole-time members, to be appointed by the central Government.
- (2) The general superintendence, direction and management of the affairs of the Board shall vest in a Board of members, which may exercise all powers and do all acts and things which may be exercised or done by the Board.
- (3) Save as otherwise determined by regulations, the Chairman shall also have powers of general superintendence and direction of the affairs of the Board and may also exercise all powers and do all acts and things which may be exercised or done by that Board.
- (4) The Chairman and members referred to in clauses (a) and (d) of sub-section (1) shall be appointed by the Central Government and the members referred to in clauses (b) and (c) of that sub-section shall be nominated by the Central Government and the Reserve Bank respectively.
- (5) The Chairman and the other members referred to in clauses (a) and (d) of subsection (1) shall be persons of ability, integrity and standing who have shown capacity in dealing with problems relating to securities market or have special knowledge or experience of law, finance, economics, accountancy, administration or in any other discipline which, in the opinion of the Central Government, shall be useful to the Board.

Term of office and conditions of service of Chairman and members of the Board [Section 5]

- (1) The term of office and other conditions of service of the Chairman and the members referred to in clause (d) of sub-section (1) of section 4 shall be such as may be prescribed.
- (2) Notwithstanding anything contained in sub-section (1), the Central Government shall have the right to terminate the services of the Chairman or a member appointed under clause (d) of sub-section (1) of section 4, at any time before the expiry of the period prescribed under sub-section (1), by giving him notice of not less than three months in writing or three months' salary and allowances in lieu thereof, and the Chairman or a member, as the case may be, shall also have the right to relinquish his office, at any time before the expiry of the period prescribed under sub-section (1), by giving to the Central Government notice of not less than three months in writing.



Removal of member from office [Section 6]

The Central Government shall remove a member from office if he -

- (a) is, or at any time has been, adjudicated as insolvent;
- (b) is of unsound mind and stands so declared by a competent court;
- (c) has been convicted of an offence which, in the opinion of the Central Government, involves a moral turpitude;
- (d) [.....]
- (e) has, in the opinion of the Central Government, so abused his position as to render his continuation in office detrimental to the public interest:

Provided that no member shall be removed under this clause unless he has been given a reasonable opportunity of being heard in the matter.

Meetings [Section 7]

- (1) The Board shall meet at such times and places, and shall observe such rules of procedure in regard to the transaction of business at its meetings (including quorum at such meetings) as may be provided by regulations.
- (2) The Chairman or, if for any reason, he is unable to attend a meeting of the Board, any other member chosen by the members present from amongst themselves at the meeting shall preside at the meeting.
- (3) All questions which come up before any meeting of the Board shall be decided by a majority votes of the members present and voting, and, in the event of an equality of votes, the Chairman, or in his absence, the person presiding, shall have a second or casting vote.

Member not to participate in meetings in certain cases [Section 7A]

"Any member, who is a director of a company and who as such director has any direct or indirect pecuniary interest in any matter coming up for consideration at a meeting of the Board, shall, as soon as possible after relevant circumstances have come to his knowledge, disclose the nature of his interest at such meeting and such disclosure shall be recorded in the proceedings of the Board, and the member shall not take any part in any deliberation or decision of the Board with respect to that matter".

Vacancies etc., not to invalidate proceedings of Board [Section 8]

No act or proceeding of the Board shall be invalid merely by reason of -

- (a) any vacancy in, or any defect in the constitution of, the Board; or
- (b) any defect in the appointment of a person acting as a member of the Board; or
- (c) any irregularity in the procedure of the Board not affecting the merits of the case.

Officers and employees of the Board [Section 9]

- (1) The Board may appoint such other officers and employees as it considers necessary for the efficient discharge of its functions under this Act.
- (2) The term and other conditions of service of officers and employees of the Board appointed under sub- section (1) shall be such as may be determined by regulations.

TRANSFER OF ASSETS, LIABILITIES, ETC., OF THE EXISTING SECURITIES AND EXCHANGE BOARD TO THE BOARD

Transfer of assets, liabilities, etc., of existing Securities and Exchange Board to the Board [Section 10]

- (1) On and from the date of establishment of the Board,-
 - (a) any reference to the existing Securities and Exchange Board in any law other than this Act or in any contract or other instrument shall be deemed as a reference to the Board;
 - (b) all properties and assets, movable and immovable, of, or belonging to, the existing Securities and Exchange Board, shall vest in the Board;
 - (c) all rights and liabilities of the existing Securities and Exchange Board shall be transferred to, and be the rights and liabilities of, the Board;
 - (d) without prejudice to the provisions of clause (c), all debts, obligations and liabilities incurred, all contracts entered into and all matters and things engaged to be done by, with or for the existing Securities and Exchange Board immediately before that date, for or in connection with the purpose of the said existing Board shall be deemed to have been incurred, entered into or engaged to be done by, with or for, the Board;
 - (e) all sums of money due to the existing Securities and Exchange Board immediately before that date shall be deemed to be due to the Board;
 - (f) all suits and other legal proceedings instituted or which could have been instituted by or against the existing Securities and Exchange Board immediately before that date may be continued or may be instituted by or against the Board; and
 - (g) every employee holding any office under the existing Securities and Exchange Board immediately before that date shall hold his office in the Board by the same tenure and upon the same terms and conditions of service as respects remuneration, leave, provident fund, retirement and other terminal benefits as he would have held such office if the Board had not been established and shall continue to do so as an employee of the Board or until the expiry of the period of six months from that date if such employee opts not to be the employee of the Board within such period.
- (2) Notwithstanding anything contained in the Industrial Disputes Act, 1947, or in any other law for the time being in force, absorption of any employee by the Board in its regular service under this section shall not entitle such employee to any compensation under that Act or other law and no such claim shall be entertained by any court, tribunal or other authority.

POWERS AND FUNCTIONS OF THE BOARD

Functions of Board [Section 11]

- (1) Subject to the provisions of this Act, it shall be the duty of the Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit.
- (2) Without prejudice to the generality of the foregoing provisions, the measures referred to therein may provide for -
 - (a) regulating the business in stock exchanges and any other securities markets;
 - (b) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;



- (ba) registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Board may, by notification, specify in this behalf;
 - (c) registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds;
 - (d) promoting and regulating self-regulatory organisations;
 - (e) prohibiting fraudulent and unfair trade practices relating to securities markets;
 - (f) promoting investors' education and training of intermediaries of securities markets;
 - (g) prohibiting insider trading in securities;
 - (h) regulating substantial acquisition of shares and take-over of companies;
 - (i) calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and self-regulatory organisations in the securities market;
 - (ia) calling for information and record from any bank or any other authority or board or corporation established or constituted by or under any Central, State or Provincial Act in respect of any transaction in securities which is under investigation or inquiry by the Board;
 - (j) performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central Government;
 - (k) levying fees or other charges for carrying out the purposes of this section;
 - (l) conducting research for the above purposes;
 - (la) calling from or furnishing to any such agencies, as may be specified by the Board, such information as may be considered necessary by it for the efficient discharge of its functions;
 - (m) performing such other functions as may be prescribed.
- (2A) Without prejudice to the provisions contained in sub-section (2), the Board may take measures to undertake inspection of any book, or register, or other document or record of any listed public company or a public company (not being intermediaries referred to in section 12) which intends to get its securities listed on any recognised stock exchange where the Board has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market.
- (3) Notwithstanding anything contained in any other law for the time being in force while exercising the powers under clause (i) or clause (ia) of sub-section (2) or sub-section (2A), the Board shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely :
- (i) the discovery and production of books of account and other documents, at such place and such time as may be specified by the Board;
 - (ii) summoning and enforcing the attendance of persons and examining them on oath;
 - (iii) inspection of any books, registers and other documents of any person referred to in section 12, at any place;]
 - (iv) inspection of any book, or register, or other document or record of the company referred to in sub-section (2A);
 - (v) issuing commissions for the examination of witnesses or documents.]

- (4) Without prejudice to the provisions contained in sub-sections (1), (2), (2A) and (3) and section 11B, the Board may, by an order, for reasons to be recorded in writing, in the interests of investors or securities market, take any of the following measures, either pending investigation or inquiry or on completion of such investigation or inquiry, namely:-

- (a) suspend the trading of any security in a recognised stock exchange;
- (b) restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell or deal in securities;
- (c) suspend any office-bearer of any stock exchange or self-regulatory organisation from holding such position;
- (d) impound and retain the proceeds or securities in respect of any transaction which is under investigation;
- (e) attach, after passing of an order on an application made for approval by the Judicial Magistrate of the first class having jurisdiction, for a period not exceeding one month, one or more bank account or accounts of any intermediary or any person associated with the securities market in any manner involved in violation of any of the provisions of this Act, or the rules or the regulations made thereunder:

Provided that only the bank account or accounts or any transaction entered therein, so far as it relates to the proceeds actually involved in violation of any of the provisions of this Act, or the rules or the regulations made thereunder shall be allowed to be attached;

- (f) direct any intermediary or any person associated with the securities market in any manner not to dispose of or alienate an asset forming part of any transaction which is under investigation:

Provided that the Board may, without prejudice to the provisions contained in sub-section (2) or sub-section (2A), take any of the measures specified in clause (d) or clause (e) or clause (f), in respect of any listed public company or a public company (not being intermediaries referred to in section 12) which intends to get its securities listed on any recognised stock exchange where the Board has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market:

Provided further that the Board shall, either before or after passing such orders, give an opportunity of hearing to such intermediaries or persons concerned.]

Board to regulate or prohibit issue of prospectus, offer document or advertisement soliciting money for issue of securities [Section 11A]

- (1) Without prejudice to the provisions of the Companies Act, 1956, the Board may, for the protection of investors, -
- (a) specify, by regulations –
 - (i) the matters relating to issue of capital, transfer of securities and other matters incidental thereto; and
 - (ii) the manner in which such matters shall be disclosed by the companies;
 - (b) by general or special orders –
 - (i) prohibit any company from issuing prospectus, any offer document, or advertisement soliciting money from the public for the issue of securities;
 - (ii) specify the conditions subject to which the prospectus, such offer document or advertisement, if not prohibited, may be issued.



- (2) Without prejudice to the provisions of section 21 of the Securities Contracts (Regulation) Act, 1956, the Board may specify the requirements for listing and transfer of securities and other matters incidental thereto.”]

Collective Investment Scheme [Section 11AA]

- (1) Any scheme or arrangement which satisfies the conditions referred to in sub-section (2) shall be a collective investment scheme.
- (2) Any scheme or arrangement made or offered by any company under which,---
- (i) the contributions, or payments made by the investors, by whatever name called, are pooled and utilized solely for the purposes of the scheme or arrangement;
 - (ii) the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property, whether movable or immovable from such scheme or arrangement;
 - (iii) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not, is managed on behalf of the investors;
 - (iv) the investors do not have day to day control over the management and operation of the scheme or arrangement.
- (3) Notwithstanding anything contained in sub-section (2), any scheme or arrangement-
- (i) made or offered by a co-operative society registered under the co-operative societies Act, 1912 or a society being a society registered or deemed to be registered under any law relating to co-operative societies for the time being in force in any state;
 - (ii) under which deposits are accepted by non-banking financial companies as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934;
 - (iii) being a contract of insurance to which the Insurance Act, 1938, applies;
 - (iv) providing for any scheme, Pension Scheme or the Insurance Scheme framed under the Employees Provident Fund and Miscellaneous Provisions Act, 1952;
 - (v) under which deposits are accepted under section 58A of the Companies Act, 1956;
 - (vi) under which deposits are accepted by a company declared as a Nidhi or a mutual benefit society under section 620A of the Companies Act, 1956;
 - (vii) falling within the meaning of Chit business as defined in clause (d) of section 2 of the Chit Fund Act, 1982;
 - (viii) under which contributions made are in the nature of subscription to a mutual fund;
- shall not be a collective investment scheme.

Power to issue directions [Section 11B]

Save as otherwise provided in section 11, if after making or causing to be made an enquiry, the Board is satisfied that it is necessary,-

- (i) in the interest of investors, or orderly development of securities market; or
 - (ii) to prevent the affairs of any intermediary or other persons referred to in section 12 being conducted in a manner detrimental to the interest of investors or securities market; or
 - (iii) to secure the proper management of any such intermediary or person, it may issue such directions,-
- (a) to any person or class of persons referred to in section 12, or associated with the securities market; or

- (b) to any company in respect of matters specified in section 11A, as may be appropriate in the interests of investors in securities and the securities market

Investigation [Section 11C]

- (1) Where the Board has reasonable ground to believe that –
 - (a) the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market; or
 - (b) any intermediary or any person associated with the securities market has violated any of the provisions of this Act or the rules or the regulations made or directions issued by the Board thereunder,

It may, at any time by order in writing, direct any person (hereafter in this section referred to as the Investigating Authority) specified in the order to investigate the affairs of such intermediary or persons associated with the securities market and to report thereon to the Board.

- (2) Without prejudice to the provisions of sections 235 to 241 of the Companies Act, 1956, it shall be the duty of every manager, managing director, officer and other employee of the company and every intermediary referred to in section 12 or every person associated with the securities market to preserve and to produce to the Investigating Authority or any person authorised by it in this behalf, all the books, registers, other documents and record of, or relating to, the company or, as the case may be, of or relating to, the intermediary or such person, which are in their custody or power.
- (3) The Investigating Authority may require any intermediary or any person associated with securities market in any manner to furnish such information to, or produce such books, or registers, or other documents, or record before him or any person authorised by it in this behalf as it may consider necessary if the furnishing of such information or the production of such books, or registers, or other documents, or record is relevant or necessary for the purposes of its investigation.
- (4) The Investigating Authority may keep in its custody any books, registers, other documents and record produced under sub-section (2) or sub-section (3) for six months and thereafter shall return the same to any intermediary or any person associated with securities market by whom or on whose behalf the books, registers, other documents and record are produced:

Provided that the Investigating Authority may call for any book, register, other document and record if they are needed again:

Provided further that if the person on whose behalf the books, registers, other documents and record are produced requires certified copies of the books, registers, other documents and record produced before the Investigating Authority, it shall give certified copies of such books, registers, other documents and record to such person or on whose behalf the books, registers, other documents and record were produced.

- (5) Any person, directed to make an investigation under sub-section (1), may examine on oath, any manager, managing director, officer and other employee of any intermediary or any person associated with securities market in any manner, in relation to the affairs of his business and may administer an oath accordingly and for that purpose may require any of those persons to appear before it personally.
- (6) If any person fails without reasonable cause or refuses –
 - (a) to produce to the Investigating Authority or any person authorised by it in this behalf any book, register, other document and record which is his duty under sub-section (2) or sub-section (3) to produce; or
 - (b) to furnish any information which is his duty under sub-section (3) to furnish; or



(c) to appear before the Investigating Authority personally when required to do so under sub-section (5) or to answer any question which is put to him by the Investigating Authority in pursuance of that sub-section; or

(d) to sign the notes of any examination referred to in sub-section (7),

he shall be punishable with imprisonment for a term which may extend to one year, or with fine, which may extend to one crore rupees, or with both, and also with a further fine which may extend to five lakh rupees for every day after the first during which the failure or refusal continues.

(7) Notes of any examination under sub-section (5) shall be taken down in writing and shall be read over to, or by, and signed by, the person examined, and may thereafter be used in evidence against him.

(8) Where in the course of investigation, the Investigating Authority has reasonable ground to believe that the books, registers, other documents and record of, or relating to, any intermediary or any person associated with securities market in any manner, may be destroyed, mutilated, altered, falsified or secreted, the Investigating Authority may make an application to the Judicial Magistrate of the first class having jurisdiction for an order for the seizure of such books, registers, other documents and record.

(9) After considering the application and hearing the Investigating Authority, if necessary, the Magistrate may, by order, authorise the Investigating Authority –

(a) to enter, with such assistance, as may be required, the place or places where such books, registers, other documents and record are kept;

(b) to search that place or those places in the manner specified in the order; and

(c) to seize books, registers, other documents and record, if it considers necessary for the purposes of the investigation:

Provided that the Magistrate shall not authorise seizure of books, registers, other documents and record, of any listed public company or a public company (not being the intermediaries specified under section 12) which intends to get its securities listed on any recognised stock exchange unless such company indulges in insider trading or market manipulation.

(10) The Investigating Authority shall keep in its custody the books, registers, other documents and record seized under this section for such period not later than the conclusion of the investigation as it considers necessary and thereafter shall return the same to the company or the other body corporate, or, as the case may be, to the managing director or the manager or any other person, from whose custody or power they were seized and inform the Magistrate of such return:

Provided that the Investigating Authority may, before returning such books, registers, other documents and record as aforesaid, place identification marks on them or any part thereof.

(11) Save as otherwise provided in this section, every search or seizure made under this section shall be carried out in accordance with the provisions of the Code of Criminal Procedure, 1973, relating to searches or seizures made under that Code.

Cease and desist proceedings [Section 11D]

If the Board finds, after causing an inquiry to be made, that any person has violated, or is likely to violate, any provisions of this Act, or any rules or regulations made thereunder, it may pass an order requiring such person to cease and desist from committing or causing such violation:

Provided that the Board shall not pass such order in respect of any listed public company or a public company (other than the intermediaries specified under section 12) which intends to get its securities listed on any recognised stock exchange unless the Board has reasonable grounds to believe that such company has indulged in insider trading or market manipulation.

REGISTRATION CERTIFICATE**Registration of stock brokers, sub-brokers, share transfer agents, etc. [Section 12]**

- (1) No stock-broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary who may be associated with securities market shall buy, sell or deal in securities except under, and in accordance with, the conditions of a certificate of registration obtained from the Board in accordance with the regulations made under this Act:

Provided that a person buying or selling securities or otherwise dealing with the securities market as a stock-broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary who may be associated with securities market immediately before the establishment of the Board for which no registration certificate was necessary prior to such establishment, may continue to do so for a period of three months from such establishment or, if he has made an application for such registration within the said period of three months, till the disposal of such application.

Provided further that any certificate of registration, obtained immediately before the commencement of the Securities Laws (Amendment) Act, 1995, shall be deemed to have been obtained from the Board in accordance with the regulations providing for such registration.

- (1A) No depository, participant, custodian of securities, foreign institutional investor, credit rating agency or any other intermediary associated with the securities market as the Board may by notification in this behalf specify, shall buy or sell or deal in securities except under and in accordance with the conditions of a certificate of registration obtained from the Board in accordance with the regulations made under this Act:

Provided that a person buying or selling securities or otherwise dealing with the securities market as a depository, participant, custodian of securities, foreign institutional investor or credit rating agency immediately before the commencement of the Securities Laws (Amendment) Act, 1995, for which no certificate of registration was required prior to such commencement, may continue to buy or sell securities or otherwise deal with the securities market until such time regulations are made under clause (d) of sub-section (2) of section 30.

- (1B) No person shall sponsor or cause to be sponsored or carry on or cause to be carried on any venture capital funds or collective investment schemes including mutual funds, unless he obtains a certificate of registration from the Board in accordance with the regulations:

Provided that any person sponsoring or causing to be sponsored, carrying on or causing to be carried on any venture capital funds or collective investment schemes operating in the securities market immediately before the commencement of the Securities Laws (Amendment) Act, 1995, for which no certificate of registration was required prior to such commencement, may continue to operate till such time regulations are made under clause (d) of sub-section (2) of section 30.]

Explanation.- For the removal of doubts, it is hereby declared that, for the purpose of this section, a collective investment scheme or mutual fund shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a component of investment besides the component of insurance issued by an insurer.

- (2) Every application for registration shall be in such manner and on payment of such fees as may be determined by regulations.
- (3) The Board may, by order, suspend or cancel a certificate of registration in such manner as may be determined by regulations.

Provided that no order under this sub-section shall be made unless the person concerned has been given a reasonable opportunity of being heard.



PROHIBITION OF MANIPULATIVE AND DECEPTIVE DEVICES, INSIDER TRADING AND SUBSTANTIAL ACQUISITION OF SECURITIES OR CONTROL

Prohibition of manipulative and deceptive devices, insider trading and substantial acquisition of securities or control [Section 12A]

No person shall directly or indirectly –

- (a) use or employ, in connection with the issue, purchase or sale of any securities listed or proposed to be listed on a recognised stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or the rules or the regulations made thereunder;
- (b) employ any device, scheme or artifice to defraud in connection with issue or dealing in securities which are listed or proposed to be listed on a recognised stock exchange;
- (c) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed on a recognised stock exchange, in contravention of the provisions of this Act or the rules or the regulations made thereunder;
- (d) engage in insider trading;
- (e) deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or the rules or the regulations made thereunder;
- (f) acquire control of any company or securities more than the percentage of equity share capital of a company whose securities are listed or proposed to be listed on a recognised stock exchange in contravention of the regulations made under this Act.

FINANCE, ACCOUNTS AND AUDIT

Grants by the Central Government [Section 13]

The Central Government may, after due appropriation made by Parliament by law in this behalf, make to the Board grants of such sums of money as that Government may think fit for being utilised for the purposes of this Act.

Fund [Section 14]

- (1) There shall be constituted a Fund to be called the Securities and Exchange Board of India General Fund and there shall be credited thereto-
 - (a) all grants, fees and charges received by the Board under this Act;
 - (b) all sums received by the Board from such other sources as may be decided upon by the Central Government.
- (2) The Fund shall be applied for meeting -
 - (a) the salaries, allowances and other remuneration of members, officers and other employees of the Board;
 - (b) the expenses of the Board in the discharge of its functions under section 11;
 - (c) the expenses on objects and for purposes authorised by this Act.

Accounts and Audit. (Section 15)

- (1) The Board shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor- General of India.
- (2) The accounts of the Board shall be audited by the Comptroller and Auditor- General of India at

such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Board to the Comptroller and Auditor-General of India.

- (3) The Comptroller and Auditor-General of India and any other person appointed by him in connection with the audit of the accounts of the Board shall have the same rights and privileges and authority in connection with such audit as the Comptroller and Auditor-General generally has in connection with the audit of the Government accounts and, in particular, shall have the right to demand the production of books, accounts, connected vouchers and other documents and papers and to inspect any of the offices of the Board.
- (4) The accounts of the Board as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf together with the audit report thereon shall be forwarded annually to the Central Government and that Government shall cause the same to be laid before each House of Parliament.

PENALTIES AND ADJUDICATION

Penalty for failure to furnish information, return, etc. [Section 15A]

If any person, who is required under this Act or any rules or regulations made thereunder,-

- (a) to furnish any document, return or report to the Board, fails to furnish the same, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
- (b) to file any return or furnish any information, books or other documents within the time specified therefor in the regulations, fails to file return or furnish the same within the time specified therefor in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
- (c) to maintain books of accounts or records, fails to maintain the same, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure by any person to enter into agreement with clients [Section 15B]

If any person, who is registered as an intermediary and is required under this Act or any rules or regulations made thereunder to enter into an agreement with his client, fails to enter into such agreement, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure to redress investors' grievances [Section 15C]

If any listed company or any person who is registered as an intermediary, after having been called upon by the Board in writing, to redress the grievances of investors, fails to redress such grievances within the time specified by the Board, such company or intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for certain defaults in case of mutual funds. (Section 15D)

If any person, who is –

- (a) required under this Act or any rules or regulations made thereunder to obtain a certificate of registration from the Board for sponsoring or carrying on any collective investment scheme, including mutual funds, sponsors or carries on any collective investment scheme, including mutual funds, without obtaining such certificate of registration, he shall be liable to a penalty of one lakh rupees for each day during which he sponsors or carries on any such collective investment scheme including mutual funds, or one crore rupees, whichever is less;
- (b) registered with the Board as a collective investment scheme, including mutual funds, for sponsoring



or carrying on any investment scheme, fails to comply with the terms and conditions of certificate of registration, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;

- (c) registered with the Board as a collective investment scheme, including mutual funds, fails to make an application for listing of its schemes as provided for in the regulations governing such listing, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
- (d) registered as a collective investment scheme, including mutual funds, fails to dispatch unit certificates of any scheme in the manner provided in the regulation governing such despatch, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
- (e) registered as a collective investment scheme, including mutual funds, fails to refund the application monies paid by the investors within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.]
- (f) registered as a collective investment scheme, including mutual funds, fails to invest money collected by such collective investment schemes in the manner or within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure to observe rules and regulations by an asset management company [Section 15E]

Where any asset management company of a mutual fund registered under this Act, fails to comply with any of the regulations providing for restrictions on the activities of the asset management companies, such asset management company shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure in case of stock brokers [Section 15F]

If any person, who is registered as a stock broker under this Act, -

- (a) fails to issue contract notes in the form and manner specified by the stock exchange of which such broker is a member, he shall be liable to a penalty not exceeding five times the amount for which the contract note was required to be issued by that broker;
- (b) fails to deliver any security or fails to make payment of the amount due to the investor in the manner within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
- (c) charges an amount of brokerage which is in excess of the brokerage specified in the regulations, he shall be liable to a penalty of one lakh rupees or five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher.

Penalty for insider trading [Section 15G]

If any insider who,-

- (i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price sensitive information; or
- (ii) communicates any unpublished price- sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or
- (iii) counsels, or procures for any other person to deal in any securities of any body corporate on the basis of unpublished price-sensitive information, shall be liable to a penalty of twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher.

Penalty for non-disclosure of acquisition of shares and takeovers [Section 15H]

If any person, who is required under this Act or any rules or regulations made thereunder, fails to,-

- (i) disclose the aggregate of his shareholding in the body corporate before he acquires any shares of that body corporate; or
- (ii) make a public announcement to acquire shares at a minimum price; or
- (iii) make a public offer by sending letter of offer to the shareholders of the concerned company; or
- (iv) make payment of consideration to the shareholders who sold their shares pursuant to letter of offer,

he shall be liable to a penalty of twenty-five crore rupees or three times the amount of profits made out of such failure, whichever is higher.

Penalty for fraudulent and unfair trade practices [Section 15HA]

If any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty of twenty-five crore rupees or three times the amount of profits made out of such practices, whichever is higher.

Penalty for contravention where no separate penalty has been provided [Section 15HB]

Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees.

Power to adjudicate [Section 15-I]

- (1) For the purpose of adjudging under sections 15A, 15B, 15C, 15D, 15E, 15F, 15G, 15H, 15HA and 15HB], the Board shall appoint any officers not below the rank of a Division Chief to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.
- (2) While holding an inquiry, the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which in the opinion of the adjudicating officer, may be useful for or relevant to the subject-matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections specified in sub-section (1), he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.

Factors to be taken into account by the adjudicating officer [Section 15J]

While adjudging quantum of penalty under section 15-I, the adjudicating officer shall have due regard to the following factors, namely:

- (a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;
- (b) the amount of loss caused to an investor or group of investors as a result of the default;
- (c) the repetitive nature of the default.

Crediting sums realized by way of penalties to Consolidated Fund of India [Section 15JA]

All sums realised by way of penalties under this Act shall be credited to the Consolidated Fund of India.



ESTABLISHMENT, JURISDICTION, AUTHORITY AND PROCEDURE OF APPELLATE TRIBUNAL

Establishment of Securities Appellate Tribunals [Section 15K]

- (1) The Central Government shall, by notification, establish one or more Appellate Tribunals to be known as the Securities Appellate Tribunal to exercise the jurisdiction, powers and authority conferred on such Tribunal by or under this Act or any other law for the time being in force.
- (2) The Central Government shall also specify in the notification referred to in sub-section (1) the matters and places in relation to which the Securities Appellate Tribunal may exercise jurisdiction.

Composition of Securities Appellate Tribunal [Section 15L]

A Securities Appellate Tribunal shall consist of a Presiding Officer and two other Members, to be appointed, by notification, by the Central Government:

Provided that the Securities Appellate Tribunal, consisting of one person only, established before the commencement of the Securities and Exchange Board of India (Amendment) Act, 2002, shall continue to exercise the jurisdiction, powers and authority conferred on it by or under this Act or any other law for the time being in force till two other Members are appointed under this section.

Qualification for appointment as Presiding Officer or Member of the Securities Appellate Tribunal [Section 15M]

- (1) A person shall not be qualified for appointment as the Presiding Officer of a Securities Appellate Tribunal unless he is a sitting or retired Judge of the Supreme Court or a sitting or retired Chief Justice of a High Court:

Provided that the Presiding Officer of the Securities Appellate Tribunal shall be appointed by the Central Government in consultation with the Chief Justice of India or his nominee.

- (2) A person shall not be qualified for appointment as Member of a Securities Appellate Tribunal unless he is a person of ability, integrity and standing who has shown capacity in dealing with problems relating to securities market and has qualification and experience of corporate law, securities laws, finance, economics or accountancy:

Provided that a member of the Board or any person holding a post at senior management level equivalent to Executive Director in the Board shall not be appointed as Presiding Officer or Member of a Securities Appellate Tribunal during his service or tenure as such with the Board or within two years from the date on which he ceases to hold office as such in the Board.

Tenure of office of Presiding Officer and other Members of Securities Appellate Tribunal [Section 15N]

The Presiding Officer and every other Member of a Securities Appellate Tribunal shall hold office for a term of five years from the date on which he enters upon his office and shall be eligible for re-appointment:

Provided that no person shall hold office as the Presiding Officer of the Securities Appellate Tribunal after he has attained the age of sixty-eight years:

Provided further that no person shall hold office as a Member of the Securities Appellate Tribunal after he has attained the age of sixty-two years.

Salary and allowances and other terms and conditions of service of Presiding Officers [Section 15O]

The salary and allowances payable to and the other terms and conditions of service including pension, gratuity and other retirement benefits of the Presiding Officer and other Member of a Securities Appellate Tribunal shall be such as may be prescribed:

Provided that neither the salary and allowances nor the other terms and conditions of service of the Presiding Officer and other Members of a Securities Appellate Tribunal shall be varied to their disadvantage after appointment.

Filling up of vacancies [Section 15P]

If, for reason other than temporary absence; any vacancy occurs in the office of the Presiding Officer or any other Member of a Securities Appellate Tribunal, then the Central Government shall appoint another person in accordance with the provisions of this Act to fill the vacancy and the proceedings may be continued before the Securities Appellate Tribunal from the stage at which the vacancy is filled.

Resignation and removal [Section 15Q]

- (1) The Presiding Officer or any other Member of a Securities Appellate Tribunal may, by notice in writing under his hand addressed to the Central Government, resign his office:

Provided that the Presiding Officer or any other Member shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office, until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor enters upon his office or until the expiry of his term of office, whichever is the earliest.

- (2) The Presiding Officer or any other Member of a Securities Appellate Tribunal shall not be removed from his office except by an order by the Central Government on the ground of proved misbehaviour or incapacity after an inquiry made by a Judge of the Supreme Court, in which the Presiding Officer or any other Member concerned has been informed of the charges against him and given a reasonable opportunity of being heard in respect of these charges.
- (3) The Central Government may, by rules, regulate the procedure for the investigation of misbehavior or incapacity of the Presiding Officer or any other Member].

Orders constituting Appellate Tribunal to be final and not to invalidate its proceedings [Section 15R]

No order of the Central Government appointing any person as the Presiding Officer or a Member of a Securities Appellate Tribunal shall be called in question in any manner, and no act or proceeding before a Securities Appellate Tribunal shall be called in question in any manner on the ground merely of any defect in the constitution of a Securities Appellate Tribunal.

Staff of the Securities Appellate Tribunal [Section 15S]

- (1) The Central Government shall provide the Securities Appellate Tribunal with such officers and employees as that Government may think fit.
- (2) The officers and employees of the Securities Appellate Tribunal shall discharge their functions under general superintendence of the Presiding Officer.
- (3) The salaries and allowances and other conditions of service of the officers and employees of the Securities Appellate Tribunal shall be such as may be prescribed.

Appeal to the Securities Appellate Tribunal [Section 15T]

- (1) Save as provided in sub-section (2), any person aggrieved,-
 - (a) by an order of the Board made, on and after the commencement of the Securities Laws (Second Amendment) Act, 1999, under this Act, or the rules or regulations made thereunder; or
 - (b) by an order made by an adjudicating officer under this Act,
 may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter.
- (2) No appeal shall lie to the Securities Appellate Tribunal from an order made__
 - (a) by the Board on and after the commencement of the Securities Laws (Second Amendment) Act, 1999;



(b) by an adjudicating officer, with the consent of the parties.

- (3) Every appeal under sub-section (1) shall be filed within a period of forty-five days from the date on which a copy of the order made by the Board or the adjudicating officer, as the case may be, is received by him and it shall be in such form and be accompanied by such fee as may be prescribed:

Provided that the Securities Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

- (4) On receipt of an appeal under sub-section (1), the Securities Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.
- (5) The Securities Appellate Tribunal shall send a copy of every order made by it to the Board, the parties to the appeal and to the concerned Adjudicating Officer.
- (6) The appeal filed before the Securities Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

Procedure and powers of the Securities Appellate Tribunal [Section 15U]

- (1) The Securities Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act and of any rules, the Securities Appellate Tribunal shall have powers to regulate their own procedure including the places at which they shall have their sittings.
- (2) The Securities Appellate Tribunal shall have, for the purposes of discharging their functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:
- (a) summoning and enforcing the attendance of any person and examining him on oath;
 - (b) requiring the discovery and production of documents;
 - (c) receiving evidence on affidavits;
 - (d) issuing commissions for the examination of witnesses or documents;
 - (e) reviewing its decisions;
 - (f) dismissing an application for default or deciding it ex parte;
 - (g) setting aside any order of dismissal of any application for default or any order passed by it ex parte;
 - (h) any other matter which may be prescribed.
- (3) Every proceeding before the Securities Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code, and the Securities Appellate Tribunal shall be deemed to be a civil court for all the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

Right to legal representation [Section 15V]

The appellant may either appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to present his or its case before the Securities Appellate Tribunal.

Explanation.- For the purposes of this section,--

- (a) "chartered accountant" means a chartered accountant as defined in clause(b) of sub-section(1) of section 2 of the Chartered Accountants Act, 1949 and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (b) "company secretary" means a company secretary as defined in clause(c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (c) "cost accountant" means a cost accountant as defined in clause(b) of subsection(1) of section 2 of the Cost and Works Accountants Act, 1959 and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (d) "legal practitioner" means an advocate, vakil or any attorney of any High Court, and includes a pleader in practice.

Limitation [Section 15W]

The provisions of the Limitation Act, 1963 , shall, as far as may be, apply to an appeal made to a Securities Appellate Tribunal.

Presiding Officer, Members and staff of Securities Appellate Tribunals to be public servants [Section 15X]

The Presiding Officer, Members and other officers and employees of a Securities Appellate Tribunal shall be deemed to be public servants within the meaning of section 21 of the Indian Penal Code.

Civil Court not to have jurisdiction [Section 15Y]

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which an Adjudicating Officer appointed under this Act or a Securities Appellate Tribunal constituted under this Act is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

Appeal to Supreme Court [Section 15Z]

Any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of law arising out of such order:

Provided that the Supreme Court may, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

MISCELLANEOUS

Power of Central Government to issue directions [Section 16]

- (1) without prejudice to the foregoing provisions of this Act or the Depositories Act, 1996, the Board shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on questions of policy as the Central Government may give in writing to it from time to time:

Provided that the Board shall, as far as practicable, be given an opportunity to express its views before any direction is given under this sub-section.

- (2) The decision of the Central Government whether a question is one of policy or not shall be final.

Power of Central Government to supersede the Board [Section 17]

- (1) If at any time the Central Government is of opinion-

- (a) that on account of grave emergency, the Board is unable to discharge the functions and



duties imposed on it by or under the provisions of this Act; or

(b) that the Board has persistently made default in complying with any direction issued by the Central Government under this Act or in the discharge of the functions and duties imposed on it by or under the provisions of this Act and as a result of such default the financial position of the Board or the administration of the Board has deteriorated; or

(c) that circumstances exist which render it necessary in the public interest so to do,

the Central Government may, by notification, supersede the Board for such period, not exceeding six months, as may be specified in the notification.

(2) Upon the publication of a notification under sub-section (1) superseding the Board,-

(a) all the members shall, as from the date of supersession, vacate their offices as such;

(b) all the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of the Board, shall until the Board is reconstituted under sub-section (3), be exercised and discharged by such person or persons as the Central Government may direct; and

(c) all property owned or controlled by the Board shall, until the Board is reconstituted under sub-section (3), vest in the Central Government.

(3) On the expiration of the period of supersession specified in the notification issued under sub-section (1), the Central Government may reconstitute the Board by a fresh appointment and in such case any person or persons who vacated their offices under clause (a) of sub-section (2), shall not be deemed disqualified for appointment:

Provided that the Central Government may, at any time, before the expiration of the period of supersession, take action under this sub-section.

(4) The Central Government shall cause a notification issued under sub-section (1) and a full report of any action taken under this section and the circumstances leading to such action to be laid before each House of Parliament at the earliest.

Returns and reports [Section 18]

(1) The Board shall furnish to the Central Government at such time and in such form and manner as may be prescribed or as the Central Government may direct, such returns and statements and such particulars in regard to any proposed or existing programme for the promotion and development of the securities market, as the Central Government may, from time to time, require.

(2) Without prejudice to the provisions of sub-section (1), the Board shall, within ninety days after the end of each financial year, submit to the Central Government a report in such form, as may be prescribed, giving a true and full account of its activities, policy and programmes during the previous financial year.

(3) A copy of the report received under sub-section (2) shall be laid, as soon as may be after it is received, before each House of Parliament.

Delegation [Section 19]

The Board may, by general or special order in writing delegate to any member, officer of the Board or any other person subject to such conditions, if any, as may be specified in the order, such of its powers and functions under this Act (except the powers under section 29) as it may deem necessary.

Appeals [Section 20]

(1) Any person aggrieved by an order of the Board made, before the commencement of the Securities Laws (Second Amendment) Act, 1999, under this Act, or the rules or regulations made thereunder

may prefer an appeal to the Central Government within such time as may be prescribed.

- (2) No appeal shall be admitted if it is preferred after the expiry of the period prescribed therefore:

Provided that an appeal may be admitted after the expiry of the period prescribed therefore if the appellant satisfies the Central Government that he had sufficient cause for not preferring the appeal within the prescribed period.

- (3) Every appeal made under this section shall be made in such form and shall be accompanied by a copy of the order appealed against and by such fees as may be prescribed.

- (4) The procedure for disposing of an appeal shall be such as may be prescribed:

Provided that before disposing of an appeal, the appellant shall be given a reasonable opportunity of being heard.

Bar of jurisdiction [Section 20A]

No order passed by the Board or the adjudicating officer under this Act shall be appealable except as provided in section 15T or section 20 and no Civil Court shall have jurisdiction in respect of any matter which the Board or the adjudicating officer is empowered by, or under, this Act to pass any order and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any order passed by the Board or the adjudicating office by, or under, this Act.

Savings [Section 21]

Nothing in this Act shall exempt any person from any suit or other proceedings which might, apart from this Act, be brought against him.

Members, Officers and employees of the Board to be public servants [Section 22]

All members, officers and other employees of the Board shall be deemed, when acting or purporting to act in pursuance of any of the provisions of this Act, to be public servants within the meaning of section 21 of the Indian Penal Code.

Protection of action taken in good faith [Section 23]

No suit, prosecution or other legal proceedings shall lie against the Central Government or Board or any officer of the Central Government or any member, officer or other employee of the Board for anything which is in good faith done or intended to be done under this Act or the rules or regulations made thereunder.

Offences [Section 24]

- (1) Without prejudice to any award of penalty by the Adjudicating Officer under this Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations made thereunder, he shall be punishable with imprisonment for a term which may extend to ten years, or with fine, which may extend to twenty-five crore rupees or with both.
- (2) If any person fails to pay the penalty imposed by the Adjudicating Officer or fails to comply with any of his directions or orders, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years or with fine, which may extend to twenty-five crore rupees or with both.

Composition of certain offences [Section 24A]

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending.



Power to grant immunity [Section 24B]

- (1) The Central Government may, on recommendation by the Board, if the Central Government is satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made thereunder, has made a full and true disclosure in respect of the alleged violation, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made thereunder or also from the imposition of any penalty under this Act with respect to the alleged violation:

Provided that no such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity:

Provided further that recommendation of the Board under this sub-section shall not be binding upon the Central Government.

- (2) An immunity granted to a person under sub-section (1) may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

Exemption from tax on wealth and income [Section 25]

Notwithstanding anything contained in the Wealth Tax Act, 1957, the Income Tax Act, 1961 or any other enactment for the time being in force relating to tax on wealth, income, profits or gains -

- (a) the Board;
- (b) the existing Securities and Exchange Board from the date of its constitution to the date of establishment of the Board,

shall not be liable to pay wealth-tax, income-tax or any other tax in respect of their wealth, income, profits or gains derived.

Cognizance of offences by courts [Section 26]

- (1) No court shall take cognizance of any offence punishable under this Act or any rules or regulations made thereunder, save on a complaint made by the Board.
- (2) No court inferior to that of a Court of Session shall try any offence punishable under this Act.

Offences by companies [Section 27]

- (1) Where an offence under this Act has been committed by a company, every person who at the time the offence was committed was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

- (2) Notwithstanding anything contained in sub-section (1), where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall

also be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Explanation.- For the purposes of this section, -

- (a) "company" means any body corporate and includes a firm or other association of individuals; and
- (b) "director" in relation to a firm, means a partner in the firm.

Power to make rules [Section 29]

- (1) The Central Government may, by notification, make rules for carrying out the purposes of this Act.
- (2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:-
 - (a) the term of office and other conditions of service of the Chairman and the members under sub-section (1) of section 5;
 - (b) the additional functions that may be performed by the Board under section 11;
 - (c) [****]
 - (d) the manner in which the accounts of the Board shall be maintained under section 15;
 - (da) the manner of inquiry under sub-section (1) of section 15-I;
 - (db) the salaries and allowances and other terms and conditions of service of the Presiding Officers, Members and other officers and employees of the Securities Appellate Tribunal under section 15-O and sub-section (3) of section 15S;
 - (dc) the procedure for the investigation of misbehaviour or incapacity of the Presiding Officers, or other Members of the Securities Appellate Tribunal under sub-section (3) of section 15Q;
 - (dd) the form in which an appeal may be filed before the Securities Appellate Tribunal under section 15 -T and the fees payable in respect of such appeal;
 - (e) the form and the manner in which returns and report to be made to the Central Government under section 18;
 - (f) any other matter which is to be, or may be, prescribed, or in respect of which provision is to be, or may be, made by rules.

Power to make regulations [Section 30]

- (1) The Board may, by notification, make regulations consistent with this Act and the rules made thereunder to carry out the purposes of this Act.
- (2) In particular, and without prejudice to the generality of the foregoing power, such regulations may provide for all or any of the following matters, namely:-
 - (a) the times and places of meetings of the Board and the procedure to be followed at such meetings under sub-section (1) of section 7 including quorum necessary for the transaction of business;
 - (b) the terms and other conditions of service of officers and employees of the Board under sub-section (2) of section 9;
 - (c) the matters relating to issue of capital, transfer of securities and other matters incidental thereto and the manner in which such matters shall be disclosed by the companies under section 11A;



- (d) the conditions subject to which certificate of registration is to be issued, the amount of fee to be paid for certificate of registration and the manner of suspension or cancellation of certificate of registration under section 12.

Rules and regulations to be laid before Parliament [Section 31]

Every rule and every regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or regulation or both Houses agree that the rule or regulation should not be made, the rule or regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule or regulation.

Application of other laws not barred [Section 32]

The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

Power to remove difficulties [Section 34]

- (1) If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order, published in the Official Gazette, make such provisions not inconsistent with the provisions of this Act as may appear to be necessary for removing the difficulty:

Provided that no order shall be made under this section after the expiry of five years from the commencement of this Act.

- (2) Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

Repeal and saving [Section 35]

- (1) The Securities and Exchange Board of India Ordinance, 1992, is hereby repealed.
- (2) Notwithstanding such repeal, anything done or any action taken under the said Ordinance, shall be deemed to have been done or taken under the corresponding provisions of this Act.

3.2 THE SECURITIES CONTRACTS (REGULATION) ACT, 1956

PRELIMINARY

Short title, extent and commencement [Section 1]

- (1) This Act may be called the Securities Contracts (Regulation) Act, 1956.
- (2) It extends to the whole of India.
- (3) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint.

Definitions [Section 2]

In this Act, unless the context otherwise requires,—

- (a) “contract” means a contract for or relating to the purchase or sale of securities;
- (aa) “corporatisation” means the succession of a recognised stock exchange, being a body of individuals or a society registered under the Societies Registration Act, 1860, by another stock exchange, being a company incorporated for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities carried on by such individuals or society;
- (ab) “demutualisation” means the segregation of ownership and management from the trading rights of the members of a recognised stock exchange in accordance with a scheme approved by the Securities and Exchange Board of India;
- (ac) “derivative” includes—
 - (A) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;
 - (B) a contract which derives its value from the prices, or index of prices, of underlying securities;
- (b) “Government security” means a security created and issued, whether before or after the commencement of this Act, by the Central Government or a State Government for the purpose of raising a public loan and having one of the forms specified in clause (2) of section 2 of the Public Debt Act, 1944;
- (c) “member” means a member of a recognised stock exchange;
- (d) “option in securities” means a contract for the purchase or sale of a right to buy or sell, or a right to buy and sell, securities in future, and includes a teji, a mandi, a teji mandi, a galli, a put, a call or a put and call in securities;
- (e) “prescribed” means prescribed by rules made under this Act;
- (f) “recognised stock exchange” means a stock exchange which is for the time being recognised by the Central Government under section 4;
- (g) “rules”, with reference to the rules relating in general to the constitution and management of a stock exchange, includes, in the case of a stock exchange which is an incorporated association, its memorandum and articles of association;
- (ga) “scheme” means a scheme for corporatisation or demutualisation of a recognised stock exchange which may provide for—
 - (i) the issue of shares for a lawful consideration and provision of trading rights in lieu of membership cards of members of a recognised stock exchange;



- (ii) the restrictions on voting rights;
 - (iii) the transfer of property, business, assets, rights, liabilities, recognitions, contracts of the recognised stock exchange, legal proceedings by, or against, the recognised stock exchange, whether in the name of the recognised stock exchange or any trustee or otherwise and any permission given to, or by, the recognised stock exchange;
 - (iv) the transfer of employees of a recognised stock exchange to another recognised stock exchange;
 - (v) any other matter required for the purpose of, or in connection with, the corporatisation or demutualisation, as the case may be, of the recognised stock exchange;
- (gb) "Securities Appellate Tribunal" means a Securities Appellate Tribunal established under sub-section (1) of section 15K of the Securities and Exchange Board of India Act, 1992;
- (h) "securities" include—
- (i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;
 - (ia) derivative;
 - (ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;
 - (ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
 - (id) units or any other such instrument issued to the investors under any mutual fund scheme;
- Explanation.** – For the removal of doubts, it is hereby declared that "securities" shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938;
- (ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;
 - (ii) Government securities;
 - (iia) such other instruments as may be declared by the Central Government to be securities; and
 - (iii) rights or interest in securities;
- (i) "spot delivery contract" means a contract which provides for—
- (a) actual delivery of securities and the payment of a price therefore either on the same day as the date of the contract or on the next day, the actual period taken for the despatch of the securities or the remittance of money therefore through the post being excluded from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality;
 - (b) transfer of the securities by the depository from the account of a beneficial owner to the account of another beneficial owner when such securities are dealt with by a depository;

- (j) “stock exchange” means—
- (a) any body of individuals, whether incorporated or not, constituted before corporatisation and demutualisation under sections 4A and 4B, or
 - (b) a body corporate incorporated under the Companies Act, 1956 whether under a scheme of corporatisation and demutualisation or otherwise,
- for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

Interpretation of certain words and expressions [Section 2A]

Words and expressions used herein and not defined in this Act but defined in the Companies Act, 1956 or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 shall have the same meanings respectively assigned to them in those Acts.

RECOGNISED STOCK EXCHANGES

Application for recognition of stock exchanges (Section 3)

- (1) Any stock exchange, which is desirous of being recognised for the purposes of this Act, may make an application in the prescribed manner to the Central Government.
- (2) Every application under sub-section (1) shall contain such particulars as may be prescribed, and shall be accompanied by a copy of the bye-laws of the stock exchange for the regulation and control of contracts and also a copy of the rules relating in general to the constitution of the stock exchange and in particular, to—
 - (a) the governing body of such stock exchange, its constitution and powers of management and the manner in which its business is to be transacted;
 - (b) the powers and duties of the office bearers of the stock exchange;
 - (c) the admission into the stock exchange of various classes of members, the qualifications for membership, and the exclusion, suspension, expulsion and readmission of members therefrom or thereinto;
 - (d) the procedure for the registration of partnerships as members of the stock exchange in cases where the rules provide for such membership; and the nomination and appointment of authorised representatives and clerks.

Grant of recognition to stock exchanges [Section 4]

- (1) If the Central Government is satisfied, after making such inquiry as may be necessary in this behalf and after obtaining such further information, if any, as it may require,—
 - (a) that the rules and bye-laws of a stock exchange applying for registration are in conformity with such conditions as may be prescribed with a view to ensure fair dealing and to protect investors;
 - (b) that the stock exchange is willing to comply with any other conditions (including conditions as to the number of members) which the Central Government, after consultation with the governing body of the stock exchange and having regard to the area served by the stock exchange and its standing and the nature of the securities dealt with by it, may impose for the purpose of carrying out the objects of this Act; and
 - (c) that it would be in the interest of the trade and also in the public interest to grant recognition to the stock exchange;

it may grant recognition to the stock exchange subject to the conditions imposed upon it as aforesaid and in such form as may be prescribed.



- (2) The conditions which the Central Government may prescribe under clause (a) of sub-section (1) for the grant of recognition to the stock exchanges may include, among other matters, conditions relating to,—
 - (i) the qualifications for membership of stock exchanges;
 - (ii) the manner in which contracts shall be entered into and enforced as between members;
 - (iii) the representation of the Central Government on each of the stock exchange by such number of persons not exceeding three as the Central Government may nominate in this behalf; and
 - (iv) the maintenance of accounts of members and their audit by chartered accountants whenever such audit is required by the Central Government.
- (3) Every grant of recognition to a stock exchange under this section shall be published in the Gazette of India and also in the Official Gazette of the State in which the principal office of the stock exchange is situate, and such recognition shall have effect as from the date of its publication in the Gazette of India.
- (4) No application for the grant of recognition shall be refused except after giving an opportunity to the stock exchange concerned to be heard in the matter; and the reasons for such refusal shall be communicated to the stock exchange in writing.
- (5) No rules of a recognised stock exchange relating to any of the matters specified in sub-section (2) of section 3 shall be amended except with the approval of the Central Government.

Corporatisation and demutualisation of stock exchanges [Section 4A]

On and from the appointed date, all recognised stock exchanges (if not corporatized and demutualised before the appointed date) shall be corporatised and demutualised in accordance with the provisions contained in section 4B:

Provided that the Securities and Exchange Board of India may, if it is satisfied that any recognised stock exchange was prevented by sufficient cause from being corporatised and demutualised on or after the appointed date, specify another appointed date in respect of that recognised stock exchange and such recognised stock exchange may continue as such before such appointed date.

Explanation.—For the purposes of this section, “appointed date” means the date which the Securities and Exchange Board of India may, by notification in the Official Gazette, appoint and different appointed dates may be appointed for different recognised stock exchanges.

Procedure for corporatisation and demutualization [Section 4B]

- (1) All recognised stock exchanges referred to in section 4A shall, within such time as may be specified by the Securities and Exchange Board of India, submit a scheme for corporatisation and demutualisation for its approval:

Provided that the Securities and Exchange Board of India, may, by notification in the Official Gazette, specify name of the recognised stock exchange, which had already been corporatised and demutualised, and such stock exchange shall not be required to submit the scheme under this section.

- (2) On receipt of the scheme referred to in sub-section (1), the Securities and Exchange Board of India may, after making such enquiry as may be necessary in this behalf and obtaining such further information, if any, as it may require and if it is satisfied that it would be in the interest of the trade and also in the public interest, approve the scheme with or without modification.
- (3) No scheme under sub-section (2) shall be approved by the Securities and Exchange Board of India if the issue of shares for a lawful consideration or provision of trading rights in lieu of

membership card of the members of a recognised stock exchange or payment of dividends to members have been proposed out of any reserves or assets of that stock exchange.

- (4) Where the scheme is approved under sub-section (2), the scheme so approved shall be published immediately by—

- (a) the Securities and Exchange Board of India in the Official Gazette;
- (b) the recognised stock exchange in such two daily newspapers circulating in India, as may be specified by the Securities and Exchange Board of India,

and upon such publication, notwithstanding anything to the contrary contained in this Act or any other law for the time being in force or any agreement, award, judgment, decree or other instrument for the time being in force, the scheme shall have effect and be binding on all persons and authorities including all members, creditors, depositors and employees of the recognised stock exchange and on all persons having any contract, right, power, obligation or liability with, against, over, to, or in connection with, the recognised stock exchange or its members.

- (5) Where the Securities and Exchange Board of India is satisfied that it would not be in the interest of the trade and also in the public interest to approve the scheme under sub-section (2), it may, by an order, reject the scheme and such order of rejection shall be published by it in the Official Gazette:

Provided that the Securities and Exchange Board of India shall give a reasonable opportunity of being heard to all the persons concerned and the recognised stock exchange concerned before passing an order rejecting the scheme.

- (6) The Securities and Exchange Board of India may, while approving the scheme under sub-section (2), by an order in writing, restrict—

- (a) the voting rights of the shareholders who are also stock brokers of the recognised stock exchange;
- (b) the right of shareholders or a stock broker of the recognised stock exchange to appoint the representatives on the governing board of the stock exchange;
- (c) the maximum number of representatives of the stock brokers of the recognised stock exchange to be appointed on the governing board of the recognised stock exchange, which shall not exceed one-fourth of the total strength of the governing board.

- (7) The order made under sub-section (6) shall be published in the Official Gazette and on the publication thereof, the order shall, notwithstanding anything to the contrary contained in the Companies Act, 1956, or any other law for the time being in force, have full effect.

- (8) Every recognised stock exchange, in respect of which the scheme for corporatization or demutualisation has been approved under sub-section (2), shall, either by fresh issue of equity shares to the public or in any other manner as may be specified by the regulations made by the Securities and Exchange Board of India, ensure that at least fifty-one per cent of its equity share capital is held, within twelve months from the date of publication of the order under sub-section (7), by the public other than shareholders having trading rights:

Provided that the Securities and Exchange Board of India may, on sufficient cause being shown to it and in the public interest, extend the said period by another twelve months.

Withdrawal of recognition [Section 5]

- (1) If the Central Government is of opinion that the recognition granted to a stock exchange under the provisions of this Act should, in the interest of the trade or in the public interest, be withdrawn, the Central Government may serve on the governing body of the stock exchange a written notice that the Central Government is considering the withdrawal of the recognition for the



reasons stated in the notice and after giving an opportunity to the governing body to be heard in the matter, the Central Government may withdraw, by notification in the Official Gazette, the recognition granted to the stock exchange:

Provided that no such withdrawal shall affect the validity of any contract entered into or made before the date of the notification, and the Central Government may, after consultation with the stock exchange, make such provision as it deems fit in the notification of withdrawal or in any subsequent notification similarly published for the due performance of any contracts outstanding on that date.

- (2) Where the recognised stock exchange has not been corporatised or demutualised or it fails to submit the scheme referred to in sub-section (1) of section 4B within the specified time therefore or the scheme has been rejected by the Securities and Exchange Board of India under sub-section (5) of section 4B, the recognition granted to such stock exchange under section 4, shall, notwithstanding anything to the contrary contained in this Act, stand withdrawn and the Central Government shall publish, by notification in the Official Gazette, such withdrawal of recognition:

Provided that no such withdrawal shall affect the validity of any contract entered into or made before the date of the notification, and the Securities and Exchange Board of India may, after consultation with the stock exchange, make such provisions as it deems fit in the order rejecting the scheme published in the Official Gazette under sub-section (5) of section 4B.

Power of Central Government to call for periodical returns or direct inquiries to be made. [Section 6]

- (1) Every recognised stock exchange shall furnish to the Securities and Exchange Board of India such periodical returns relating to its affairs as may be prescribed.
- (2) Every recognised stock exchange and every member thereof shall maintain and preserve for such periods not exceeding five years such books of account, and other documents as the Central Government, after consultation with the stock exchange concerned, may prescribe in the interest of the trade or in the public interest, and such books of account, and other documents shall be subject to inspection at all reasonable times by the Securities and Exchange Board of India.
- (3) Without prejudice to the provisions contained in sub-sections (1) and (2), the Securities and Exchange Board of India, if it is satisfied that it is in the interest of the trade or in the public interest so to do, may, by order in writing,—
 - (a) call upon a recognised stock exchange or any member thereof to furnish in writing such information or explanation relating to the affairs of the stock exchange or of the member in relation to the stock exchange as the Securities and Exchange Board of India may require; or
 - (b) appoint one or more persons to make an inquiry in the prescribed manner in relation to the affairs of the governing body of a stock exchange or the affairs of any of the members of the stock exchange in relation to the stock exchange and submit a report of the result of such inquiry to the Securities and Exchange Board of India within such time as may be specified in the order or, in the case of an inquiry in relation to the affairs of any of the members of a stock exchange, direct the governing body to make the inquiry and submit its report to the Securities and Exchange Board of India.
- (4) Where an inquiry in relation to the affairs of a recognised stock exchange or the affairs of any of its members in relation to the stock exchange has been undertaken under sub-section (3),—
 - (a) every director, manager, secretary or other officer of such stock exchange;
 - (b) every member of such stock exchange;

- (c) if the member of the stock exchange is a firm, every partner, manager, secretary or other officer of the firm; and
- (d) every other person or body of persons who has had dealings in the course of business with any of the persons mentioned in clauses (a), (b) and (c), whether directly or indirectly;

shall be bound to produce before the authority making the inquiry all such books of account, and other documents in his custody or power relating to or having a bearing on the subject-matter of such inquiry and also to furnish the authorities within such time as may be specified with any such statement or information relating thereto as may be required of him.

Annual reports to be furnished to Central Government by stock exchanges [Section 7]

Every recognised stock exchange shall furnish the Central Government with a copy of the annual report, and such annual report shall contain such particulars as may be prescribed.

Power of recognised stock exchange to make rules restricting voting rights, etc. [Section 7A]

- (1) A recognised stock exchange may make rules or amend any rules made by it to provide for all or any of the following matters, namely:—
 - (a) the restriction of voting rights to members only in respect of any matter placed before the stock exchange at any meeting;
 - (b) the regulation of voting rights in respect of any matter placed before the stock exchange at any meeting so that each member may be entitled to have one vote only, irrespective of his share of the paid-up equity capital of the stock exchange;
 - (c) the restriction on the right of a member to appoint another person as his proxy to attend and vote at a meeting of the stock exchange;
 - (d) in clauses (a), (b) and (c).
- (2) No rules of a recognised stock exchange made or amended in relation to any matter referred to in clauses (a) to (d) of sub-section (1) shall have effect until they have been approved by the Central Government and published by that Government in the Official Gazette and, in approving the rules so made or amended, the Central Government may make such modifications therein as it thinks fit, and on such publication, the rules as approved by the Central Government shall be deemed to have been validly made, notwithstanding anything to the contrary contained in the Companies Act, 1956.

Power of Central Government to direct rules to be made or to make rules [Section 8]

- (1) Where, after consultation with the governing bodies of stock exchanges generally or with the governing body of any stock exchange in particular, the Central Government is of opinion that it is necessary or expedient so to do, it may, by order in writing together with a statement of the reasons therefore, direct recognised stock exchanges generally or any recognised stock exchange in particular, as the case may be, to make any rules or to amend any rules already made in respect of all or any of the matters specified in sub-section (2) of section 3 within a period of two months from the date of the order.
- (2) If any recognised stock exchange fails or neglects to comply with any order made under sub-section (1) within the period specified therein, the Central Government may make the rules for, or amend the rules made by, the recognised stock exchange, either in the form proposed in the order or with such modifications thereof as may be agreed to between the stock exchange and the Central Government.
- (3) Where in pursuance of this section any rules have been made or amended, the rules so made or amended shall be published in the Gazette of India and also in the Official Gazette or Gazettes of the State or States in which the principal office or offices of the recognised stock exchange or



exchanges is or are situate, and, on the publication thereof in the Gazette of India, the rules so made or amended shall, notwithstanding anything to the contrary contained in the Companies Act, 1956, or in any other law for the time being in force, have effect as if they had been made or amended by the recognised stock exchange or stock exchanges, as the case may be.

Clearing corporation [Section 8A]

- (1) A recognised stock exchange may, with the prior approval of the Securities and Exchange Board of India, transfer the duties and functions of a clearing house to a clearing corporation, being a company incorporated under the Companies Act, 1956, for the purpose of—
 - (a) the periodical settlement of contracts and differences thereunder;
 - (b) the delivery of, and payment for, securities;
 - (c) any other matter incidental to, or connected with, such transfer.
- (2) Every clearing corporation shall, for the purpose of transfer of the duties and functions of a clearing house to a clearing corporation referred to in sub-section (1), make bye-laws and submit the same to the Securities and Exchange Board of India for its approval.
- (3) The Securities and Exchange Board of India may, on being satisfied that it is in the interest of the trade and also in the public interest to transfer the duties and functions of a clearing house to a clearing corporation, grant approval to the bye-laws submitted to it under sub-section (2) and approve the transfer of the duties and functions of a clearing house to a clearing corporation referred to in sub-section (1).
- (4) The provisions of sections 4, 5, 6, 7, 8, 9, 10, 11 and 12 shall, as far as may be, apply to a clearing corporation referred to in sub-section (1) as they apply in relation to a recognised stock exchange.

Power of recognised stock exchanges to make bye-laws [Section 9]

- (1) Any recognised stock exchange may, subject to the previous approval of the Securities and Exchange Board of India, make bye-laws for the regulation and control of contracts.
- (2) In particular, and without prejudice to the generality of the foregoing power, such bye-laws may provide for:
 - (a) the opening and closing of markets and the regulation of the hours of trade;
 - (b) a clearing house for the periodical settlement of contracts and differences thereunder, the delivery of and payment for securities, the passing on of delivery orders and the regulation and maintenance of such clearing house;
 - (c) the submission to the Securities and Exchange Board of India by the clearing house as soon as may be after each periodical settlement of all or any of the following particulars as the Securities and Exchange Board of India may, from time to time, require, namely:—
 - (i) the total number of each category of security carried over from one settlement period to another;
 - (ii) the total number of each category of security, contracts in respect of which have been squared up during the course of each settlement period;
 - (iii) the total number of each category of security actually delivered at each clearing;
 - (d) the publication by the clearing house of all or any of the particulars submitted to the Securities and Exchange Board of India under clause (c) subject to the directions, if any, issued by the Securities and Exchange Board of India in this behalf;
 - (e) the regulation or prohibition of blank transfers;

- (f) the number and classes of contracts in respect of which settlements shall be made or differences paid through the clearing house;
 - (g) the regulation, or prohibition of budlas or carry-over facilities;
 - (h) the fixing, altering or postponing of days for settlements;
 - (i) the determination and declaration of market rates, including the opening, closing highest and lowest rates for securities;
 - (j) the terms, conditions and incidents of contracts, including the prescription of margin requirements, if any, and conditions relating thereto, and the forms of contracts in writing;
 - (k) the regulation of the entering into, making, performance, recession and termination, of contracts, including contracts between members or between a member and his constituent or between a member and a person who is not a member, and the consequences of default or insolvency on the part of a seller or buyer or intermediary, the consequences of a breach or omission by a seller or buyer, and the responsibility of members who are not parties to such contracts;
 - (l) the regulation of taravani business including the placing of limitations thereon;
 - (m) the listing of securities on the stock exchange, the inclusion of any security for the purpose of dealings and the suspension or withdrawal of any such securities, and the suspension or prohibition of trading in any specified securities;
 - (n) the method and procedure for the settlement of claims or disputes, including settlement by arbitration;
 - (o) the levy and recovery of fees, fines and penalties;
 - (p) the regulation of the course of business between parties to contracts in any capacity;
 - (q) the fixing of a scale of brokerage and other charges;
 - (r) the making, comparing, settling and closing of bargains;
 - (s) the emergencies in trade which may arise, whether as a result of pool or syndicated operations or cornering or otherwise, and the exercise of powers in such emergencies, including the power to fix maximum and minimum prices for securities;
 - (t) the regulation of dealings by members for their own account;
 - (u) the separation of the functions of jobbers and brokers;
 - (v) the limitations on the volume of trade done by any individual member in exceptional circumstances;
 - (w) the obligation of members to supply such information or explanation and to produce such documents relating to the business as the governing body may require.
- (3) The bye-laws made under this section may—
- (a) specify the bye-laws the contravention of which shall make a contract entered into otherwise than in accordance with the bye-laws void under sub-section (1) of section 14;
 - (b) provide that the contravention of any of the bye-laws shall render the member concerned liable to one or more of the following punishments, namely:—
 - (i) fine,
 - (ii) expulsion from membership,
 - (iii) suspension from membership for a specified period,



(iv) any other penalty of a like nature not involving the payment of money.

- (4) Any bye-laws made under this section shall be subject to such conditions in regard to previous publication as may be prescribed, and, when approved by the Securities and Exchange Board of India, shall be published in the Gazette of India and also in the Official Gazette of the State in which the principal office of the recognised stock exchange is situate, and shall have effect as from the date of its publication in the Gazette of India:

Provided that if the Securities and Exchange Board of India is satisfied in any case that in the interest of the trade or in the public interest any bye-law should be made immediately, it may, by order in writing specifying the reasons therefore, dispense with the condition of previous publication.

Power of Securities and Exchange Board of India to make or amend bye-laws of recognised stock exchanges [Section 10]

- (1) The Securities and Exchange Board of India may, either on a request in writing received by it in this behalf from the governing body of a recognised stock exchange or on its own motion, if it is satisfied after consultation with the governing body of the stock exchange that it is necessary or expedient so to do and after recording its reasons for so doing, make bye-laws for all or any of the matters specified in section 9 or amend any bye-laws made by such stock exchange under that section.
- (2) Where in pursuance of this section any bye-laws have been made or amended the bye-laws so made or amended shall be published in the Gazette of India and also in the Official Gazette of the State in which the principal office of the recognised stock exchange is situate, and on the publication thereof in the Gazette of India, the bye-laws so made or amended shall have effect as if they had been made or amended by the recognised stock exchange concerned.
- (3) Notwithstanding anything contained in this section, where the governing body of a recognised stock exchange objects to any bye-laws made or amended under this section by the Securities and Exchange Board of India on its own motion, it may, within two months of the publication thereof in the Gazette of India under sub-section (2), apply to the Securities and Exchange Board of India for revision thereof, and the Securities and Exchange Board of India may, after giving an opportunity to the governing body of the stock exchange to be heard in the matter, revise the bye-laws so made or amended, anywhere any bye-laws so made or amended are revised as a result of any action taken under this sub-section, the bye-laws so revised shall be published and shall become effective as provided in sub-section (2).
- (4) The making or the amendment or revision of any bye-laws under this section shall in all cases be subject to the condition of previous publication:

Provided that if the Securities and Exchange Board of India is satisfied in any case that in the interest of the trade or in the public interest any bye-laws should be made, amended or revised immediately, it may, by order in writing specifying the reasons therefore, dispense with the condition of previous publication.

Power of Central Government to supersede governing body of a recognised stock exchange. [Section 11]

- (1) Without prejudice to any other powers vested in the Central Government under this Act, where the Central Government is of opinion that the governing body of any recognised stock exchange should be superseded, then, notwithstanding anything contained in any other law for the time being in force, in the Central Government may serve on the governing body a written notice that the Central Government is considering the supersession of the governing body for the reasons specified in the notice and after giving an opportunity to the governing body to be heard in the matter, it may, by notification in the Official Gazette, declare the governing body of such stock

exchange to be superseded, and may appoint any person or persons to exercise and perform all the powers and duties of the governing body, and, where more persons than one are appointed, may appoint one of such persons to be the chairman and another to be the vice-chairman thereof.

- (2) On the publication of a notification in the Official Gazette under sub-section (1), the following consequences shall ensue, namely:—
 - (a) the members of the governing body which has been superseded shall, as from the date of the notification of supersession, cease to hold office as such members;
 - (b) the person or persons appointed under sub-section (1) may exercise and perform all the powers and duties of the governing body which has been superseded;
 - (c) all such property of the recognised stock exchange as the person or persons appointed under sub-section (1) may, by order in writing, specify in this behalf as being necessary for the purpose of enabling him or them to carry on the business of the stock exchange, shall vest in such person or persons.
- (3) Notwithstanding anything to the contrary contained in any law or the rules or bye-laws of the recognised stock exchange the governing body of which is superseded under sub-section (1), the person or persons appointed under that sub-section shall hold office for such period as may be specified in the notification published under that sub-section and the Central Government may from time to time, by like notification, vary such period.
- (4) The Central Government may at any time before the determination of the period of office of any person or persons appointed under this section call upon the recognised stock exchange to re-constitute the governing body in accordance with its rules and on such re-constitution all the property of the recognised stock exchange which has vested in, or was in the possession of, the person or persons appointed under sub-section (1), shall re-vest or vest, as the case may be, in the governing body so re-constituted:

Provided that until a governing body is so re-constituted, the person or persons appointed under sub-section (1) shall continue to exercise and perform their powers and duties.

Power to suspend business of recognised stock exchanges [Section 12]

If in the opinion of the Central Government an emergency has arisen and for the purpose of meeting the emergency the Central Government considers it expedient so to do, it may, by notification in the Official Gazette, for reasons to be set out therein, direct a recognised stock exchange to suspend such of its business for such period not exceeding seven days and subject to such conditions as may be specified in the notification, and, if, in the opinion of the Central Government, the interest of the trade or the public interest requires that the period should be extended, may, by like notification extend the said period from time to time:

Provided that where the period of suspension is to be extended beyond the first period, no notification extending the period of suspension shall be issued unless the governing body of the recognised stock exchange has been given an opportunity of being heard in the matter.

Power to issue directions [Section 12A]

If, after making or causing to be made an inquiry, the Securities and Exchange Board of India is satisfied that it is necessary—

- (a) in the interest of investors, or orderly development of securities market; or
- (b) to prevent the affairs of any recognised stock exchange or clearing corporation, or such other agency or person, providing trading or clearing or settlement facility in respect of securities, being conducted in a manner detrimental to the interests of investors or securities market; or



- (c) to secure the proper management of any such stock exchange or clearing corporation or agency or person, referred to in clause (b),

it may issue such directions,—

- (i) to any stock exchange or clearing corporation or agency or person referred to in clause (b) or any person or class of persons associated with the securities market; or
- (ii) to any company whose securities are listed or proposed to be listed in a recognised stock exchange,

as may be appropriate in the interests of investors in securities and the securities market.

CONTRACTS AND OPTIONS IN SECURITIES

Contracts in notified areas illegal in certain circumstances [Section 13]

If the Central Government is satisfied, having regard to the nature or the volume of transactions in securities in any State or States or area that it is necessary so to do, it may, by notification in the Official Gazette, declared this section to apply to such State or States or area, and thereupon every contract in such State or States or area] which is entered into after the date of the notification otherwise than between the members of a recognised stock exchange or recognised stock exchanges in such State or States or area or through or with such member shall be illegal:

Provided that any contract entered into between members of two or more recognised stock exchanges in such State or States or area, shall—

- (i) be subject to such terms and conditions as may be stipulated by the respective stock exchanges with prior approval of Securities and Exchange Board of India;
- (ii) require prior permission from the respective stock exchanges if so stipulated by the stock exchanges with prior approval of Securities and Exchange Board of India.

Additional trading floor [Section 13A]

A stock exchange may establish additional trading floor with the prior approval of the Securities and Exchange Board of India in accordance with the terms and conditions stipulated by the said Board.

Explanation.- For the purposes of this section, "additional trading floor" means a trading ring or trading facility offered by a recognised stock exchange outside its area of operation to enable the investors to buy and sell securities through such trading floor under the regulatory framework of that stock exchange.

Contracts in notified areas to be void in certain circumstances [Section 14]

- (1) Any contract entered into in any State or area specified in the notification under section 13 which is in contravention of any of the bye-laws specified in that behalf under clause (a) of sub-section (3) of section 9 shall be void -
 - (i) as respects the rights of any member of the recognised stock exchange who has entered into such contract in contravention of any such bye-law, and also
 - (ii) as respects the rights of any other person who has knowingly participated in the transaction entailing such contravention.
- (2) Nothing in sub-section (1) shall be construed to affect the right of any person other than a member of the recognised stock exchange to enforce any such contract or to recover any sum under or in respect of such contract if such person had no knowledge that the transaction was in contravention of any of the bye-laws specified in clause (a) of sub-section (3) of section 9.

Members may not act as principals in certain circumstances [Section 15]

No member of a recognised stock exchange shall in respect of any securities enter into any contract

as a principal with any person other than a member of a recognised stock exchange, unless he has secured the consent or authority of such person and discloses in the note, memorandum or agreement of sale or purchase that he is acting as a principal:

Provided that where the member has secured the consent or authority of such person otherwise than in writing he shall secure written confirmation by such person or such consent or authority within three days from the date of the contract:

Provided further that no such written consent or authority of such person shall be necessary for closing out any outstanding contract entered into by such person in accordance with the bye-laws, if the member discloses in the note, memorandum or agreement of sale or purchase in respect of such closing out that he is acting as a principal.

Power to prohibit contracts in certain cases [Section 16]

- (1) If the Central Government is of opinion that it is necessary to prevent undesirable speculation in specified securities in any State or area, it may, by notification in the Official Gazette, declare that no person in the State or area specified in the notification shall, save with the permission of the Central Government, enter into any contract for the sale or purchase of any security specified in the notification except to the extent and in the manner, if any, specified therein.
- (2) All contracts in contravention of the provisions of sub-section (1) entered into after the date of notification issued thereunder shall be illegal.

Licensing of dealers in securities in certain areas [Section 17]

- (1) Subject to the provisions of sub-section (3) and to the other provisions contained in this Act, no person shall carry on or purport to carry on, whether on his own behalf or on behalf of any other person, the business of dealing in securities in any State or area to which section 13 has not been declared to apply and to which the Central Government may, by notification in the Official Gazette, declare this section to apply, except under the authority of a licence granted by the Securities and Exchange Board of India in this behalf.
- (2) No notification under sub-section (1) shall be issued with respect to any State or area unless the Central Government is satisfied, having regard to the manner in which securities are being dealt with in such State or area, that it is desirable or expedient in the interest of the trade or in the public interest that such dealings should be regulated by a system of licensing.
- (3) The restrictions imposed by sub-section (1) in relation to dealings in securities shall not apply to the doing of anything by or on behalf of a member of any recognised stock exchange.

Public issue and listing of securities referred to in sub-clause (ie) of clause (h) of section 2 [Section 17A]

- (1) Without prejudice to the provisions contained in this Act or any other law for the time being in force, no securities of the nature referred to in sub-clause (ie) of clause (h) of section 2 shall be offered to the public or listed on any recognised stock exchange unless the issuer fulfils such eligibility criteria and complies with such other requirements as may be specified by regulations made by the Securities and Exchange Board of India.
- (2) Every issuer referred to in sub-clause (ie) of clause (h) of section 2 intending to offer the certificates or instruments referred therein to the public shall make an application, before issuing the offer document to the public, to one or more recognised stock exchanges for permission for such certificates or instruments to be listed on the stock exchange or each such stock exchange.
- (3) Where the permission applied for under sub-section (2) for listing has not been granted or refused by the recognised stock exchanges or any of them, the issuer shall forthwith repay all moneys, if any, received from applicants in pursuance of the offer document, and if any such money is not repaid within eight days after the issuer becomes liable to repay it, the issuer and every director



or trustee thereof, as the case may be, who is in default shall, on and from the expiry of the eighth day, be jointly and severally liable to repay that money with interest at the rate of fifteen per cent per annum.

Explanation.—In reckoning the eighth day after another day, any intervening day which is a public holiday under the Negotiable Instruments Act, 1881, shall be disregarded, and if the eighth day (as so reckoned) is itself such a public holiday, there shall for the said purposes be substituted the first day thereafter which is not a holiday.

- (4) All the provisions of this Act relating to listing of securities of a public company on a recognised stock exchange shall, mutatis mutandis, apply to the listing of the securities of the nature referred to in sub-clause (ie) of clause (h) of section 2 by the issuer, being a special purpose distinct entity.]

Exclusion of spot delivery contracts from sections 13, 14, 15 and 17 [Section 18]

- (1) Nothing contained in sections 13, 14, 15 and 17 shall apply to spot delivery contracts.
- (2) Notwithstanding anything contained in sub-section (1), if the Central Government is of opinion that in the interest of the trade or in the public interest it is expedient to regulate and control the business of dealing in spot delivery contracts also in any State or area (whether section 13 has been declared to apply to that State or area or not), it may, by notification in the Official Gazette, declare that the provisions of section 17 shall also apply to such State or area in respect of spot delivery contracts generally or in respect of spot delivery contracts for the sale or purchase of such securities as may be specified in the notification, and may also specify the manner in which, and the extent to which, the provisions of that section shall so apply.

Contracts in derivative [Section 18A]

Notwithstanding anything contained in any other law for the time being in force, contracts in derivative shall be legal and valid if such contracts are—

- (a) traded on a recognised stock exchange;
 - (b) settled on the clearing house of the recognised stock exchange,
- in accordance with the rules and bye-laws of such stock exchange.

Stock exchanges other than recognised stock exchanges prohibited [Section 19]

- (1) No person shall, except with the permission of the Central Government, organize or assist in organising or be a member of any stock exchange (other than a recognised stock exchange) for the purpose of assisting in, entering into or performing any contracts in securities.
- (2) This section shall come into force in any State or area on such date as the Central Government may, by notification in the Official Gazette, appoint.

LISTING OF SECURITIES

Conditions for listing [Section 21]

Where securities are listed on the application of any person in any recognised stock exchange, such person shall comply with the conditions of the listing agreement with that stock exchange.

Delisting of securities [Section 21A]

- (1) A recognised stock exchange may delist the securities, after recording the reasons therefore, from any recognised stock exchange on any of the ground or grounds as may be prescribed under this Act:

Provided that the securities of a company shall not be delisted unless the company concerned has been given a reasonable opportunity of being heard.

- (2) A listed company or an aggrieved investor may file an appeal before the Securities Appellate Tribunal against the decision of the recognised stock exchange delisting the securities within fifteen days from the date of the decision of the recognised stock exchange delisting the securities and the provisions of sections 22B to 22E of this Act, shall apply, as far as may be, to such appeals:

Provided that the Securities Appellate Tribunal may, if it is satisfied that the company was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding one month.

Right of appeal against refusal of stock exchanges to list securities of public companies [Section 22]

Where a recognised stock exchange acting in pursuance of any power given to it by its bye-laws, refuses to list the securities of any public company or collective investment scheme, the company or scheme shall be entitled to be furnished with reasons for such refusal, and may,—

- (a) within fifteen days from the date on which the reasons for such refusal are furnished to it, or
- (b) where the stock exchange has omitted or failed to dispose of, within the time specified in sub-section (1) of section 73 of the Companies Act, 1956 (hereafter in this section referred to as the "specified time"), the application for permission for the shares or debentures to be dealt with on the stock exchange, within fifteen days from the date of expiry of the specified time or within such further period, not exceeding one month, as the Central Government may, on sufficient cause being shown, allow,

appeal to the Central Government against such refusal, omission or failure, as the case may be, and thereupon the Central Government may, after giving the stock exchange an opportunity of being heard,—

- (i) vary or set aside the decision of the stock exchange, or
- (ii) where the stock exchange has omitted or failed to dispose of the application within the specified time, grant or refuse the permission,

and where the Central Government sets aside the decision of the recognised stock exchange or grants the permission, the stock exchange shall act in conformity with the orders of the Central Government:

Provided that no appeal shall be preferred against refusal, omission or failure, as the case may be, under this section on and after the commencement of the Securities Laws (Second Amendment) Act, 1999.

Right of appeal to Securities Appellate Tribunal against refusal of stock exchange to list securities of public companies [Section 22A]

- (1) Where a recognised stock exchange, acting in pursuance of any power given to it by its bye-laws, refuses to list the securities of any company, the company shall be entitled to be furnished with reasons for such refusal, and may,—
- (a) within fifteen days from the date on which the reasons for such refusal are furnished to it, or
 - (b) where the stock exchange has omitted or failed to dispose of, within the time specified in sub-section (1A) of section 73 of the Companies Act, 1956 (hereafter in this section referred to as the "specified time"), the application for permission for the shares or debentures to be dealt with on the stock exchange, within fifteen days from the date of expiry of the specified time or within such further period, not exceeding one month, as the Securities Appellate Tribunal may, on sufficient cause being shown, allow,

appeal to the Securities Appellate Tribunal having jurisdiction in the matter against such refusal, omission or failure, as the case may be, and thereupon the Securities Appellate Tribunal may, after giving the stock exchange, an opportunity of being heard,—



- (i) vary or set aside the decision of the stock exchange; or
- (ii) where the stock exchange has omitted or failed to dispose of the application within the specified time, grant or refuse the permission,

and where the Securities Appellate Tribunal sets aside the decision of the recognised stock exchange or grants the permission, the stock exchange shall act in conformity with the orders of the Securities Appellate Tribunal.

- (2) Every appeal under sub-section (1) shall be in such form and be accompanied by such fee as may be prescribed.
- (3) The Securities Appellate Tribunal shall send a copy of every order made by it to the Board and parties to the appeal.
- (4) The appeal filed before the Securities Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

Procedure and powers of Securities Appellate Tribunal [Section 22B]

- (1) The Securities Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act and of any rules, the Securities Appellate Tribunal shall have powers to regulate their own procedure including the places at which they shall have their sittings.
- (2) The Securities Appellate Tribunal shall have, for the purpose of discharging their functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:—
 - (a) summoning and enforcing the attendance of any person and examining him on oath;
 - (b) requiring the discovery and production of documents;
 - (c) receiving evidence on affidavits;
 - (d) issuing commissions for the examination of witnesses or documents;
 - (e) reviewing its decisions;
 - (f) dismissing an application for default or deciding it ex parte;
 - (g) setting aside any order of dismissal of any application for default or any order passed by it ex parte; and
 - (h) any other matter which may be prescribed.
- (3) Every proceeding before the Securities Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code and the Securities Appellate Tribunal shall be deemed to be a civil court for all the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

Right to legal representation [Section 22C]

The appellant may either appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to present his or its case before the Securities Appellate Tribunal.

Explanation. — for the purposes of this section,—

- (a) “chartered accountant” means a chartered accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;

- (b) “company secretary” means a company secretary as defined in clause (c) of subsection (1) of section 2 of the Company Secretaries Act, 1980 and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (c) “cost accountant” means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (d) “legal practitioner” means an advocate, vakil or an attorney of any High Court, and includes a pleader in practice.

Limitation [Section 22D]

The provisions of the Limitation Act, 1963 shall, as far as may be, apply to an appeal made to a Securities Appellate Tribunal.

Civil court not to have jurisdiction [Section 22E]

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which a Securities Appellate Tribunal is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

Appeal to Supreme Court [Section 22F]

Any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of law arising out of such order:

Provided that the Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

PENALTIES AND PROCEDURE

Penalties [Section 23]

- (1) Any person who—
 - (a) without reasonable excuse (the burden of proving which shall be on him) fails to comply with any requisition made under sub-section (4) of section 6; or
 - (b) enters into any contract in contravention of any of the provisions contained in section 13 or section 16; or
 - (c) contravenes the provisions contained in section 17 or section 17A or section 19; or
 - (d) enters into any contract in derivative in contravention of section 18A or the rules made under section 30;
 - (e) owns or keeps a place other than that of a recognised stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act and knowingly permits such place to be used for such purposes; or
 - (f) manages, controls, or assists in keeping any place other than that of a recognised stock exchange which is used for the purpose of entering into or performing any contracts in contravention of any of the provisions of this Act or at which contracts are recorded or adjusted or rights or liabilities arising out of contracts are adjusted, regulated or enforced in any manner whatsoever; or
 - (g) not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed



under section 17 wilfully represents to or induces any person to believe that contracts can be entered into or performed under this Act through him; or

- (h) not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17, canvasses, advertises or touts in any manner either for himself or on behalf of any other persons for any business connected with contracts in contravention of any of the provisions of this Act; or
- (i) joins, gathers or assists in gathering at any place other than the place of business specified in the bye-laws of a recognised stock exchange any person or persons for making bids or offers or for entering into or performing any contracts in contravention of any of the provisions of this Act;

shall, without prejudice to any award of penalty by the Adjudicating Officer under this Act, on conviction, be punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty-five crore rupees, or with both.

- (2) Any person who enters into any contract in contravention of the provisions contained in section 15 or who fails to comply with the provisions of section 21 or section 21A or with the orders of or section 22 or with the orders of the Securities Appellate Tribunal shall, without prejudice to any award of penalty by the Adjudicating Officer under this Act, on conviction, be punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty-five crore rupees, or with both.

Penalty for failure to furnish information, return, etc. [Section 23A]

Any person, who is required under this Act or any rules made thereunder,—

- (a) to furnish any information, document, books, returns or report to a recognised stock exchange, fails to furnish the same within the time specified therefore in the listing agreement or conditions or bye-laws of the recognised stock exchange, shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less for each such failure;
- (b) to maintain books of account or records, as per the listing agreement or conditions, or bye-laws of a recognised stock exchange, fails to maintain the same, shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure by any person to enter into an agreement with clients [Section 23B]

If any person, who is required under this Act or any bye-laws of a recognised stock exchange made thereunder, to enter into an agreement with his client, fails to enter into such an agreement, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less for every such failure.

Penalty for failure to redress investors' grievances [Section 23C]

If any stock broker or sub-broker or a company whose securities are listed or proposed to be listed in a recognised stock exchange, after having been called upon by the Securities and Exchange Board of India or a recognised stock exchange in writing, to redress the grievances of the investors, fails to redress such grievances within the time stipulated by the Securities and Exchange Board of India or a recognised stock exchange, he or it shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure to segregate securities or moneys of client or clients [Section 23D]

If any person, who is registered under section 12 of the Securities and Exchange Board of India Act, 1992 as a stock broker or sub-broker, fails to segregate securities or moneys of the client or clients or

uses the securities or moneys of a client or clients for self or for any other client, he shall be liable to a penalty not exceeding one crore rupees.

Penalty for failure to comply with provision of listing conditions or delisting conditions or grounds [Section 23E]

If a company or any person managing collective investment scheme or mutual fund, fails to comply with the listing conditions or delisting conditions or grounds or commits a breach thereof, it or he shall be liable to a penalty not exceeding twenty-five crore rupees.

Penalty for excess dematerialisation or delivery of unlisted securities [Section 23F]

If any issuer dematerialises securities more than the issued securities of a company or delivers in the stock exchanges the securities which are not listed in the recognised stock exchange or delivers securities where no trading permission has been given by the recognised stock exchange, he shall be liable to a penalty not exceeding twenty-five crore rupees.

Penalty for failure to furnish periodical returns, etc. [Section 23G]

If a recognised stock exchange fails or neglects to furnish periodical returns to the Securities and Exchange Board of India or fails or neglects to make or amend its rules or bye-laws as directed by the Securities and Exchange Board of India or fails to comply with directions issued by the Securities and Exchange Board of India, such recognised stock exchange shall be liable to a penalty which may extend to twenty-five crore rupees.

Penalty for contravention where no separate penalty has been provided [Section 23H]

Whoever fails to comply with any provision of this Act, the rules or articles or byelaws or the regulations of the recognised stock exchange or directions issued by the Securities and Exchange Board of India for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees.

Power to adjudicate [Section 23-I]

- (1) For the purpose of adjudging under sections 23A, 23B, 23C, 23D, 23E, 23F, 23G and 23H, the Securities and Exchange Board of India shall appoint any officer not below the rank of a Division Chief of the Securities and Exchange Board of India to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.
- (2) While holding an inquiry, the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document, which in the opinion of the adjudicating officer, may be useful for or relevant to the subject-matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections specified in sub-section (1), he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.

Factors to be taken into account by adjudicating officer [Section 23J]

While adjudging the quantum of penalty under section 23-I, the adjudicating officer shall have due regard to the following factors, namely:—

- (a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;
- (b) the amount of loss caused to an investor or group of investors as a result of the default;
- (c) the repetitive nature of the default.

Crediting sums realised by way of penalties to Consolidated Fund of India [Section 23K]



All sums realised by way of penalties under this Act shall be credited to the Consolidated Fund of India.

Appeal to Securities Appellate Tribunal [Section 23L]

- (1) Any person aggrieved, by the order or decision of the recognised stock exchange or the adjudicating officer or any order made by the Securities and Exchange Board of India under section 4B, may prefer an appeal before the Securities Appellate Tribunal and the provisions of sections 22B, 22C, 22D and 22E of this Act, shall apply, as far as may be, to such appeals.
- (2) Every appeal under sub-section (1) shall be filed within a period of forty-five days from the date on which a copy of the order or decision is received by the appellant and it shall be in such form and be accompanied by such fee as may be prescribed:

Provided that the Securities Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

- (3) On receipt of an appeal under sub-section (1), the Securities Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.
- (4) The Securities Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned adjudicating officer.
- (5) The appeal filed before the Securities Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

Offences [Section 23M]

- (1) Without prejudice to any award of penalty by the adjudicating officer under this Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations or bye-laws made thereunder, for which no punishment is provided elsewhere in this Act, he shall be punishable with imprisonment for a term which may extend to ten years, or with fine, which may extend to twenty-five crore rupees or with both.
- (2) If any person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any of his directions or orders, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years, or with fine, which may extend to twenty-five crore rupees, or with both.

Composition of certain offences [Section 23N]

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending.

Power to grant immunity [Section 23O]

- (1) The Central Government may, on recommendation by the Securities and Exchange Board of India, if the Central Government is satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made thereunder, has made a full and true disclosure in respect of alleged violation, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made there under or also from the imposition of any penalty under this Act with respect to the alleged violation:

Provided that no such immunity shall be granted by the Central Government in cases where the

proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity:

Provided further that the recommendation of the Securities and Exchange Board of India under this sub-section shall not be binding upon the Central Government.

- (2) An immunity granted to a person under sub-section (1) may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

Offences by companies [Section 24]

- (1) Where an offence has been committed by a company, every person who, at the time when the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence, and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of such offence.

- (2) Notwithstanding anything contained in sub-section (1), where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any gross negligence on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer of the company, shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Explanation.— For the purpose of this section,—

- (a) "company" means any body corporate and includes a firm or other association of individuals, and
- (b) "director", in relation to—
 - (i) a firm, means a partner in the firm;
 - (ii) any association of persons or a body of individuals, means any member controlling the affairs thereof.

- (3) The provisions of this section shall be in addition to, and not in derogation of, the provisions of section 22A.

Certain offences to be cognizable [Section 25]

Notwithstanding anything contained in the Code of Criminal Procedure, 1898, any offence punishable under section 23 shall be deemed to be a cognizable offence within the meaning of that Code.

Cognizance of offences by courts [Section 26]

- (1) No court shall take cognizance of any offence punishable under this Act or any rules or regulations or bye-laws made thereunder, save on a complaint made by the Central Government or State Government or the Securities and Exchange Board of India or a recognised stock exchange or by any person.
- (2) No court inferior to that of a Court of Session shall try any offence punishable under this Act.



MISCELLANEOUS

Title to dividends [Section 27]

- (1) It shall be lawful for the holder of any security whose name appears on the books of the company issuing the said security to receive and retain any dividend declared by the company in respect thereof for any year, notwithstanding that the said security has already been transferred by him for consideration, unless the transferee who claims the dividend from the transferor has lodged the security and all other documents relating to the transfer which may be required by the company with the company for being registered in his name within fifteen days of the date on which the dividend became due.

Explanation.— The period specified in this section shall be extended—

- (i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the dividend;
 - (ii) in case of loss of the transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof; and
 - (iii) in case of delay in the lodging of any security and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.
- (2) Nothing contained in sub-section (1) shall affect—
 - (a) the right of a company to pay any dividend which has become due to any person whose name is for the time being registered in the books of the company as the holder of the security in respect of which the dividend has become due; or
 - (b) the right of the transferee of any security to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the company has refused to register the transfer of the security in the name of the transferee.

Right to receive income from collective investment scheme [Section 27A]

- (1) It shall be lawful for the holder of any securities, being units or other instruments issued by the collective investment scheme, whose name appears on the books of the collective investment scheme issuing the said security to receive and retain any income in respect of units or other instruments issued by the collective investment scheme declared by the collective investment scheme in respect thereof for any year, notwithstanding that the said security, being units or other instruments issued by the collective investment scheme, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units or other instruments issued by the collective investment scheme from the transfer or has lodged the security and all other documents relating to the transfer which may be required by the collective investment scheme with the collective investment scheme for being registered in his name within fifteen days of the date on which the income in respect of units or other instruments issued by the collective investment scheme became due.

Explanation.— The period specified in this section shall be extended—

- (i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the income in respect of units or other instrument issued by the collective investment scheme;
 - (ii) in case of loss of the transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof; and
 - (iii) in case of delay in the lodging of any security, being units or other instruments issued by the collective investment scheme, and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.

- (2) Nothing contained in sub-section (1) shall affect—
- (a) the right of a collective investment scheme to pay any income from units or other instruments issued by the collective investment scheme which has become due to any person whose name is for the time being registered in the books of the collective investment scheme as the holder of the security being units or other instruments issued by the collective investment scheme in respect of which the income in respect of units or other instruments issued by the collective scheme has become due; or
 - (b) the right of transferee of any security, being units or other instruments issued by the collective investment scheme, to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the company has refused to register the transfer of the security being units or other instruments issued by the collective investment scheme in the name of the transferee.

Right to receive income from mutual fund [Section 27B]

- (1) It shall be lawful for the holder of any securities, being units or other instruments issued by any mutual fund, whose name appears on the books of the mutual fund issuing the said security to receive and retain any income in respect of units or other instruments issued by the mutual fund declared by the mutual fund in respect thereof for any year, notwithstanding that the said security, being units or other instruments issued by the mutual fund, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units or other instruments issued by the mutual fund from the transferor has lodged the security and all other documents relating to the transfer which may be required by the mutual fund with the mutual fund for being registered in his name within fifteen days of the date on which the income in respect of units or other instruments issued by the mutual fund became due.

Explanation.— The period specified in this section shall be extended—

- (i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the income in respect of units or other instrument issued by the mutual fund;
 - (ii) in case of loss of the transfer deed by theft or any other cause beyond the control of transferee, by the actual period taken for the replacement thereof; and
 - (iii) in case of delay in the lodging of any security, being units or other instruments issued by the mutual fund, and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.
- (2) Nothing contained in sub-section (1) shall affect—
- (a) the right of a mutual fund to pay any income from units or other instruments issued by the mutual fund which has become due to any person, whose name is for the time being registered in the books of the mutual fund as the holder of the security being units or other instruments issued by the mutual fund in respect of which the income in respect of units or other instruments issued by the mutual fund has become due; or
 - (b) the right of transferee of any security, being units or other instruments issued by the mutual fund, to enforce against the transferor or any other person, his rights, if any, in relation to the transfer in any case where the mutual fund has refused to register the transfer of the security being units or other instruments issued by the mutual fund in the name of the transferee.

Act not to apply in certain cases [Section 28]

- (1) The provisions of this Act shall not apply to—
- (a) the Government, the Reserve Bank of India, any local authority or any corporation set-up by a special law or any person who has effected any transaction with or through the agency of any such authority as is referred to in this clause;

- (b) any convertible bond or share warrant or any option or right in relation thereto, insofar as it entitles the person in whose favour any of the foregoing has been issued to obtain at his option from the company or other body corporate, issuing the same or from any of its shareholders or duly appointed agents' shares of the company or other body corporate, whether by conversion of the bond or warrant or otherwise, on the basis of the price agreed upon when the same was issued.
- (2) Without prejudice to the provisions contained in sub-section (1), if the Central Government is satisfied that in the interests of trade and commerce or the economic development of the country it is necessary or expedient so to do, it may, by notification in the Official Gazette, specify any class of contracts as contracts to which this Act or any provision contained therein shall not apply, and also the conditions, limitations or restrictions, if any, subject to which it shall not so apply.

Protection of action taken in good faith [Section 29]

No suit, prosecution or other legal proceeding whatsoever shall lie in any court against the governing body or any member, office bearer or servant of any recognised stock exchange or against any person or persons appointed under sub-section (1) of section 11 for anything which is in good faith done or intended to be done in pursuance of this Act or of any rules or bye-laws made there under.

Power to delegate [Section 29A]

The Central Government may, by order published in the Official Gazette, direct that the powers (except the power under section 30) exercisable by it under any provision of this Act shall, in relation to such matters and subject to such conditions, if any, as may be specified in the order, be exercisable also by the Securities and Exchange Board of India or the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934.

Power to make rules [Section 30]

- (1) The Central Government may, by notification in the Official Gazette, make rules for the purpose of carrying into effect the objects of this Act.
- (2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for,—
 - (a) the manner in which applications may be made, the particulars which they should contain and the levy of a fee in respect of such applications;
 - (b) the manner in which any inquiry for the purpose of recognising any stock exchange may be made, the conditions which may be imposed for the grant of such recognition, including conditions as to the admission of members if the stock exchange concerned is to be the only recognised stock exchange in the area; and the form in which such recognition shall be granted;
 - (c) the particulars which should be contained in the periodical returns and annual reports to be furnished to the Central Government;
 - (d) the documents which should be maintained and preserved under section 6 and the periods for which they should be preserved;
 - (e) the manner in which any inquiry by the governing body of a stock exchange shall be made under section 6;
 - (f) the manner in which the bye-laws to be made or amended under this Act shall before being so made or amended be published for criticism;
 - (g) the manner in which applications may be made by dealers in securities for licences under section 17, the fee payable in respect thereof and the period of such licences, the conditions subject to which licences may be granted, including conditions relating to the forms which

may be used in making contracts, the documents to be maintained by licensed dealers and the furnishing of periodical information to such authority as may be specified and the revocation of licences for breach of conditions;

- (h) the requirements which shall be complied with—
 - (A) by public companies for the purpose of getting their securities listed on any stock exchange;
 - (B) by collective investment scheme for the purpose of getting their units listed on any stock exchange;
 - (ha) the grounds on which the securities of a company may be delisted from any recognised stock exchange under sub-section (1) of section 21A;
 - (hb) the form in which an appeal may be filed before the Securities Appellate Tribunal under sub-section (2) of section 21A and the fees payable in respect of such appeal;
 - (hc) the form in which an appeal may be filed before the Securities Appellate Tribunal under section 22A and the fees payable in respect of such appeal;
 - (hd) the manner of inquiry under sub-section (1) of section 23-I;
 - (he) the form in which an appeal may be filed before the Securities Appellate Tribunal under section 23L and the fees payable in respect of such appeal;
 - (i) any other matter which is to be or may be prescribed.
- (3) Every rule made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

Power of Securities and Exchange Board of India to make regulations [Section 31]

- (1) Without prejudice to the provisions contained in section 30 of the Securities and Exchange Board of India Act, 1992, the Securities and Exchange Board of India may, by notification in the Official Gazette, make regulations consistent with the provisions of this Act and the rules made thereunder to carry out the purposes of this Act.
- (2) In particular, and without prejudice to the generality of the foregoing power, such regulations may provide for all or any of the following matters, namely :—
 - (a) the manner, in which at least fifty-one per cent of equity share capital of a recognised stock exchange is held within twelve months from the date of publication of the order under sub-section (7) of section 4B by the public other than the shareholders having trading rights under sub-section (8) of that section;
 - (b) the eligibility criteria and other requirements under section 17A.
- (3) Every regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the regulation or both Houses agree that the regulation should not be made, the regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that regulation.



3.3 SEBI (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS)

REGULATIONS, 2009

In exercise of the powers conferred by section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Board hereby makes the following regulations, namely:—

PRELIMINARY

Short title and commencement [Regulation 1]

- (1) These regulations may be called the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.
- (2) They shall come into force on the date of their publication in the Official Gazette.

Definitions [Regulation 2]

- (1) In these regulations, unless the context otherwise requires:
 - (a) "Act" means the Securities and Exchange Board of India Act, 1992 (15 of 1992);
 - (b) "advertisement" includes notices, brochures, pamphlets, show cards, catalogues, hoardings, placards, posters, insertions in newspaper, cover pages of offer documents, pictures and films in any print media or electronic media, radio, television programme;
 - (c) "anchor investor" means a qualified institutional buyer '[who makes] an application for a value of ten crore rupees or more in a public issue made through the book building process in accordance with these regulations;
 - (d) "Application Supported by Blocked Amount (ASBA)" means an application for subscribing to a public issue or rights issue, along with an authorisation to Self Certified Syndicate Bank to block the application money in a bank account;
 - (e) "Board" means the Securities and Exchange Board of India established under section 3 of the Act;
 - (f) "book building" means a process undertaken to elicit demand and to assess the price for determination of the quantum or value of specified securities or Indian Depository Receipts, as the case may be, in accordance with these regulations;
 - (g) "book runner" means a merchant banker appointed by the issuer to undertake the book building process;
 - (h) "composite issue" means an issue of specified securities by a listed issuer on public-cum-rights basis, wherein the allotment in both public issue and rights issue is proposed to be made simultaneously;
 - (i) "control" shall have the same meaning as assigned to it under clause (c) of sub-regulation (l) of regulation 2 of the Securities and Exchange Board of India (Substantial Acquisitions of Shares and Takeovers) Regulations, 1997;
 - (j) "convertible debt instrument" means an instrument which creates or acknowledges indebtedness and is convertible into equity shares of the issuer at a later date at or without the option of the holder of the instrument, whether constituting a charge on the assets of the issuer or not;
 - (k) "convertible security" means a security which is convertible into or exchangeable with equity shares of the issuer at a later date, with or without the option of the holder of the security and includes convertible debt instrument and convertible preference shares;]
 - (l) "designated stock exchange" means a recognised stock exchange in which securities of

an issuer are listed or proposed to be listed and which is chosen by the issuer as a designated stock exchange for the purpose of a particular issue of specified securities under these regulations:

Provided that where one or more of such stock exchanges have nationwide trading terminals, the issuer shall choose one of them as the designated stock exchange:

Provided further that subject to the provisions of this clause, the issuer may choose a different recognised stock exchange as a designated stock exchange for any subsequent issue of specified securities under these regulations;

- (m) "employee" means a permanent and full-time employee, working in India or abroad, of the issuer or of the holding company or subsidiary company or of that material associate(s) of the issuer whose financial statements are consolidated with the issuer's financial statements as per Accounting Standard 21, or a director of the issuer, whether whole time or part time and does not include promoters and an immediate relative of the promoter (i.e., any spouse of that person, or any parent, brother, sister or child of that person or of the spouse);
- (n) "further public offer" means an offer of specified securities by a listed issuer to the public for subscription and includes an offer for sale of specified securities to the public by any existing holders of such securities in a listed issuer;
- (na.) "General Corporate Purposes" include such identified purposes for which no specific amount is allocated or any amount so specified towards General Corporate Purpose or any such purpose by whatever name called, in the draft offer document filed with the Board.

Provided that any issue related expenses shall not be considered as a part of General Corporate Purpose merely because no specific amount has been allocated for such expenses in the draft offer document filed with the Board.]

- (o) "green shoe option" means an option of allotting equity shares in excess of the equity shares offered in the public issue as a post-listing price stabilizing mechanism;
- (p) "initial public offer" means an offer of specified securities by an unlisted issuer to the public for subscription and includes an offer for sale of specified securities to the public by any existing holders of such securities in an unlisted issuer;
- (q) "issue size" includes offer through document and promoters' contribution;
- (r) "issuer" means any person making an offer of specified securities;
- (s) "key management personnel" means the officers vested with executive powers and the officers at the level immediately below the board of directors of the issuer and includes any other person whom the issuer may declare as a key management personnel;
- (t) "listed issuer" means an issuer whose equity shares are listed in a recognized stock exchange;
- (u) "net offer to public" means an offer of specified securities to the public but does not include reservation;
- (v) "net worth" means the aggregate of the paid up share capital, share premium account, and reserves and surplus (excluding revaluation reserve) as reduced by the aggregate of miscellaneous expenditure (to the extent not adjusted or written off) and the debit balance of the profit and loss account;
- (w) "non-institutional investor" means an investor other than a retail individual investor and qualified institutional buyer;
- (x) "offer document" means a red herring prospectus, prospectus or shelf prospectus and information memorandum in terms of section 60A of the Companies Act, 1956 in case of a public issue and letter of offer in case of a rights issues;



- (y) "offer through offer document" means net offer to public and reservations;
- (z) "preferential issue" means an issue of specified securities by a listed issuer to any select person or group of persons on a private placement basis and does not include an offer of specified securities made through a public issue, rights issue, bonus issue, employee stock option scheme, employee stock purchase scheme or qualified institutions placement or an issue of sweat equity shares or depository receipts issued in a country outside India or foreign securities;
- (za) "promoter" includes:
- (i) the person or persons who are in control of the issuer;
 - (ii) the person or persons who are instrumental in the formulation of a plan or programme pursuant to which specified securities are offered to public;
 - (iii) the person or persons named in the offer document as promoters:
- Provided** that a director or officer of the issuer or a person, if acting as such merely in his professional capacity, shall not be deemed as a promoter;
- Provided further** that a financial institutions, scheduled bank, foreign institutional investor and mutual fund shall not be deemed to be a promoter merely by virtue of the fact that ten per cent or more of the equity share capital of the issuer is held by such person;
- Provided further** that such financial institution, scheduled bank and foreign institutional investor shall be treated as promoter for the subsidiaries or companies promoted by them or for the mutual fund sponsored by them;
- (zb) "promoter group" includes:
- (i) the promoter;
 - (ii) an immediate relative of the promoter (i.e., any spouse of that person, or any parent, brother, sister or child of the person or of the spouse); and
 - (iii) in case promoter is a body corporate:
 - (A) a subsidiary or holding company of such body corporate;
 - (B) anybody corporate in which the promoter holds ten per cent or more of the equity share capital or which holds ten per cent or more of the equity share capital of the promoter;
 - (C) anybody corporate in which a group of individuals or companies or combinations thereof which hold twenty per cent or more of the equity share capital in that body corporate also holds twenty per cent or more of the equity share capital of the issuer; and
 - (iv) in case the promoter is an individual:
 - (A) anybody corporate in which ten per cent or more of the equity share capital is held by the promoter or an immediate relative of the promoter or a firm or Hindu Undivided Family in which the promoter or any one or more of his immediate relative is a member;
 - (B) anybody corporate in which a body corporate as provided in (A) above holds ten per cent or more, of the equity share capital;
 - (C) any Hindu Undivided Family or firm in which the aggregate shareholding of the promoter and his immediate relatives is equal to or more than ten per cent of the total; and

- (v) all persons whose shareholding is aggregated for the purpose of disclosing in the prospectus under the heading "shareholding of the promoter group":
Provided that a financial institution, scheduled bank, foreign institutional investor and mutual fund shall not be deemed to be promoter group merely by virtue of the fact that ten per cent or more of the equity share capital of the issuer is held by such person:
Provided further that such financial institution, scheduled bank and foreign institutional investor shall be treated as promoter group for the subsidiaries or companies promoted by them or for the mutual fund sponsored by them;
- (zc) "public issue" means an initial public offer or further public offer;
- (zd) "qualified institutional buyer" means:
 - (i) a mutual fund, venture capital fund [Alternative Investment Fund] and foreign venture capital investor registered with the Board;
 - (ii) a foreign institutional investor and sub-account (other than a sub-account which is a foreign corporate or foreign individual), registered with the Board;
 - (iii) a public financial institution as defined in section 4A of the Companies Act, 1956;
 - (iv) a scheduled commercial bank;
 - (v) a multilateral and bilateral development financial institution;
 - (vi) a state industrial development corporation;
 - (vii) an insurance company registered with the Insurance Regulatory and Development Authority.
 - (viii) A provident fund with minimum corpus of twenty five crore rupees;
 - (ix) A pension fund with minimum corpus of twenty five crore rupees;
 - (x) National Investment Fund set up by resolution F. No. 2/3/2005 – DDII dated November 23, 2005 of the Government of India published in the Gazette of India;
 - (xi) Insurance funds set up and managed by army, navy or air force of the Union of India;
 - (xii) Insurance funds set up and managed by the Department of Posts, India;
- (ze) "retail individual investor" means an investor who applies or bids for specified securities for a value of not more than [two] lakh rupees;
- (zf) "retail individual shareholder" means a shareholder of a listed issuer, who:
 - (i) [***]
 - (ii) Applies or bids for specified securities for a value of not more than [two] lakh rupees;
- (zg) "rights issue" means an offer of specified securities by a listed issuer to the shareholders of the issuer as on the record date fixed for the said purpose;
- (zh) "Schedule" means schedule annexed to these regulations;
- (zi) "Self Certified Syndicate Bank" means a banker to an issue registered with the Board, which offers the facility of Application Supported by Blocked Amount;
- (zj) "specified securities" means equity shares and convertible securities;
- (zk) "stabilising agent" means a merchant banker who is responsible for stabilizing the price of



equity shares under a green shoe option, in terms of these regulations;

"syndicate member" means an intermediary registered with the Board and who is permitted to carry on the activity as an underwriter;

(zm) "unlisted issuer" means an issuer which is not a listed issuer.

- (2) All other words and expressions used but not defined in these regulations, but defined in the Act or the Companies Act, 1956, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and/or the rules and regulations made thereunder shall have the same meaning as respectively assigned to them in such Acts or rules or regulations or any statutory modification or re-enactment thereto, as the case may be.

Applicability of the regulations [Regulation 3]

Unless otherwise provided, these regulations shall apply to the following:

- (a) a public issue;
- (b) a rights issue, where the aggregate value of specified securities offered is fifty lakh rupees or more;
- (c) a preferential issue;
- (d) an issue of bonus shares by a listed issuer;
- (e) a qualified institutions placement by a listed issuer;
- (f) an issue of Indian Depository Receipts:

Provided that the provisions of these regulations shall not apply to issue of securities under clauses (b), (d) and (e) of sub-regulation (1) of regulation 9 of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

COMMON CONDITIONS FOR PUBLIC ISSUES AND RIGHTS ISSUES

General conditions [Regulation 4]

- (1) Any issuer offering specified securities through a public issue or rights issue shall satisfy the conditions of this Chapter at the time of filing draft offer document with the Board (unless stated otherwise in this Chapter) and at the time of registering or filing the final offer document with the Registrar of Companies or designated stock exchange, as the case may be.
- (2) No issuer shall make a public issue or rights issue of specified securities:
 - (a) if the issuer, any of its promoters, promoter group or directors or persons in control of the issuer are debarred from accessing the capital market by the Board;
 - (b) if any of the promoters, directors or persons in control of the issuer was or also is a promoter, director or person in control of any other company which is debarred from a made by the Board;
 - (c) if the issuer of convertible debt instruments is in the list of willful defaulters published by the Reserve Bank of India or it is in default of payment of interest or repayment of principal amount in respect of debt instruments issued by it to the public, if any, for a period of more than six months;
 - (d) unless it has made an application to one or more recognized stock exchanges for listing of specified securities on such stock exchanges and has chosen one of them as the designated stock exchange:

Provided that in case of an initial public offer, the issuer shall make an application for listing of the specified securities in at least one recognized stock exchange having nationwide

trading terminals;

- (e) unless it has entered into an agreement with a depository for dematerialization of specified securities already issued or proposed to be issued;
 - (f) unless all existing partly paid-up equity shares of the issuer have either been fully paid up or forfeited;
 - (g) unless firm arrangements of finance through verifiable means towards seventy five per cent of the stated means of finance, excluding the amount to be raised through the proposed public issue or rights issue or through existing identifiable internal accruals, have been made.
- (3) Warrants may be issued along with public issue or rights issue of specified securities subject to the following:
- (a) the tenure of such warrants shall not exceed twelve months from their date of allotment in the public / rights issue;
 - (b) not more than one warrant shall be attached to one specified security.
- (4) The amount for general corporate purposes, as mentioned in objects of the issue in the draft offer document filed with the Board, shall not exceed twenty five per cent of the amount raised by the issuer by issuance of specified securities.

Appointment of merchant banker and other intermediaries [Regulation 5]

- (1) The issuer shall appoint one or more merchant bankers, at least one of whom shall be a lead merchant banker and shall also appoint other intermediaries, in consultation with the lead merchant banker, to carry out the obligations relating to the issue.
- (2) The issuer shall, in consultation with the lead merchant banker, appoint only those intermediaries which are registered with the Board.
- (3) Where the issue is managed by more than one merchant banker, the rights, obligations and responsibilities, relating inter alia to disclosures, allotment, refund and underwriting obligations, if any, of each merchant banker shall be predetermined and disclosed in the offer document as specified in Schedule I.

Provided that where any of the merchant bankers is an associate of the issuer, it shall declare itself as a marketing lead manager and its role shall be limited to marketing of the issue.

- (4) The lead merchant banker shall, only after independently assessing the capability of other intermediaries to carry out their obligations, advise the issuer on their appointment.
- (5) The issuer shall enter into an agreement with the lead merchant banker in the format specified in Schedule II and with other intermediaries as required under the respective regulations applicable to the intermediary concerned:

Provided that such agreements may include such other clauses as the issuer and the intermediary may deem fit without diminishing or limiting in any way the liabilities and obligations of the merchant bankers, other intermediaries and the issuer under the Act, the Companies Act, 1956, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and the rules and regulations made thereunder or any statutory modification or statutory enactment thereof:

Provided further that in case of ASBA process, the issuer shall take cognizance of the deemed agreement of the issuer with Self Certified Syndicate Banks.

- (6) An issuer shall, in case of an issue made through the book building process, appoint syndicate members and in the case of any other issue, appoint bankers to issue, at all mandatory collection centres as specified in Schedule III and such other collection centres as it may deem fit.



- (7) The issuer shall appoint a registrar which has connectivity with all the depositories:

Provided that if issuer itself is a registrar to an issue registered with the Board, then another registrar to an issue shall be appointed as registrar to the issue:

Provided further that the lead merchant banker shall not act as a registrar to the issue in which it is also handling the post issue responsibilities.

Explanation.- or the purpose of this regulation, in case of a book built issue, the lead merchant banker appointed by the issuer shall act as the lead book runner.

Filing of offer document [Regulation 6]

- (1) No issuer shall make,
- (a) a public issue; or
- (b) a rights issue, where the aggregate value of the specified securities offered is fifty lakh rupees or more,
- unless a draft offer document, along with fees as specified in Schedule IV, has been filed with the Board through the lead merchant banker, at least thirty days prior to registering the prospectus, red herring prospectus or shelf prospectus with the Registrar of Companies or filing the letter of offer with the designated stock exchange, as the case may be.
- (2) The Board may specify changes or issue observations, if any, on the draft offer document within thirty days from the later of the following dates:
- (a) the date of receipt of the draft offer document under sub-regulation (1); or
- (b) the date of receipt of satisfactory reply from the lead merchant bankers, where the Board has sought any clarification or additional information from them; or
- (c) the date of receipt of clarification or information from any regulator or agency, where the Board has sought any clarification or information from such regulator or agency; or
- (d) the date of receipt of a copy of in-principle approval letter issued by the recognised stock exchanges.
- (3) If the Board specifies changes or issues observations on the draft offer document, the issuer and lead merchant banker shall carry out such changes in the draft offer document and comply with the observations issued by the Board before registering the prospectus, red herring prospectus or shelf prospectus, as the case may be, with the Registrar of Companies or filing the letter of offer with the designated stock exchange.
- (4) The issuer shall, simultaneously while registering the prospectus, red herring prospectus or shelf prospectus with the Registrar of Companies or filing the letter of offer with the designated stock exchange or before the opening of the issue, file a copy thereof with the Board through the lead merchant banker.
- (5) The lead merchant banker shall, while filing the offer document with the Board in terms of sub-regulation (1) and sub-regulation (4), file a copy of such document with the recognized stock exchanges where the specified securities are proposed to be listed.
- (6) The offer document file with the Board under this regulation shall also be furnished to the Board in a soft copy in the manner specified in Schedule V.

In-principle approval from recognized stock exchanges [Regulation 7]

The issuer shall obtain in-principle approval from recognized stock exchanges as follows:

- (a) in case of an initial public offer, from all the recognized stock exchanges in which the issuer proposes to get its specified securities listed; and

- (b) in case of a further public offer and rights issue:
 - (i) where the specified securities are listed only on recognized stock exchanges having nationwide trading terminals, from all such stock exchanges;
 - (ii) where the specified securities are not listed on any recognized stock exchange having nationwide trading terminals, from all the stock exchanges in which the specified securities of the issuer are proposed to be listed.
 - (iii) where the specified securities are listed on recognized stock exchanges having nationwide trading terminals as well as on the recognized stock exchanges not having nationwide trading terminals, from all recognized stock exchanges having nationwide trading terminals.

Documents to be submitted before opening of the issue [Regulation 8]

- (1) The lead merchant the draft offer document
 - (a) a certificate, confirming that an agreement has been entered into between the issuer and the lead merchant bankers as per the format specified in Schedule II.
 - (b) [***]
 - (c) a due diligence certificate as per Form A of Schedule VI;
 - (d) in case of an issue of convertible debt instruments, a due diligence certificate from the debenture trustee as per Form B of Schedule VI;
 - (e) a certificate confirming compliance of the conditions specified in Part C of Schedule VHL
- (2) The lead merchant bankers shall submit the following documents to the Board after issuance of observations by the Board or after expiry of the period stipulated in sub-regulation (2) of regulation 6 if the Board has not issued observations:
 - (a) a statement certifying that all changes, suggestions and observations made by the Board have been incorporated in the offer document;
 - (b) a due diligence certificate as per Form C of Schedule VI, at the time of registering the prospectus with the Registrar of Companies;
 - (c) a copy of the resolution passed by the board of directors of the issuer for allotting specified securities to promoters towards amount received against promoters' contribution, before opening of the issue;
 - (d) a certificate from a Chartered Accountant, before opening of the issue, certifying that promoters' contribution has been received in accordance with these regulations, accompanying therewith the names and addresses of the promoters who have contributed to the promoters' contribution and the amount paid by each of them towards such contribution;
 - (e) a due diligence certificate as per Form D of Schedule VI, immediately before the opening of the issue, certifying that necessary corrective action, if any, has been taken;
 - (f) a due diligence certificate as per Form E of Schedule VI, after the issue has opened but before it closes for subscription.
- (3) The issuer shall, at the time of filing draft offer document with the recognised stock exchange where the specified securities are proposed to be listed, submit the Permanent Account Number, bank account number and passport number of its promoters to such stock exchange.

Draft offer document to be made public [Regulation 9]

- (1) The draft offer document filed with the Board shall be made public, for comments, if any, for a period of at least twenty one days from the date of such filing, by hosting it on the websites of



the Board, recognised stock exchanges where specified securities are proposed to be listed and merchant bankers associated with the issue.

- (2) The lead merchant bankers shall, after expiry of the period stipulated in sub-regulation (1), file with the Board a statement giving information of the comments received by them or the issuer on the draft offer document during that period and the consequential changes, if any, to be made in the draft offer document.
- (3) The issuer either on the date of filing the draft offer document with the Board or on the next day shall make a public announcement in one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated, disclosing to the public the fact of filing of draft offer document with the Board and inviting the public to give their comments to the Board in respect of disclosures made in the draft offer document.

Fast Track Issue [Regulation 10]

- (1) Nothing contained in sub-regulations (1), (2) and (3) of regulation 6 and regulations 7 and 8 shall apply to a public issue or rights issue if the issuer satisfies the following conditions:

- (a) the equity shares of the issuer have been listed on any recognised stock exchange having nationwide trading terminals for a period of at least three years immediately preceding the reference date;
- (b) the average market capitalisation of public shareholding of the issuer is at least '[three] thousand crore rupees;
- (c) the annualised trading turnover of the equity shares of the issuer during six calendar months immediately preceding the month of the reference date has been at least two per cent of the weighted average number of equity shares listed during such six months' period :

Provided that for issuers, whose public shareholding is less than fifteen per cent of its issued equity capital, the annualised trading turnover of its equity shares has been at least two per cent of the weighted average number of equity shares available as free float during such six months' period;

- (d) the issuer has redressed at/least ninety five per cent of the complaints received from the investors' till the end of the quarter immediately preceding the month of the reference date;
- (e) the issuer has been in compliance with the equity listing agreement for a period of at least three years immediately preceding the reference date:

Provided that if the issuer has not complied with the provision of the equity listing agreement relating to composition of board of directors, for any quarter during the last three years immediately preceding the reference date, but is compliant with such provisions at the time of filing of offer document with the Registrar of Companies or designated stock exchange, as the case may be, and adequate disclosures are made in the offer document about such non-compliances during the three years immediately preceding the reference date, it shall be deemed as compliance with the condition;

- (f) the impact of auditors' qualifications, if any, on the audited accounts of the issuer in respect of those financial years for which such accounts are disclosed in the offer document does not exceed five per cent of the net profit or loss after tax of the issuer for the respective years;
- (g) no show-cause notices have been issued or prosecution proceedings initiated 3[by the Board] or pending against the issuer or its promoters or whole time directors as on the reference date;

- (h) the entire shareholding of the promoter group of the issuer is held in dematerialised form on the reference date.
- (2) The issuer shall file the offer document with the Board and the recognised stock exchanges in accordance with sub-regulations (4), (5) and (6) of regulation 6 and shall pay fees to the Board as specified in Schedule IV.
- (3) The lead merchant bankers shall submit to the Board, the following documents along with the offer document:
 - (a) a due diligence certificate as per Form A of Schedule VI including additional confirmations as specified in Form F of Schedule VI;
 - (b) in case of a fast track issue of convertible debt instruments, a due diligence certificate from the debenture trustee as per Form B of Schedule VI.

Explanation: for the purposes of this regulation:

- (I) "reference date" means:
 - (a) in case of a public issue by a listed issuer, the date of registering the red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with the Registrar of Companies; and
 - (b) in case of a rights issue by a listed issuer, the date of filing the letter of offer with the designated stock exchange.
- (II) "average market capitalisation of public shareholding" means the sum of daily market capitalisation of public shareholding for a period of one year up to the end of the quarter preceding the month in which the proposed issue was approved by the shareholders or the board of the issuer, as the case may be, divided by the number of trading days.
- (III) "public shareholding" shall have the same meaning as assigned to it in the equity listing agreement.

Opening of an issue [Regulation 11]

- (1) Subject to the compliance with sub-section (4) of section 60 of the Companies Act, 1956, a public issue or rights issue may be opened:
 - (a) within twelve months from the date of issuance of the observations by the Board under regulation 6; or
 - (b) within three months of expiry of the period stipulated in sub-regulation (2) of regulation 6, if the Board has not issued observations:

Provided that in case of a fast track issue, the issue shall open within the period stipulated in sub-section (4) of section 60 of the Companies Act, 1956.
- (2) In case of shelf prospectus, the first issue may be opened within three months of issuance of observations by the Board.
- (3) The issuer shall, before registering the red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with the Registrar of Companies or filing the letter of offer with the designated stock exchange, as the case may be, file with the Board through the lead merchant bankers, an updated offer document highlighting all changes made in the offer document.
- (4) Notwithstanding anything contained in this regulation, if there are changes in the offer document in relation to the matters specified in Schedule VI, the updated offer document or new draft offer document, as the case may be, shall be filed with the Board along with fees specified in



Schedule IV.

- (5) An issue shall be opened after at least three working days from the date of registering the red herring prospectus with the Registrar of Companies.]

Dispatch of issue material [Regulation 12]

The lead merchant bankers shall dispatch the offer document and other issue material including forms for ASBA to the designated stock exchange, syndicate members, underwriters, bankers to the issue, investors' associations and Self Certified Syndicate Banks in advance.

Underwriting [Regulation 13]

- (1) Where the issuer making a public issue (other than through the book building process) or rights issue, desires to have the issue underwritten, it shall appoint the underwriters in accordance with Securities and Exchange Board of India (Underwriters) Regulations, 1993.
- (2) Where the issuer makes a public issue through the book building process, such issue shall be underwritten by book runners or syndicate members: '[Provided that at least 2[seventy five per cent] of the net offer to the public proposed to be compulsorily allotted to qualified institutional buyers for the purpose of compliance of the eligibility conditions specified in sub-regulation (2) of regulation 26 and regulation 27, cannot be underwritten.]
- (3) The issuer shall enter into underwriting agreement with the book runner, who in turn shall enter into underwriting agreement with syndicate members, indicating therein the number of specified securities which they shall subscribe to at the predetermined price in the event of/under-subscription in the issue.
- (4) If syndicate members fail to fulfill their underwriting obligations, the lead book runner shall fulfill the underwriting obligations.
- (5) The book runners and syndicate members shall not subscribe to the issue in any manner except for fulfilling their underwriting obligations.
- (6) [***]
- (7) In case of every underwritten issue, the lead merchant banker or the lead book runner shall undertake minimum underwriting obligations as specified in the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992.
- (8) Where hundred per cent of the offer through offer document is underwritten, the underwriting obligations shall be for the entire hundred per cent of the offer through offer document and shall not be restricted upto the minimum subscription level.

Minimum subscription [Regulation 14]

- (1) The minimum subscription to be received in an issue shall not be less than ninety per cent of the offer through offer document
Provided that in the case of an initial public offer, the minimum subscription to be received shall be subject to allotment of minimum number of specified securities, as prescribed in sub-clause (b) of clause (2) of rule 19 of Securities Contracts (Regulation) Rules, 1957.
- (2) In the event of non-receipt of minimum subscription referred to in sub-regulation (1), all application moneys received shall be refunded to the applicants forthwith, but not later than:
 - (a) fifteen days of the closure of the issue, in case of a non-underwritten issue; and
 - (b) seventy days of the closure of the issue, in the case of an underwritten issue where minimum subscription including devolvment obligations paid by the underwriters is not received within sixty days of the closure of the issue.

- (3) The offer document shall contain adequate disclosures regarding minimum subscription as specified in Part A of Schedule VIII.
- (4) Nothing contained in this regulation, except the requirement relating to allotment of minimum, number of specified securities, shall apply to offer for sale of specified securities.

Oversubscription [Regulation 15]

No allotment shall be made by the issuer in excess of the specified securities offered through the offer document:

Provided that in case of oversubscription, an allotment of not more than ten per cent of the net offer to public may be made for the purpose of making allotment in minimum lots.

Monitoring agency [Regulation 16]

- (1) If the issue size exceeds five hundred crore rupees, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by a public financial institution or by one of the scheduled commercial banks named in the offer document as bankers of the issuer:

Provided that nothing contained in this clause shall apply to an offer for sale or an issue of specified securities made by a bank or public financial institution [for an insurance company]

- (2) The monitoring agency shall submit its report to the issuer in the format specified in Schedule IX on a half yearly basis, till the proceeds of the issue have been fully utilized.

Manner of calls [Regulation 17]

If the issuer proposes to receive subscription monies in calls, it shall ensure that the outstanding subscription money is called within twelve months from the date of allotment in the issue and if any applicant fails to pay the call money within the said twelve months, the equity shares on which there are calls in arrear along with the subscription money already paid on such shares shall be forfeited.

Provided that it shall not be necessary to call the outstanding subscription money within twelve months, if the issuer has appointed a monitoring agency in terms of regulation 16.

Allotment, refund and payment of interest [Regulation 18]

- (1) The issuer and merchant bankers shall ensure that specified securities are allotted and / or application moneys are refunded within fifteen days from the date of closure of the issue.
- (2) Where specified securities are not allotted and /or application moneys are not refunded within the period stipulated in sub-regulation (1), the issuer shall under-take to pay interest at such rate and within such time as disclosed in the offer document.

Restriction on further capital issues [Regulation 19]

No issuer shall make any further issue of specified securities in any manner whether by way of public issue, rights issue, preferential issue, qualified institutions placement, issue of bonus shares or otherwise:

- (a) in case of a fast track issue, during the period between the date of registering the red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with the Registrar of Companies or filing the letter of offer with the designated stock exchange and the listing of the specified securities offered through the offer document or refund of application moneys; or
- (b) in case of other issues, during the period between the date of filing the draft offer document with the Board and the listing of the specified securities offered through the offer document or refund of application moneys,

unless full disclosures regarding the total number of specified securities and amount proposed to be raised from such further issue are made in such draft offer document or offer document, as the case may be.



Additional requirements for issue of convertible debt instruments [Regulation 20]

- (1) In addition to other requirements laid down in these regulations, an issuer making a public issue or rights issue of convertible debt instruments shall comply with the following conditions:
 - (a) it has obtained credit rating from one or more credit rating agencies;
 - (b) it has appointed one or more debenture trustees in accordance with the provisions of section 117B of the Companies Act, 1956 and Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993;
 - (c) it has created debenture redemption reserve in accordance with the provisions of section 117C of the Companies Act, 1956;
 - (d) if the issuer proposes to create a charge or security on its assets in respect of secured convertible debt instruments, it shall ensure that:
 - (i) such assets are sufficient to discharge the principal amount at all times;
 - (ii) such assets are free from any encumbrance;
 - (iii) where security is already created on such assets in favour of financial institutions or banks or the issue of convertible debt instruments is proposed to be secured by creation of security on a leasehold land, the consent of such financial institution, bank or lessor for a second or pari passu charge has been obtained and submitted to the debenture trustee before the opening of the issue;
 - (iv) the security/asset cover shall be arrived at after reduction of the liabilities having a first/prior charge, in case the convertible debt instruments are secured by a second or subsequent charge.
- (2) The issuer shall redeem the convertible debt instruments in terms of the offer document.

Roll over of non-convertible portion of partly convertible debt instruments [Regulation 21]

- (1) The non-convertible portion of partly convertible debt instruments issued by a listed issuer, the value of which exceeds fifty lakh rupees, may be rolled over without change in the interest rate, subject to compliance with the provisions of section 121 of the Companies Act, 1956 and the following conditions:
 - (a) seventy five per cent of the holders of the convertible debt instruments of the issuer have, through a resolution, approved the rollover through postal ballot;
 - (b) the issuer has, along with the notice for passing the resolution, sent to all holders of the convertible debt instruments, an auditors' certificate on the cash flow of the issuer and with comments on the liquidity position of the issuer;
 - (c) the issuer has undertaken to redeem the non-convertible portion of the partly convertible debt instruments of all the holders of the convertible debt instruments who have not agreed to the resolution;
 - (d) credit rating has been obtained from at least one credit rating agency registered with the Board within a period of six months prior to the due date of redemption and has been communicated to the holders of the convertible debt instruments, before the roll over.
- (2) The creation of fresh security and execution of fresh trust deed shall not be mandatory if the existing trust deed or the security documents provide for continuance of the security till redemption of secured convertible debt instruments:

Provided that whether the issuer is required to create fresh security and to execute fresh trust deed or not shall be decided by the debenture trustee.

Conversion of optionally convertible debt instruments into equity share capital [Regulation 22]

- (1) An issuer shall not convert its optionally convertible debt instruments into equity shares unless the holders of such convertible debt instruments have sent their positive consent to the issuer and non-receipt of reply to any notice sent by the issuer for this purpose shall not be construed as consent for conversion of any convertible debt instruments.
- (2) Where the value of the convertible portion of any convertible debt instruments issued by a listed issuer exceeds fifty lakh rupees and the issuer has not determined the conversion price of such convertible debt instruments at the time of making the issue, the holders of such convertible debt instruments shall be given the option of not converting the convertible portion into equity shares:
Provided that where the upper limit on the price of such convertible debt instruments and justification thereon is determined and disclosed to the investors at the time of making the issue, it shall not be necessary to give such option to the holders of the convertible debt instruments for converting the convertible portion into equity share capital within the said upper limit.
- (3) Where an option is to be given to the holders of the convertible debt instruments in terms of sub-regulation (2) and if one or more of such holders do not exercise the option to convert the instruments into equity share capital at a price determined in the general meeting of the shareholders, the issuer shall redeem that part of the instruments within one month from the last date by which option is to be exercised, at a price which shall not be less than its face value.
- (4) The provision of sub-regulation (3) shall not apply if such redemption is in terms of the disclosures made in the offer document.

Issue of convertible debt instruments for financing [Regulation 23]

No issuer shall issue convertible debt instruments for financing replenishment of funds or for providing loan to or for acquiring shares of any person who is part of the same group or who is under the same management:

Provided that an issuer may issue fully convertible debt instruments for these purposes if the period of conversion of such debt instruments is less than eighteen months from the date of issue of such debt instruments.

Explanation: For the purpose of this regulation:

- (I) Two persons shall be deemed to be "part of the same group" if they belong to the group within the meaning of clause (ef) of section 2 of the Monopolies and Restrictive Trade Practices Act, 1969 (54 of 1969) or if they own interconnected undertakings within the meaning of clause (g) of section 2 of the said Act;
- (II) The expression "under the same management" shall have the same meaning as assigned to it in sub-section (1B) of section 370 of the Companies Act, 1956 (1 of 1956).

Alteration of rights of holders of specified securities [Regulation 24]

No issuer shall alter the terms (including the terms of issue) of specified securities which may adversely affect the interests of the holders of that specified securities, except with the consent in writing of the holders of not less than three-fourths of the specified securities of that class or with the sanction of a special resolution passed at a meeting of the holders of the specified securities of that class.



PROVISIONS AS TO PUBLIC ISSUE

ELIGIBILITY REQUIREMENTS

Reference date [Regulation 25]

Unless otherwise provided in this Chapter, an issuer making a public issue shall satisfy the conditions of this Chapter as on the date of filing draft offer document with the Board and also as on the date of registering the offer document with the Registrar of Companies.

Conditions for initial public offer [Regulation 26]

- (1) An issuer may make an initial public offer, if:
 - (a) it has net tangible assets of at least three crore rupees in each of the preceding three full years (of twelve months each), of which not more than fifty per cent are held in monetary assets:

Provided that if more than fifty per cent of the net tangible assets are held in monetary assets, the issuer has made firm commitments to utilise such excess monetary assets in its business or project:

Provided further that the limit of fifty per cent on monetary assets shall not be applicable in case the public offer is made entirely through an offer for sale;
 - (b) it has a minimum average pre-tax operating profit of rupees fifteen crore, calculated on a restated and consolidated basis, during the three most profitable years out of the immediately preceding five years;
 - (c) it has a net worth of at least one crore rupees in each of the preceding three full years (of twelve months each);
 - (d) the aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed five times its pre-issue net worth as per the audited balance sheet of the preceding financial year;
 - (e) if it has changed its name within the last one year, at least fifty per cent of the revenue for the preceding one full year has been earned by it from the activity indicated by the new name.
- (2) An issuer not satisfying the condition stipulated in sub-regulation (1) may make an initial public offer if the issue is made through the book-building process and the issuer undertakes to allot, at least seventy five per cent of the net offer to public, to qualified institutional buyers and to refund full subscription money if it fails to make the said minimum allotment to qualified institutional buyers
- (3) An issuer may make an initial public offer of convertible debt instruments without making a prior public issue of its equity shares and listing thereof.
- (4) An issuer shall not make an allotment pursuant to a public issue if the number of prospective allottees is less than one thousand.
- (5) No issuer shall make an initial public offer if there are any outstanding convertible securities or any other right which would entitle any person with any option to receive equity shares:

Provided that the provisions of this sub-regulation shall not apply to:

 - (a) a public issue made during the currency of convertible debt instruments which were issued through an earlier initial public offer, if the conversion price of such convertible debt instruments was determined and disclosed in the prospectus of the earlier issue of convertible debt instruments;

- (b) outstanding options granted to employees pursuant to an employee stock option scheme framed in accordance with the relevant Guidance Note or Accounting Standards, if any, issued by the Institute of Chartered Accountants of India in this regard;
 - (c) fully paid-up outstanding convertible securities which are required to be converted on or before the date of filing of the red herring prospectus (in case of book-built issues) or the prospectus (in case of fixed price issues), as the case may be.
- (6) Subject to provisions of the Companies Act, 1956 and these regulations, equity shares may be offered for sale to public if such equity shares have been held by the sellers for a period of at least one year prior to the filing of draft offer document with the Board in accordance with sub-regulation (1) of regulation 6:

Provided that in case equity shares received on conversion or exchange of fully paid-up compulsorily convertible securities including depository receipts are being offered for sale, the holding period of such convertible securities as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period referred in this sub-regulation:

Provided further that the requirement of holding equity shares for a period of one year shall not apply:

- (a) in case of an offer for sale of specified securities of a Government company or statutory authority or corporation or any special purpose vehicle set up and controlled by any one or more of them, which is engaged in infrastructure sector;
 - (b) if the specified securities offered for sale were acquired pursuant to any scheme approved by a High Court under sections 391 -394 of the Companies Act, 1956, in lieu of business and invested capital which had been in existence for a period of more than one year prior to such approval.
- (7) No issuer shall make an initial public offer, unless as on the date of registering prospectus or red herring prospectus with the Registrar of Companies, the issuer has obtained grading for the initial public offer from at least one credit rating agency registered with the Board.

Explanation: For the purposes of this regulation:

- (I) "net tangible assets" mean the sum of all net assets of the issuer, excluding intangible assets as defined in Accounting Standard 26 (AS 26) issued by the Institute of Chartered Accountants of India;
- (II) "project" means the object for which monies are proposed to be raised to cover the objects of the issue;
- (III) In case of an issuer which had been a partnership firm, the track record of distributable profits of the partnership firm shall be considered only if the financial statements of the partnership business for the period during which the issuer was a partnership firm, conform to and are revised in the format prescribed for companies under the Companies Act, 1956 and also comply with the following:
 - (a) adequate disclosures are made in the financial statements as required to be made by the issuer as per Schedule VI of the Companies Act, 1956;
 - (b) the financial statements are duly certified by a Chartered Accountant stating that:
 - (i) the accounts and the disclosures made are in accordance with the provisions of Schedule VI of the Companies Act, 1956;
 - (ii) the accounting standards of the Institute of Chartered Accountants of India have been followed;
 - (iii) the financial statements present a true and fair view of the firm's accounts;



- (iv) In case of an issuer formed out of a division of an existing company, the track record of distributable profits of the division spun-off shall be considered only if the requirements regarding financial statements as provided for partnership firms in Explanation III are complied with;
- (v) "bid-ask spread" means the difference between quotations for sale and purchase;
- (vi) The term "infrastructure sector" includes the facilities or services as specified in Schedule X.

Conditions for further public offer [Regulation 27]

An issuer may make a further public offer if it satisfies the conditions specified in clauses (d) and (e) of sub-regulation (1) of regulation 26 and if it does not satisfy those conditions, it may make a further public offer if it satisfies the conditions specified in sub-regulation (2) of regulation 26.

PRICING IN PUBLIC ISSUE

Pricing [Regulation 28]

- (1) An issuer may determine the price of specified securities in consultation with the lead merchant banker or through the book building process.
- (2) An issuer may determine the coupon rate and conversion price of convertible debt instruments in consultation with the lead merchant banker or through the book building process.
- (3) The issuer shall undertake the book building process in a manner specified in Schedule XL.

Differential pricing [Regulation 29]

An issuer may offer specified securities at different prices, subject to the following:

- (a) retail individual investors or retail individual shareholders '[or employees 2[***] entitled for reservation made under regulation 42 making an application for specified securities of value not more than 3[two] lakh rupees,] may be offered specified securities at a price lower than the price at which net offer is made to other categories of applicants:
Provided that such difference shall not be more than ten per cent of the price at which specified securities are offered to other categories of applicants;
- (b) in case of a book built issue, the price of the specified securities offered to an anchor investor shall not be lower than the price offered to other applicants;
- (c) in case of a composite issue, the price of the specified securities offered in the public issue may be different from the price offered in rights issue and justification for such price difference shall be given in the offer document;
- (d) in case the issuer opts for the alternate method of book building in terms of Part D of Schedule XI, the issuer may offer specified securities to its employees at a price lower than the floor price :
Provided that the difference between the floor price and the price at which specified securities are offered to employees shall not be more than ten per cent of the floor price.

Price and price band [Regulation 30]

- (1) The issuer may mention a price or price band in the draft prospectus (in case of a fixed price issue) and floor price or price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before registering the prospectus with the Registrar of Companies:
Provided that the prospectus registered with the Registrar of Companies shall contain only one price or the specific coupon rate, as the case may be.

- (2) [* * *] the issuer shall announce the floor price or price band at least [five working days] before the opening of the bid (in case of an initial public offer) and at least one working day before the opening of the bid (in case of a further public offer), in all the newspapers in which the pre-issue advertisement was released.
- (3) The announcement referred to in sub-regulation (2) shall contain relevant financial ratios computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" in the prospectus.
- (3A) The announcement referred to in sub-regulation (2) and the relevant financial ratios referred to in sub-regulation (3) shall be disclosed on the websites of those stock exchanges where the securities are proposed to be listed and shall also be prefilled in the application forms available on the websites of the stock exchanges
- (4) The cap on the price band shall be less than or equal to one hundred and twenty per cent of the floor price.
- (5) The floor price or the final price shall not be less than the face value of the specified securities.

Explanation : For the purposes of sub-regulation (4), the "cap on the price band" includes cap on the coupon rate in case of convertible debt instruments.

Face value of equity shares [Regulation 31]

- (1) Subject to the provisions of the Companies Act, 1956, the Act and these regulations, an issuer making an initial public offer may determine the face value of the equity shares in the following manner:
 - (a) if the issue price per equity share is five hundred rupees or more, the issuer shall have the option to determine the face value at less than ten rupees per equity share:
Provided that the face value shall not be less than one rupee per equity share;
 - (b) if the issue price per equity share is less than five hundred rupees, the face value of the equity shares shall be ten rupees per equity share: Provided that nothing contained in this sub-regulation shall apply to initial public offer made by any Government company, statutory authority or corporation or any special purpose vehicle set up by any of them, which is engaged in infrastructure sector.
- (2) The disclosure about the face value of equity shares (including the statement about the issue price being "X" times of the face value) shall be made in the advertisements, offer documents and application forms in identical font size as that of issue price or price band.

Explanation: For the purposes of this regulation, the term "infrastructure sector" includes the facilities or services as specified in Schedule X.

PROMOTERS' CONTRIBUTION

Minimum promoters' contribution [Regulation 32]

- (1) The promoters of the issuer shall contribute in the public issue as follows:
 - (a) in case of an initial public offer, not less than twenty per cent of the post issue capital
Provided that in case the post issue shareholding of the promoters is less than twenty per cent, alternative investment funds may contribute for the purpose of meeting the shortfall in minimum contribution as specified for promoters, subject to a maximum of ten per cent of the post issue capital.
 - (b) in case of a further public offer, either to the extent of twenty per cent of the proposed issue size or to the extent of twenty per cent of the post-issue capital;



- (c) in case of a composite issue, either to the extent of twenty per cent of the proposed issue size or to the extent of twenty per cent of the post-issue capital excluding the rights issue component.
- (2) In case of a public issue or composite issue of convertible securities, minimum promoters' contribution shall be as follows:
- (a) the promoters shall contribute twenty per cent as stipulated in clause (a), (b) or (c) of sub-regulation (1), as the case may be, either by way of equity shares or by way of subscription to the convertible securities:
- Provided that if the price of the equity shares allotted pursuant to conversion is not predetermined and not disclosed in the offer document, the promoters shall contribute only by way of subscription to the convertible securities being issued in the public issue and shall undertake in writing to subscribe to the equity shares pursuant to conversion of such securities;
- (b) in case of any issue of convertible securities which are convertible or exchangeable on different dates and if the promoters' contribution is by way of equity shares (conversion price being pre-determined), such contribution shall not be at a price lower than the weighted average price of the equity share capital arising out of conversion of such securities;
- (c) subject to the provisions of clauses (a) and (b) above, in case of an initial public offer of convertible debt instruments without a prior public issue of equity shares, the promoters shall bring in a contribution of at least twenty per cent of the project cost in the form of equity shares, subject to contributing at least twenty per cent of the issue size from their own funds in the form of equity shares:
- Provided that if the project is to be implemented in stages, the promoters' contribution shall be with respect to total equity participation till the respective stage vis-a-vis the debt raised or proposed to be raised through the public issue.
- (3) In case of a further public offer or composite issue where the promoters contribute more than the stipulated minimum promoters' contribution, the allotment with respect to excess contribution shall be made at a price determined in terms of the provisions of regulation 76 or the issue price, whichever is higher.
- (4) The promoters shall satisfy the requirements of this regulation at least one day prior to the date of opening of the issue and the amount of promoters' contribution shall be kept in an escrow account with a scheduled commercial bank and shall be released to the issuer along with the release of the issue proceeds:

Provided that where the promoters' contribution has already been brought in and utilised, the issuer shall give the cash flow statement disclosing the use of such funds in the offer document:

Provided further that where the minimum promoters' contribution is more than one hundred crore rupees, the promoters shall bring in at least one hundred crore rupees before the date of opening of the issue and the remaining amount may be brought on pro rata basis before the calls are made to public.

Explanation: For the purpose of this regulation:

- (i) Promoters' contribution shall be computed on the basis of the post-issue expanded capital:
- (a) assuming full proposed conversion of convertible securities into equity shares;
- (b) assuming exercise of all vested options, where any employee stock options are outstanding at the time of initial public offer in terms of proviso (b) to sub-regulation (5) of regulation 26.

- (II) For computation of "weighted average price":
 - (a) "weights" means the number of equity shares arising out of conversion of such specified securities into equity shares at various stages;
 - (b) "price" means the price of equity shares on conversion arrived at after taking into account predetermined conversion price at various stages.

Securities ineligible for minimum promoters' contribution [Regulation 33]

- (1) For the computation of minimum promoters' contribution, the following-specified securities shall not be eligible:
 - (a) specified securities acquired during the preceding three years, if they are:
 - (i) acquired for consideration other than cash and revaluation of assets or capitalisation of intangible assets is involved in such transaction; or
 - (ii) resulting from a bonus issue by utilisation of revaluation reserves or unrealised profits of the issuer or from bonus issue against equity shares which are ineligible for minimum promoters' contribution;
 - (b) specified securities acquired by promoters I[and alternative investment funds] during the preceding one year at a price lower than the price at which specified securities are being offered to public in the initial public offer:

Provided that nothing contained in this clause shall apply:

- (i) if promoters [alternative investment funds, as applicable] pay to the issuer, the difference between the price at which specified securities are offered in the initial public offer and the price at which the specified securities had been acquired;
 - (ii) if such specified securities are acquired in terms of the scheme under sections 391-394 of the Companies Act, 1956, as approved by a High Court, by promoters in lieu of business and invested capital that had been in existence for a period of more than one year prior to such approval;
 - (iii) to an initial public offer by a Government company, statutory authority or corporation or any special purpose vehicle set up by any of them, which is engaged in infrastructure sector;
 - (c) specified securities allotted to promoters][and alternative investment funds] during the preceding one year at a price less than the issue price, against funds brought in by them during that period, in case of an issuer formed by conversion of one or more partnership firms, where the partners of the erstwhile partnership firms are the promoters of the issuer and there is no change in the management:

Provided that specified securities, allotted to promoters against capital existing in such firms for a period of more than one year on a continuous basis, shall be eligible;
 - (d) specified securities pledged with any creditor.
- (2) Specified securities referred to in clauses (a) and (c) of sub-regulation (1) shall be eligible for the computation of promoters' contribution, if such securities are acquired pursuant to a scheme which has been approved under sections 391-394 of the Companies Act, 1956.

Explanation: For the purposes of clause (b) of sub-regulation (1), the term "infrastructure sector" includes the facilities or services as specified in Schedule X.

Requirement of minimum promoters' contribution not applicable in certain cases [Regulation 34]

The requirements of minimum promoters' contribution shall not apply in case of:



- (a) an issuer which does not have any identifiable promoter;
- (b) a further public offer, where the equity shares '[of the issuer] 2[***]' are not infrequently traded in a recognised stock exchange for a period of at least three years and the issuer has a track record of dividend payment for at least immediately preceding three years:

Provided that where promoters propose to subscribe to the specified securities offered to the extent greater than higher of the two options available in clause (b) of sub-regulation (1) of regulation 32, the subscription in excess of such percentage shall be made at a price determined in terms of the provisions of regulation 76 or the issue price, whichever is higher;

- (c) rights issues.

Explanation: For the purpose of clause (b), the words "infrequently traded" have the same meaning as assigned to them in Explanation to sub-regulation (5) of regulation 20 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 and the reference date for the purpose of computing the annualised trading turnover referred to in the said Explanation shall be the date of filing the draft offer document with the Board and in case of a fast track issue, the date of filing the offer document with the Registrar of Companies before opening of the issue.

RESTRICTION ON TRANSFERABILITY (LOCK-IN) OF PROMOTERS' CONTRIBUTION, ETC.

Date of commencement of lock-in and inscription of non-transferability [Regulation 35]

- (1) Save as otherwise provided in this Chapter, specified securities held by promoters and persons other than promoters shall not be transferable (hereinafter referred to as "lock-in") from the date of allotment of the specified securities in the proposed public issue for the period stipulated in this Chapter.
- (2) The certificate of specified securities which are subject to lock-in shall contain the inscription "non-transferable" and the lock-in period and in case such specified securities are dematerialised, the issuer shall ensure that lock-in is recorded by the depository.
- (3) Where the specified securities which are subject to lock-in are partly paid-up and the amount called-up on such specified securities is less than the amount called-up on the specified securities issued to the public, the "lock-in" shall end only on the expiry of three years after such specified securities have become pari passu with the specified securities issued to the public.

Lock-in of specified securities held by promoters [Regulation 36]

In a public issue, the specified securities held by promoters shall be locked-in for the period stipulated hereunder:

- (a) minimum promoters' contribution ^[including contribution made by alternative investment funds, referred to in proviso to clause (a) of sub-regulation (1) of regulation 32,] shall be locked-in for a period of three years from the date of commencement of commercial production or date of allotment in the public issue, whichever is later;
- (b) promoters' holding in excess of minimum promoters' contribution shall be locked-in for a period of one year:

Provided that excess promoters' contribution as provided in proviso to clause (b) of regulation 34 shall not be subject to lock-in.

Explanation: For the purposes of this clause, the expression "date of commencement of commercial production" means the last date of the month in which commercial production in a manufacturing company is expected to commence as stated in the offer document.

Lock-in of specified securities held by persons other than promoters [Regulation 37]

In case of an initial public offer, the entire pre-issue capital held by persons other than promoters shall be locked-in for a period of one year:

Provided that nothing contained in this regulation shall apply to:

- (a) equity shares allotted to employees under an employee stock option or employee stock purchase scheme of the issuer prior to the initial public offer, if the issuer has made full disclosures with respect to such options or scheme in accordance with Part A of Schedule VIII;
- (b) equity shares held by a venture capital fund or alternative investment fund of Category I or a foreign venture capital investor:

Provided that such equity shares shall be locked-in for a period of at least one year from the date of purchase by the venture capital fund or alternative investment fund or foreign venture capital investor.

Explanation.- For the purpose of clause (b), in case such equity shares have resulted pursuant to conversion of fully paid-up compulsorily convertible securities, the holding period of such convertible securities as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period and convertible securities shall be deemed to be fully paid-up, if the entire consideration payable thereon has been paid and no further consideration is payable at the time of their conversion.

Lock-in of specified securities lent to stabilising agent under green shoe option [Regulation 38]

The lock-in provisions of this Chapter shall not apply with respect to the specified securities lent to stabilising agent for the purpose of green shoe option, during the period starting from the date of lending of such specified securities and ending on the date on which they are returned to the lender in terms of sub-regulation (5) or (6) of regulation 45:

Provided that the specified securities shall be locked-in for the remaining period from the date on which they are returned to the lender.

Pledge of locked-in specified securities [Regulation 39]

Specified securities held by promoters and locked-in may be pledged with any scheduled commercial bank or public financial institution as collateral security for loan granted by such bank or institution, subject to the following:

- (a) if the specified securities are locked-in in terms of clause (a) of regulation 36, the loan has been granted by such bank or institution for the purpose of financing one or more of the objects of the issue and pledge of specified securities is one of the terms of sanction of the loan;
- (b) if the specified securities are locked-in in terms of clause (b) of regulation 36 and the pledge of specified securities is one of the terms of sanction of the loan.

Transferability of locked-in specified securities [Regulation 40]

Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, the specified securities held by promoters and locked-in as per regulation 36 may be transferred to another promoter or any person of the promoter group or a new promoter or a person in control of the issuer and the specified securities held by persons other than promoters and locked-in as per regulation 37 may be transferred to any other person holding the specified securities which are locked-in along with the securities proposed to be transferred:

Provided that lock-in on such specified securities shall continue for the remaining period with the transferee and such transferee shall not be eligible to transfer them till the lock-in period stipulated in these regulations has expired.



MINIMUM OFFER TO PUBLIC, RESERVATIONS, ETC.

Minimum offer to public [Regulation 41]

[***] Subject to the provisions of sub-clause (b) of clause (2) of rule 19 of Securities Contracts (Regulation) Rules, 1957, the net offer to public:

- (a) in case of an initial public offer, shall be at least ten per cent or twenty five per cent of the post-issue capital, as the case may be; and
- (b) in case of a further public offer, shall be at least ten per cent or twenty five per cent of the issue size, as the case may be.

Reservation on competitive basis [Regulation 42]

- (1) In case of an issue made through the book building process, the issuer may make reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of the following categories of persons:

- (a) employees; and in case of a new issuer, persons who are in the permanent and full time employment of the promoting companies excluding the promoters and an immediate relative of the promoter of such companies;
- (b) shareholders (other than promoters) of:
 - (i) listed promoting companies, in case of a new issuer; and
 - (ii) listed group companies, in case of an existing issuer:

Provided that if the promoting companies are designated financial institutions or state and central financial institutions, the shareholders of such promoting companies shall not be eligible for the reservation on competitive basis;

- (c) persons who, as on the date of filing the draft offer document with the Board, are associated with the issuer as depositors, bondholders or subscribers to services of the issuer making an initial public offer :

Provided that the issuer shall not make the reservation to the issue management team, syndicate members, their promoters, directors and employees and for the group or associate companies of the issue management team and syndicate members and their promoters, directors and employees.

- (2) In case of an issue made other than through the book building process, the issuer may make reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of the following categories of persons:

- (a) employees; and in case of a new issuer, persons who are in the permanent and full time employment of the promoting companies excluding the promoters and an immediate relative of the promoter of such companies;
- (b) shareholders (other than promoters) of:
 - (i) listed promoting companies, in the case of a new issuer; and
 - (ii) listed group companies, in the case of an existing issuer:

Provided that if the promoting companies are designated financial institutions or state and central financial institutions, the shareholders of such promoting companies shall not be eligible for the reservation on competitive basis.

- (3) In case of a further public offer (not being a composite issue), the issuer may make reservation on competitive basis out of the issue size excluding promoters' contribution and net offer to public in favour of retail individual shareholders of the issuer.

- (4) The reservation on competitive basis shall be subject to following conditions:
- (a) the aggregate of reservations for employees shall not exceed '[five per cent of the post issue capital of the issuer];
 - (b) reservation for shareholders shall not exceed ten per cent of the issue size;
 - (c) reservation for persons who as on the date of filing the draft offer document with the Board, have business association as depositors, bondholders and subscribers to services with the issuer making an initial public offer shall not exceed five per cent of the issue size;
 - (d) no further application for subscription in the net offer-to public category shall be entertained from any person (except an employee and retail individual shareholder) in favour of whom reservation on competitive basis is made;
 - (e) any unsubscribed portion in any reserved category may be added to any other reserved category and the unsubscribed portion, if any, after such inter se adjustments among the reserved categories shall be added to the net offer to the public category;
 - (f) in case of under subscription in the net offer to the public category, spill-over to the extent of under subscription shall be permitted from the reserved category to the net public offer category;
 - (g) value of allotment to any employee in pursuance of reservation made under sub-regulation (1) or (2), as the case may be, shall not exceed 3[two] lakh rupees.]
- (5) In the case of reserved categories, a single applicant in the reserved category may make an application for a number of specified securities which exceeds the reservation.

Explanation.- For the purposes of this regulation:

- (I) The term "reservation on competitive basis" means reservation wherein specified securities are allotted in proportion of the number of specified securities applied for in respect of a particular reserved category to the number of specified securities reserved for that category;
- (II) The term "new issuer" means an issuer which has not completed twelve months of commercial operation and its audited operative results are not available.

Allocation in net offer to public [Regulation 43]

- (1) No person shall make an application in the net offer to public category for that number of specified securities which exceeds the number of specified securities offered to public.
- (2) In an issue made through the book building process under sub-regulation (1) of regulation 26, the allocation in the net offer to public category shall be as follows:
 - (a) not less than thirty five per cent to retail individual investors;
 - (b) not less than fifteen per cent to non-institutional investors;
 - (c) not more than fifty per cent to qualified institutional buyers, five per cent of which shall be allocated to mutual funds:

Provided that in addition to five per cent allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.
- (2A) In an issue made through the book building process under sub-regulation (2) of regulation 26, the allocation in the net offer to public category shall be as follows:
 - (a) not more than ten per cent to retail individual investors;



- (b) not more than fifteen per cent to non-institutional investors;
- (c) not less than seventy five per cent to qualified institutional buyers, five per cent of which shall be allocated to mutual funds:

Provided that in addition to five per cent allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.]

- (3) In an issue made through the book building process, the issuer may allocate upto thirty per cent of the portion available for allocation to qualified institutional buyers to an anchor investor in accordance with the conditions specified in this regard in Schedule XI.
- (4) In an issue made other than through the book building process, allocation in the net offer to public category shall be made as follows:
 - (a) minimum fifty per cent to retail individual investors; and
 - (b) remaining to:
 - (i) individual applicants other than retail individual investors; and
 - (ii) other investors including corporate bodies or institutions, irrespective of the number of specified securities applied for;
 - (c) the unsubscribed portion in either of the categories specified in clause (a) or (b) may be allocated to applicants in the other category.

Explanation.- For the purpose of sub-regulation (4), if the retail individual investor category is entitled to more than fifty per cent on proportionate basis, the retail individual investors shall be allocated that higher percentage.

Safety-net arrangement [Regulation 44]

An issuer may provide for a safety-net arrangement for the specified securities offered in any public issue in consultation with the merchant banker after ascertaining the financial capacity of the person offering the safety-net arrangement, subject to disclosures specified in this regard in Part A of Schedule VIII:

Provided that any such arrangement shall provide for an offer to purchase up to a maximum of one thousand specified securities per original resident retail individual allottee at the issue price within a period of six months from the last date of despatch of security certificates or credit of demat account.

Explanation.- For the purpose of this regulation, the term "safety net arrangement" means an arrangement provided by the issuer under which a person offers to purchase specified securities from the original resident retail individual allottees at the issue price.

Price stabilisation through green shoe option [Regulation 45]

- (1) An issuer making a public issue of specified securities may provide green shoe option for stabilising the post listing price of its specified securities, subject to the following:
 - (a) the issuer has been authorized, by a resolution passed in the general meeting of shareholders approving the public issue, to allot specified securities to the stabilising agent, if required, on the expiry of the stabilisation period;
 - (b) the issuer has appointed a merchant banker or book runner, as the case may be, from amongst the merchant bankers appointed by the issuer as a stabilising agent, who shall be responsible for the price stabilisation process;

- (c) prior to filing the draft offer document with the Board, the issuer and the stabilising agent have entered into an agreement, stating all the terms and conditions relating to the green shoe option including fees charged and expenses to be incurred by the stabilising agent for discharging his responsibilities;
 - (d) prior to filing the offer document with the Board, the stabilising agent has entered into an agreement with the promoters or pre-issue shareholders or both for borrowing specified securities from them in accordance with clause (g) of this sub-regulation, specifying therein the maximum number of specified securities that may be borrowed for the purpose of allotment or allocation of specified securities in excess of the issue size (hereinafter referred to as the "over-allotment"), which shall not be in excess of fifteen per cent of the issue size;
 - (e) subject to clause (d), the lead merchant banker or lead book runner, in consultation with the stabilising agent, shall determine the amount of specified securities to be over-allotted in the public issue;
 - (f) the draft and final offer documents shall contain all material disclosures about the green shoe option specified in this regard in Part A of Schedule VIII;
 - (g) in case of an initial public offer pre-issue shareholders and promoters and in case of a further public offer pre-issue shareholders holding more than five per cent specified securities and promoters, may lend specified securities to the extent of the proposed over-allotment;
 - (h) the specified securities borrowed shall be in dematerialised form and allocation of these securities shall be made pro rata to all successful applicants.
- (2) For the purpose of stabilisation of post'-listing price of the specified securities, the stabilising agent shall determine the relevant aspects including the timing of buying such securities, quantity to be bought and the price at which such securities are to be bought from the market.
 - (3) The stabilisation process shall be available for a period not exceeding thirty days from the date on which trading permission is given by the recognised stock exchanges in respect of the specified securities allotted in the public issue.
 - (4) The stabilising agent shall open a special account, distinct from the issue account, with a bank for crediting the monies received from the applicants against the over-allotment and a special account with a depository participant for crediting specified securities to be bought from the market during the stabilisation period out of the monies credited in the special bank account.
 - (5) The specified securities bought from the market and credited in the special account with the depository participant shall be returned to the promoters or pre-issue shareholders immediately, in any case not later than two working days after the end of the stabilization period.
 - (6) On expiry of the stabilisation period, if the stabilising agent has not been able to buy specified securities from the market to the extent of such securities over-allotted, the issuer shall allot specified securities at issue price in dematerialised form to the extent of the shortfall to the special account with the depository participant, within five days of the closure of the stabilisation period and such specified securities shall be returned to the promoters or pre-issue shareholders by the stabilising agent in lieu of the specified securities borrowed from them and the account with the depository participant shall be closed thereafter.
 - (7) The issuer shall make a listing application in respect of the further specified securities allotted under sub-regulation (6), to all the recognised stock exchanges where the specified securities allotted in the public issue are listed and the provisions of Chapter VII shall not be applicable to such allotment.
 - (8) The stabilising agent shall remit the monies with respect to the specified securities allotted under sub-regulation (6) to the issuer from the special bank account.



- (9) Any monies left in the special bank account after remittance of monies to the issuer under sub-regulation (8) and deduction of expenses incurred by the stabilising agent for the stabilisation process shall be transferred to the Investor Protection and Education Fund established by the Board and the special bank account shall be closed soon thereafter.
- (10) The stabilising agent shall submit a report to the stock exchange on a daily basis during the stabilisation period and a final report to the Board in the format specified in Schedule XII.
- (11) The stabilising agent shall maintain a register for a period of at least three years from the date of the end of the stabilisation period and such register shall contain the following particulars:
 - (a) The names of the promoters or pre-issue shareholder from whom the specified securities were borrowed and the number of specified securities borrowed from each of them;
 - (b) The price, date and time in respect of each transaction effected in the course of the stabilisation process; and
 - (c) The details of allotment made by the issuer on expiry of the stabilisation process.

Period of subscription [Regulation 46]

- (1) Except as otherwise provided in these regulations] a public issue shall be kept open for at least three working days but not more than ten working days including the days for which the issue is kept open in case of revision in price band.
- (2) In case the price band in a public issue made through the book building process is revised, the bidding (issue) period disclosed in the red herring prospectus shall be extended for a minimum period of three working days:

Provided that the total bidding period shall not exceed ten working days.

Pre-issue advertisement for public issue [Regulation 47]

- (1) Subject to the provisions of section 66 of the Companies Act, 1956, the issuer shall, after registering the red herring prospectus (in case of a book built issue) or prospectus (in case of fixed price issue) with the Registrar of Companies, make a pre-issue advertisement in one English national daily newspaper with wide circulation, Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated.
- (2) The pre-issue advertisement shall be in the format and shall contain the disclosures specified in Part A of Schedule XIII.

Issue opening and issue closing advertisement for public issue [Regulation 48].

An issuer may issue advertisements for issue opening and issue closing advertisements, which shall be in the formats specified in Parts B and C of Schedule XIII.

Minimum application value [Regulation 49]

- (1) The issuer shall stipulate in the offer document, the minimum application size in terms of number of specified securities which shall fall within the range of minimum application value of [ten thousand rupees to fifteen thousand rupees].
- (2) The issuer shall invite applications in multiples of the minimum application value, an illustration whereof is given in Schedule XIV.
- (3) The minimum sum payable on application shall not be less than twenty five per cent of the issue price:

Provided that in case of an offer for sale, the issue price payable for each specified security shall be brought in at the time of application.

Explanation.- For the purpose of this regulation, “minimum application value” shall be with reference to the issue price of the specified securities and not with reference to the amount payable on application.

Allotment procedure and basis of allotment [Regulation 50]

- (1) The allotment of specified securities to applicants other than retail individual investors and] anchor investors shall be on proportionate basis within the specified investor categories and the number of securities allotted shall be rounded off to the nearest integer, subject to minimum allotment being equal to the minimum application size as determined and disclosed by the issuer :

Provided that value of specified securities allotted to any person in pursuance of reservation made under clause (a) of sub-regulation (1) or clause (a) of sub-regulation (2) of regulation 42, shall not exceed two lakh rupees.

- (1A) The allotment of specified securities to each retail individual investor shall not be less than the minimum bid lot, subject to availability of shares in retail individual investor category, and the remaining available shares, if any, shall be allotted on a proportionate basis.
- (2) The executive director or managing director of the designated stock exchange along with the post issue lead merchant bankers and registrars to the issue shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the allotment procedure as specified in Schedule XV.

Utilisation of subscription money [Regulation 51]

The post-issue lead merchant banker shall ensure that moneys received in respect of the issue are released to the issuer in compliance with the provisions of section 73 of the Companies Act, 1956.

Annual Updation of Offer Document [Regulation 51A]

The disclosures made in the red herring prospectus while making an initial public offer, shall be updated on an annual basis by the issuer and shall be made publicly accessible in the manner specified by the Board.

RIGHTS ISSUE

Record date [Regulation 52]

- (1) A listed issuer making a rights issue shall announce a record date for the purpose of determining the shareholders eligible to apply for specified securities in the proposed rights issue.
- (2) The issuer shall not withdraw rights issue after announcement of the record date.
- (3) If the issuer withdraws the rights issue after announcing the record date, it shall not make an application for listing of any of its specified securities on any recognised stock exchange for a period of twelve months from the record date announced under sub-regulation (1):

Provided that the issuer may seek listing of its equity shares allotted pursuant to conversion or exchange of convertible securities issued prior to the announcement of the record date, on the recognised stock exchange where its securities are listed.

Restriction on rights issue [Regulation 53]

- (1) No issuer shall make a rights issue of equity shares 2[***] unless it has made reservation of equity shares of the same class in favour of the holders of 3[***] outstanding compulsorily convertible debt instruments, if any, in proportion to the convertible part thereof.
- (2) The equity shares 4[so] reserved for the holders of fully or partially [compulsorily] convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms 5[at] which the equity shares offered in the rights issue were issued.



Letter of offer, abridged letter of offer, pricing and period of subscription [Regulation 54]

- (1) The abridged letter of offer, along with application form, shall be dispatched through registered post or speed post to all the existing shareholders at least three days before the date of opening of the issue :

Provided that the letter of offer shall be given by the issuer or lead merchant banker to any existing shareholder who has made a request in this regard.

- (2) The shareholders who have not received the application form may apply in writing on a plain paper, along with the requisite application money.
- (3) The shareholders making application otherwise than on the application form shall not renounce their rights and shall not utilise the application form for any purpose including renunciation even if it is received subsequently.
- (4) Where a shareholder makes an application on application form as well as on plain paper, the application is liable to be rejected.
- (5) The issue price shall be decided before determining the record date which shall be determined in consultation with the designated stock exchange.
- (6) A rights issue shall be open for subscription for a minimum period of fifteen days and for a maximum period of thirty days.
- (7) The issuer shall give only one payment option out of the following to all the investors—
 - (a) part payment on application with balance money to be paid in calls; or
 - (b) full payment on application:

Provided that where the issuer has given the part payment option to investors, such issuer shall obtain the necessary regulatory approvals to facilitate the same.]

Pre-Issue Advertisement for rights issue [Regulation 55]

- (1) The issuer shall issue an advertisement for rights issue disclosing the following:
 - (a) the date of completion of despatch of abridged letter of offer and the application form;
 - (b) the centres other than registered office of the issuer where the shareholders or the persons entitled to receive the rights entitlements may obtain duplicate copies of the application forms in case they do not receive the application form within a reasonable time after opening of the rights issue;
 - (c) a statement that if the shareholders entitled to receive the rights entitlements have neither received the original application forms nor they are in a position to obtain the duplicate forms, they may make application in writing on a plain paper to subscribe to the rights issue;
 - (d) a format to enable the shareholders entitled to apply against their rights entitlements, to make the application on a plain paper specifying therein necessary particulars such as name, address, ratio of rights issue, issue price, number of equity shares held, ledger folio numbers, depository participant ID, client ID, number of equity shares entitled and applied for, additional shares if any, amount to be paid along with application, and particulars of cheque, etc. to be drawn in favour of the issuer's account;
 - (e) a statement that the applications can be directly sent by the shareholders entitled to apply against rights entitlements through registered post together with the application moneys to the issuer's designated official at the address given in the advertisement;

- (f) a statement to the effect that if the shareholder makes an application on plain paper and also on application form both his applications shall be liable to be rejected at the option of the issuer.
- (2) The advertisement shall be made in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where registered office of the issuer is situated, at least three days before the date of opening of the issue.

Reservation for employees along with rights issue [Regulation 55A].

Subject to other applicable provision of these regulations the issuer may make reservation for employees along with rights issue subject to the condition that value of allotment to any employee shall not exceed two lakh rupees.]

Utilisation of funds raised in rights issue [Regulation 56]

The issuer shall utilise funds collected in rights issues after the finalisation of the basis of allotment.

MANNER OF DISCLOSURES IN THE OFFER DOCUMENTS

Manner of disclosures in the offer document [Regulation 57]

- (1) The offer document shall contain all material disclosures which are true and adequate so as to enable the applicants to take an informed investment decision.
- (2) Without prejudice to the generality of sub-regulation (1):
 - (a) the red-herring prospectus, shelf prospectus and prospectus shall contain:
 - (i) the disclosures specified in Schedule II of the Companies Act, 1956; and
 - (ii) the disclosures specified in Part A of Schedule VIII, subject to the provisions of Parts B and C thereof;
 - (iii) the letter of offer shall contain disclosures as specified in Part E of Schedule VD3

Provided that in the case of a further public offer or a rights issue, the offer document shall be deemed to be in compliance with the provisions of this regulation, if suitable references are made to the updated disclosures in the offer document referred to in regulation 51A of these regulations.

Abridged prospectus, abridged letter of offer and ASBA [Regulation 58]

- (1) The abridged prospectus shall contain the disclosures of the memorandum prescribed under sub-section (3) of section 56 of the Companies Act, 1956 and additional disclosures as specified in Part D of Schedule VIII.
- (2) The abridged letter of offer shall contain the disclosures as specified in Part F of Schedule VIII.
- (3) The abridged prospectus and abridged letter of offer shall not contain any matter extraneous to the contents of the offer document.
- (4) Every application form including ASBA form distributed by the issuer or any other person in relation to an issue shall be accompanied by a copy of the abridged prospectus or abridged letter of offer, as the case may be.
- (5) In all public issues and rights issues, where not more than one payment option is given, the issuer shall provide the facility of ASBA in accordance with the procedure and eligibility criteria specified by the Board :

Provided that in case of qualified institutional buyers and non-institutional investors the issuer shall accept bids using ASBA facility only.]



GENERAL OBLIGATIONS OF ISSUER AND INTERMEDIARIES WITH RESPECT TO PUBLIC ISSUE AND RIGHTS ISSUE

Prohibition on payment of incentives [Regulation 59]

No person connected with the issue shall offer any incentive, whether direct or indirect, in any manner, whether in cash or kind or services or otherwise to any person for making an application for allotment of specified securities: Provided that nothing contained in this regulation shall apply to fees or commission for services rendered in relation to the issue.

Explanation.- For the purpose of this regulation, the expression "person connection with the issue" includes a person connected with the distribution of the issue.

Public communications, publicity materials, advertisements and research reports [Regulation 60]

- (1) Any public communication including advertisement and publicity material issued by the issuer or research report made by the issuer or any intermediary concerned with the issue or their associates shall contain only factual information and shall not contain projections, estimates, conjectures, etc. or any matter extraneous to the contents of the offer document.
- (2) All public communications and publicity material issued or published in any media during the period commencing from the date of the meeting of the board of directors of the issuer in which the public issue or rights issue is approved till the date of filing draft offer document with the Board shall be consistent with its past practices:

Provided that where such public communication or publicity material is not consistent with the past practices of the issuer, it shall be prominently displayed or announced in such public communication or publicity material that the issuer is proposing to make a public or rights issue of specified securities in the near future and is in the process of filing a draft offer document with the Board.

- (3) All public communications and publicity material issued or published in any media during the period commencing from the date of filing draft offer document with the Board till the date of allotment of securities offered in the issue, shall prominently disclose that:
 - (a) the issuer is proposing to make a public issue or rights issue of the specified securities and has filed a draft offer document with the Board or has filed the red herring prospectus or prospectus with the Registrar of Companies or the letter of offer with the designated stock exchange, as the case may be.
 - (b) the draft offer document, red herring prospectus or final offer document, as the case may be, is available on the website of the Board, lead merchant bankers or lead book runners.
- (4) The issuer shall make prompt, true and fair disclosure of all material developments which take place during the following period mentioned in this sub-regulation, relating to its business and securities and also relating to the business and securities of its subsidiaries, group companies, etc., which may have a material effect on the issuer, by issuing public notices in all the newspapers in which the issuer had issued pre-issue advertisement under regulation 47 or regulation 55, as the case may be:
 - (a) in case of public issue, between the date of registering final prospectus or the red herring prospectus, as the case may be, with the Registrar of Companies, and the date of allotment of specified securities;
 - (b) in case of a rights issue, between the date of filing the letter of offer with the designated stock exchange and the date of allotment of the specified securities.
- (5) The issuer shall not, directly or indirectly, release, during any conference or at any other time, any material or information which is not contained in the offer document.

- (6) In respect of all public communications, issue advertisements and publicity materials, the issuer shall obtain approval from the lead merchant bankers responsible for marketing the issue and shall also make copies of all issue related materials available with the lead merchant bankers at least till the allotment is completed.
- (7) Any advertisement or research report issued or caused to be issued by an issuer, any intermediary concerned with the issue or their associates shall comply with the following:
 - (a) it shall be truthful, fair and shall not be manipulative or deceptive or distorted and it shall not contain any statement, promise or forecast which is untrue or misleading;
 - (b) if it reproduces or purports to reproduce any information contained in an offer document, it shall reproduce such information in full and disclose all relevant facts and not be restricted to select extracts relating to that information;
 - (c) it shall be set forth in a clear, concise and understandable language;
 - (d) it shall not include any issue slogans or brand names for the issue except the normal commercial name of the issuer or commercial brand names of its products already in use;
 - (e) if it presents any financial data, data for the past three years shall also be included along with particulars relating to sales, gross profit, net profit, share capital, reserves, earnings per share, dividends and the book values;
 - (f) no advertisement shall use extensive technical, legal terminology or complex language and excessive details which may distract the investor;
 - (g) no issue advertisement shall contain statements which promise or guarantee rapid increase in profits;
 - (h) no issue advertisement shall display models, celebrities, fictional characters, landmarks or caricatures or the likes;
 - (i) no issue advertisement shall appear in the form of crawlers (the advertisements which run simultaneously with the programme in a narrow strip at the bottom of the television screen) on television;
 - (j) in any issue advertisement on television screen, the risk factors shall not be scrolled on the television screen and the advertisement shall advise the viewers to refer to the red herring prospectus or other offer document for details;
 - (k) no issue advertisement shall contain slogans, expletives or non-factual and unsubstantiated titles;
 - (l) if an advertisement or research report contains highlights, it shall also contain risk factors with equal importance in all respects including print size of not less than point seven size;
 - (m) an issue advertisement displayed on a billboard shall not contain information other than that specified in Parts A, B and C of Schedule XIII, as applicable;
 - (n) an issue advertisement which contains highlights or information other than the details contained in the format as specified in Parts A and B of Schedule XIII shall contain risk factors.
- (8) No advertisement shall be issued giving any impression that the issue has been fully subscribed or oversubscribed during the period the issue is open for subscription.
- (9) An announcement regarding closure of issue shall be made only after the lead merchant banker(s) is satisfied that at least ninety per cent of the offer through offer document has been subscribed and a certificate has been obtained to that effect from the registrar to the issue:



Provided that such announcement shall not be made before the date on which the issue is to be closed.

- (10) No advertisement or distribution material with respect to the issue shall contain any offer of incentives, whether direct or indirect, in any manner, whether in cash or kind or services or otherwise.
- (11) No product advertisement shall contain any reference, directly or indirectly, to the performance of the issuer during the period commencing from the date of the resolution of the board of directors of the issuer approving the public issue or rights issue till the date of allotment of specified securities offered in such issue.
- (12) A research report may be prepared only on the basis of information, disclosed to the public by the issuer by updating the offer document or otherwise.
- (13) No selective or additional information or information which is extraneous to the information disclosed to the public through the offer document or otherwise, shall be given by the issuer or any member of the issue management team or syndicate to any particular section of the investors or to any research analyst in any manner whatsoever, including at road shows, presentations, in research or sales reports or at bidding centres.
- (14) The merchant bankers shall submit a compliance certificate in the format specified in Part D of Schedule XIII, for the period between the date of filing the draft offer document with the Board and the date of closure of the issue, in respect of news reports appearing in any of the following media:
 - (a) newspapers mentioned in sub-regulation (3) of regulation 9;
 - (b) major business magazines;
 - (c) print and electronic media controlled by a media group where the media group has a private treaty/shareholders' agreement with the issuer or promoters of the issuer.

Explanation.- For the purpose of this regulation:

- (I) "public communication or publicity material" includes corporate, product and issue advertisements of the issuer, interviews by its promoters, directors, duly authorized employees or representatives of the issuer, documentaries about the issuer or its promoters, periodical reports and press releases.
- (II) An issue advertisement shall be considered to be misleading, if it contains:
 - (a) Statements made about the performance or activities of the issuer without necessary explanatory or qualifying statements, which may give an exaggerated picture of such performance or activities.
 - (b) An inaccurate portrayal of past performance or its portrayal in a manner which implies that past gains or income will be repeated in the future.

Copies of offer documents to be available to public [Regulation 61]

- (1) The issuer and lead merchant bankers shall ensure that the contents of offer documents hosted on the websites as required in these regulations are the same as that of their printed versions as filed with the Registrar of Companies, Board and the stock exchanges.
- (2) The lead merchant bankers and the recognised stock exchange shall provide copies of the draft offer document and final offer document to the public as and when requested.
- (3) The lead merchant bankers or the recognised stock exchange may charge a reasonable sum for providing the copy of the offer document.

Redressal of investor grievances [Regulation 62]

The post-issue lead merchant bankers shall actively associate himself with post-issue activities such as allotment, refund, despatch and giving instructions to syndicate members, Self-Certified Syndicate Banks and other intermediaries and shall regularly monitor redressal of investor grievances arising therefrom.

Appointment of Compliance Officer [Regulation 63]

The issuer shall appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors' grievances.

Explanation.- For the purpose of this regulation, the term "securities laws" means the Companies Act, 1956, the Act, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and the rules and regulations made thereunder and the regulations, general or special orders, guidelines or circulars made or issued by the Board.

Due diligence [Regulation 64]

- (1) The lead merchant bankers shall exercise due diligence and satisfy himself about all the aspects of the issue including the veracity and adequacy of disclosure in the offer documents.
- (2) The lead merchant bankers shall call upon the issuer, its promoters or directors or in case of an offer for sale, the selling shareholders, to fulfill their obligations as disclosed by them in the offer document and as required in terms of these Regulations.
- (3) The post-issue merchant banker shall continue to be responsible for post-issue activities till the subscribers have received the securities certificates, credit to their demat account or refund of application moneys and the listing agreement is entered into by the issuer with the stock exchange and listing/trading permission is obtained.
- (4) The responsibility of the lead merchant banker shall continue even after the completion of issue process.

Post-issue reports [Regulation 65]

- (1) The lead merchant banker shall submit post-issue reports to the Board in accordance with sub-regulation (2).
- (2) The post-issue reports shall be submitted as follows:
 - (a) initial post issue report as specified in Parts A and B of Schedule XVI, within three days of closure of the issue;
 - (b) final post issue report as specified in Parts C and D of Schedule XVI, within fifteen days of the date of finalisation of basis of allotment or within fifteen days of refund of money in case of failure of issue.
- (3) The lead merchant banker shall submit a due diligence certificate as per the format specified in Form G of Schedule VI, along with the final post issue report.

Post-issue Advertisements [Regulation 66]

- (1) The post-issue merchant banker shall ensure that advertisement giving details relating to over subscription, basis of allotment, number, value and percentage of all applications including ASBA, number, value and percentage of successful allottees for all applications including ASBA, date of completion of despatch of refund orders or instructions to Self-Certified Syndicate Banks by the Registrar, date of despatch of certificates and date of filing of listing application, etc. is released within ten days from the date of completion of the various activities in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place



where registered office of the issuer is situated.

- (2) The post-issue merchant banker shall ensure that issuer, advisors, brokers or any other entity connected with the issue do not publish any advertisement stating that issue has been over subscribed or indicating investors' response to the issue, during the period when the public issue is still open for subscription by the public.

Co-ordination with Intermediaries [Regulation 67]

- (1) The post-issue merchant banker shall maintain close co-ordination with the registrars to the issue and arrange to depute its officers to the offices of various intermediaries at regular intervals after the closure of the issue to monitor the flow of applications from collecting bank branches and/or Self Certified Syndicate Banks, processing of the applications including application form for ASBA and other matters till the basis of allotment is finalised, despatch of security certificates and refund orders are completed and securities are listed.
- (2) Any act of omission or commission on the part of any of the intermediaries noticed during such visits shall be duly reported to the Board.
- (3) In case there is a devolvment on underwriters, the merchant banker shall ensure that the notice for devolvment containing the obligation of the underwriters is issued within a period of ten days from the date of closure of the issue.
- (4) In case of under subscribed issues, the merchant banker shall furnish information in respect of underwriters who have failed to meet their underwriting devolvment to the Board in the format specified in Schedule XVII.
- (5) The post-issue merchant banker shall confirm to the bankers to the issue by way of copies of listing and trading approvals that all formalities in connection with the issue have been completed and that the banker is free to release the money to the issuer or release the money for refund in case of failure of the issue.

Audited financial statements in the offer document [Regulation 68]

The merchant banker shall ensure that the information contained in the offer document and the particulars as per audited financial statements in the offer document are not more than six months old from the issue opening date.

Other responsibilities [Regulation 69]

- (1) The post-issue merchant banker shall ensure that the despatch of refund orders, allotment letters and share certificates is done by way of registered post or certificate of posting, as may be applicable.
- (2) The post-issue merchant banker shall ensure payment of interest to the applicants for delayed despatch of allotment letters, refund orders, etc. as per the disclosure made in the offer document.
- (3) In case of absence of definite information about subscription figures, the issue shall be kept open for the required number of days to avoid any dispute, at a later date, by the underwriters in respect of their liability.
- (4) The issuer shall ensure that transactions in securities by the promoter and promoter group during the period between the date of registering the offer document with the Registrar of Companies or filing the letter of offer with the designated stock exchange, as the case may be and the date of closure of the issue shall be reported to the recognised stock exchanges where the specified securities of the issuer are listed, within twenty four hours of the transactions.

PREFERENTIAL ISSUE**Chapter VII not to apply in certain cases [Regulation 70]**

- (1) The provisions of this Chapter shall not apply where the preferential issue of equity shares is made:
 - (a) pursuant to conversion of loan or option attached to convertible debt instruments in terms of sub-sections (3) and (4) of section 81 of the Companies Act, 1956;
 - (b) pursuant to a scheme approved by a High Court under sections 391 to 394 of the Companies Act, 1956;
 - (c) in terms of the rehabilitation scheme approved by the Board of Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985:

Provided that the lock-in provisions of this Chapter shall apply to preferential issue of equity shares mentioned in clause (c).
- (2) The provisions of this Chapter relating to pricing and lock-in shall not apply to equity shares allotted to any financial institution within the meaning of sub-clauses (ia) and (ii) of clause (h) of section 2 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993 (51 of 1993).
- (3) The provisions of regulation 73 and regulation 76 shall not apply to a preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, where the Board has granted relaxation to the issuer in terms of regulation 29A of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, if adequate disclosures about the plan and process proposed to be followed for identifying the allottees are given in the explanatory statement to notice for the general meeting of shareholders.
- (4) The provisions of sub-regulation (2) of regulation 72 and sub-regulation (6) of regulation 78 shall not apply to a preferential issue of specified securities where the proposed allottee is a Mutual Fund registered with the Board or Insurance Company registered with Insurance Regulatory and Development Authority.

Relevant date [Regulation 71]

For the purpose of this Chapter, "relevant date" means:

- (a) in case of preferential issue of equity shares, the date thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue:

Provided that in case of preferential issue of equity shares pursuant to a scheme approved under the Corporate Debt Restructuring Framework of

Reserve Bank of India, the date of approval of the Corporate Debt Restructuring Package shall be the relevant date;
- (b) in case of preferential issue of convertible securities, either the relevant date referred to in clause (a) of this regulation or a date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.

Explanation — Where the relevant date falls on a Weekend/Holiday, the day preceding the Weekend/Holiday will be reckoned to be the relevant date.

Conditions for preferential issue [Regulation 72]

- (1) A listed issuer may make a preferential issue of specified securities, if:
 - (a) a special resolution has been passed by its shareholders;
 - (b) all the equity shares, if any, held by the proposed allottees in the issuer are in dematerialised form;



- (c) the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement with the recognised stock exchange where the equity shares of the issuer are listed;
 - (d) the issuer has obtained the Permanent Account Number of the proposed allottees.
- (2) The issuer shall not make preferential issue of specified securities to any person who has sold any equity shares of the issuer during the six months preceding the relevant date:
- Provided that in respect of the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, the Board may grant relaxation from the requirements of this sub-regulation, if the Board has granted relaxation in terms of regulation 29A of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 to such preferential allotment.
- Explanation.**—Where any person belonging to promoter(s) or the promoter group has sold his equity shares in the issuer during the six months preceding the relevant date, the promoter(s) and promoter group shall be ineligible for allotment of specified securities on preferential basis.
- (3) Where any person belonging to promoter(s) or the promoter group has previously subscribed to warrants of an issuer but failed to exercise the warrants, the promoter(s) and promoter group shall be ineligible for issue of specified securities of such issuer on preferential basis for a period of one year from:
- (a) the date of expiry of the tenure of the warrants due to non-exercise of the option to convert; or
 - (b) the date of cancellation of the warrants, as the case may be.

Disclosures [Regulation 73]

- (1) The issuer shall, in addition to the disclosures required under section 173 of the Companies Act, 1956 or any other applicable law, disclose the following in the explanatory statement to the notice for the general meeting proposed for passing special resolution:
- (a) the objects of the preferential issue;
 - (b) the proposal of the promoters, directors or key management personnel of the issuer to subscribe to the offer;
 - (c) the shareholding pattern of the issuer before and after the preferential issue;
 - (d) the time within which the preferential issue shall be completed;
 - (e) the identity of the proposed allottees, the percentage of post preferential issue capital that may be held by them and change in control, if any, in the issuer consequent to the preferential issue;
 - (f) an undertaking that the issuer shall re-compute the price of the specified securities in terms of the provision of these regulations where it is required to do so;
 - (g) an undertaking that if the amount payable on account of there-computation of price is not paid within the time stipulated in these regulations, the specified securities shall continue to be locked-in till the time such amount is paid by the allottees.
- (2) The issuer shall place a copy of the certificate of its statutory auditor before the general meeting of the shareholders, considering the proposed preferential issue, certifying that the issue is being made in accordance with the requirements of these regulations.
- (3) Where specified securities are issued on a preferential basis to promoters, their relatives, associates and related entities for consideration other than cash, the valuation of the assets in consideration for which the equity shares are issued shall be done by an independent qualified valuer, which

shall be submitted to the recognised stock exchanges where the equity shares of the issuer are listed:

Provided that if the recognised stock exchange is not satisfied with the appropriateness of the valuation, it may get the valuation done by any other valuer and for this purpose it may obtain any information, as deemed necessary, from the issuer.

- (4) The special resolution shall specify the relevant date on the basis of which price of the equity shares to be allotted on conversion or exchange of convertible securities shall be calculated.

Explanation: For the purpose of sub-regulation (3), the term 'valuer' has the same meaning as is assigned to it under clause (r) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Issue of Sweat Equity) Regulations, 2002.

Allotment pursuant to special resolution [Regulation 74]

- (1) Allotment pursuant to the special resolution shall be completed within a period of fifteen days from the date of passing of such resolution:

Provided that where any application for exemption from the applicability of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 or any approval or permission by any regulatory authority or the Central Government for allotment is pending, the period of fifteen days shall be counted from the date of order on such application or the date of approval or permission, as the case may be:

Provided further that where the Board has granted relaxation to the issuer in terms of regulation 29A of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, shall be made by it within such time as may be specified by the Board in its order granting the relaxation:

Provided further that requirement of allotment within fifteen days shall not apply to allotment of specified securities on preferential basis pursuant to a scheme of corporate debt restructuring as per the corporate debt restructuring framework specified by the Reserve Bank of India.

- (2) If the allotment of specified securities is not completed within fifteen days from the date of special resolution, a fresh special resolution shall be passed and the relevant date for determining the price of specified securities under this Chapter will be taken with reference to the date of latter special resolution.
- (3) Notwithstanding anything contained in this regulation, where a preferential allotment is made that attracts an obligation to make an open offer for shares of the issuer under Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, and there is no offer made under sub-regulation (1) of regulation 20 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, the period of fifteen days shall be counted from the expiry of the period specified in sub-regulation (1) of regulation 20 or date of receipt of all statutory approvals required for the completion of an open offer under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011:

Provided that if an offer is made under sub-regulation (1) of regulation 20 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, the period of fifteen days shall be counted from the expiry of the offer period as defined in the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011:

Provided further that the provisions of this sub-regulation shall not apply to an offer made under sub-regulation (1) of regulation 20 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, pursuant to a preferential allotment.]



Tenure of convertible securities [Regulation 75]

The tenure of the convertible securities of the issuer shall not exceed eighteen months from the date of their allotment.

Pricing of equity shares [Regulation 76]

- (1) If the equity shares of the issuer have been listed on a recognised stock exchange for a period [twenty six weeks] or more as on the relevant date, the equity shares shall be allotted at a price not less than higher of the following:
 - (a) The average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the [twenty six weeks] preceding the relevant date; or
 - (b) The average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.
- (2) If the equity shares of the issuer have been listed on a recognised stock exchange for a period of less than [twenty six weeks] as on the relevant date, the equity shares shall be allotted at a price not less than the higher of the following:
 - (a) the price at which equity shares were issued by the issuer in its initial public offer or the value per share arrived at in a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, pursuant to which the equity shares of the issuer were listed, as the case may be; or
 - (b) the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the period shares have been listed preceding the relevant date; or
 - (c) the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.
- (3) Where the price of the equity shares is determined in terms of sub-regulation (2), such price shall be recomputed by the issuer on completion of [twenty six weeks] from the date of listing on a recognised stock exchange with reference to the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during these [twenty six weeks] and if such recomputed price is higher than the price paid on allotment, the difference shall be paid by the allottees to the issuer.
- (4) Any preferential issue of specified securities, to qualified institutional buyers not exceeding five in number, shall be made at a price not less than the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

Explanation.- For the purpose of this regulation, 'stock exchange' means any of the recognised stock exchanges in which the equity shares are listed and in which the highest trading volume in respect of the equity shares of the issuer has been recorded during the preceding [twenty six weeks] prior to the relevant date.

Payment of consideration [Regulation 77]

- (1) Full consideration of specified securities other than warrants issued under this Chapter shall be paid by the allottees at the time of allotment of such specified securities:

Provided that in case of a preferential issue of specified securities pursuant to a scheme of corporate debt restructuring as per the corporate debt restructuring framework specified by the

Reserve Bank of India, the allottee may pay the consideration in terms of such scheme.

- (2) An amount equivalent to at least twenty five per cent of the consideration determined in terms of regulation 76 shall be paid against each warrant on the date of allotment of warrants.
- (3) The balance seventy five per cent of the consideration shall be paid at the time of allotment of equity shares pursuant to exercise of option against each such warrant by the warrant holder.
- (4) In case the warrant holder does not exercise the option to take equity shares against any of the warrants held by him, the consideration paid in respect of such warrant in terms of sub-regulation (2) shall be forfeited by the issuer.

Lock-in of specified securities [Regulation 78]

- (1) The specified securities allotted on preferential basis to promoter or promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to promoter or promoter group, shall be locked-in for a period of three years from the date of allotment of the specified securities or equity shares allotted pursuant to exercise of the option attached to warrant, as the case may be:

Provided that not more than twenty per cent of the total capital of the issuer shall be locked-in for three years from the date of allotment:

Provided further that equity shares allotted in excess of the twenty per cent shall be locked-in for one year from the date of their allotment pursuant to exercise of options or otherwise, as the case may be.

- (2) The specified securities allotted on preferential basis to persons other than promoter and promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to such persons shall be locked-in for a period of one year from the date of their allotment.
- (3) The lock-in of equity shares allotted pursuant to conversion of convertible securities other than warrants, issued on preferential basis shall be reduced to the extent the convertible securities have already been locked-in.
- (4) The equity shares issued on preferential basis pursuant to a scheme of corporate debt restructuring as per the Corporate Debt Restructuring framework specified by the Reserve Bank of India shall be locked-in for a period of one year from the date of allotment:

Provided that partly paid up equity shares, if any, shall be locked-in from the date of allotment and the lock-in shall end on the expiry of one year from the date when such equity shares become fully paid up.

- (5) If the amount payable by the allottee, in case of re-calculation of price under sub-regulation (3) of regulation 76 is not paid till the expiry of lock-in period, the equity shares shall continue to be locked-in till such amount is paid by the allottee.
- (6) The entire pre-preferential allotment shareholding of the allottees, if any, shall be locked-in from the relevant date upto a period of six months from the date of preferential allotment.

Explanation.- For the purpose of this regulation:

- (I) The expression "total capital of the issuer" means:
 - (a) equity share capital issued by way of public issue or rights issue including equity shares issued pursuant to conversion of specified securities which are convertible; and
 - (b) specified securities issued on a preferential basis to promoter or promoter group.
- (II) (a) For the computation of twenty per cent of the total capital of the issuer, the amount of minimum promoters' contribution held and locked-in, in the past in terms of Securities



and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000 or these regulations shall be taken into account.

(b) The minimum promoters' contribution shall not again be put under fresh lock-in, even though it is considered for computing the requirement of twenty per cent of the total capital of the issuer, in case the said minimum promoters' contribution is free of lock-in at the time of the preferential issue.

Transferability of locked-in specified securities and warrants issued on preferential basis [Regulation 79]

Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, specified securities held by promoters and locked-in in terms of sub-regulation (1) of regulation 78 may be transferred among promoters or promoter group or to a new promoter or persons in control of the issuer :

Provided that lock-in on such specified securities shall continue for the remaining period with the transferee.

QUALIFIED INSTITUTIONS PLACEMENT

Applicability [Regulation 80]

The provisions of this Chapter shall apply to a qualified institutions placement made by a listed issuer.

Definitions [Regulation 81]

For the purpose of this Chapter:

- (a) "eligible securities" include equity shares, non-convertible debt instruments along with warrants and convertible securities other than warrants;
- (b) "qualified institutions placement" means allotment of eligible securities by a listed issuer to qualified institutional buyers on private placement basis in terms of these regulations;
- (c) "relevant date" means:
 - (i) in case of allotment of equity shares, the date of the meeting in which the board of directors of the issuer or the committee of directors duly authorised by the board of directors of the issuer decides to open the proposed issue;
 - (ii) in case of allotment of eligible convertible securities, either the date of the meeting in which the board of directors of the issuer or the committee of directors duly authorised by the board of directors of the issuer decides to open the issue of such convertible securities or the date on which the holders of such convertible securities become entitled to apply for the equity shares.

Conditions for qualified institutions placement [Regulation 82]

A listed issuer may make qualified institutions placement if it satisfies the following conditions:

- (a) a special resolution approving the qualified institutions placement has been passed by its shareholders;
- (b) the equity shares of the same class, which are proposed to be allotted through qualified institutions placement or pursuant to conversion or exchange of eligible securities offered through qualified institutions placement, have been listed on a recognised stock exchange having nationwide trading terminal for a period of at least one year prior to the date of issuance of notice to its shareholders for convening the meeting to pass the special resolution:

Provided that where an issuer, being a transferee-company in a scheme of merger, demerger, amalgamation or arrangement sanctioned by a High Court under sections 391 to 394 of the Companies Act, 1956, makes qualified institutions placement, the period for which the equity

shares of the same class of the transferor-company were listed on a stock exchange having nationwide trading terminals shall also be considered for the purpose of computation of the period of one year;

- (c) it is in compliance with the requirement of minimum public shareholding specified in the Securities Contracts (Regulation) Rules, 1957;
- (d) in the special resolution, it shall be, among other relevant matters, specified that the allotment is proposed to be made through qualified institutions placement and the relevant date referred to in sub-clause (ii) of clause (c) of regulation 81 shall also be specified.

Explanation.—For the purpose of clause (b), “equity shares of the same class” shall have the same meaning as assigned to them in Explanation to sub-rule (4) of rule 19 of the Securities Contracts (Regulation) Rules, 1957.

Appointment of merchant banker [Regulation 83]

- (1) A qualified institutions placement shall be managed by merchant banker(s) registered with the Board who shall exercise due diligence.
- (2) The merchant banker shall, while seeking in-principle approval for listing of the eligible securities issued under qualified institutions placement, furnish to each stock exchange on which the same class of equity shares of the issuer are listed, a due diligence certificate stating that the eligible securities are being issued under qualified institutions placement and that the issuer complies with requirements of this Chapter.

Placement document [Regulation 84]

- (1) The qualified institutions placement shall be made on the basis of a placement document which shall contain all material information, including those specified in Schedule XVIII.
- (2) The placement document shall be serially numbered and copies shall be circulated only to select investors.
- (3) The issuer shall, while seeking in-principle approval from the recognised stock exchange, furnish a copy of the placement document, a certificate confirming compliance with the provisions of this Chapter along with any other documents required by the stock exchange.
- (4) The placement document shall also be placed on the website of the concerned stock exchange and of the issuer with a disclaimer to the effect that it is in connection with a qualified institutions placement and that no offer is being made to the public or to any other category of investors.

Pricing [Regulation 85]

- (1) The qualified institutions placement shall be made at a price not less than the average of the weekly high and low of the closing prices of the equity shares of the same class quoted on the stock exchange during the two weeks preceding the relevant date 2[:]

Provided that the issuer may offer a discount of not more than five per cent on the price so calculated for the qualified institutions placement, subject to approval of shareholders as specified in clause (f) of regulation 82 of these regulations

- (2) Where eligible securities are convertible into or exchangeable with equity shares of the issuer, the issuer shall determine the price of such equity shares allotted pursuant to such conversion or exchange taking the relevant date as decided and disclosed by it while passing the special resolution.
- (3) The issuer shall not allot partly paid up eligible securities:

Provided that in case of allotment of non-convertible debt instruments along with warrants, the



allottees may pay the full consideration or part thereof payable with respect to warrants, at the time of allotment of such warrants:

Provided further that on allotment of equity shares on exercise of options attached to warrants, such equity shares shall be fully paid up.

- (4) The prices determined for qualified institutions placement shall be subject to appropriate adjustments if the issuer:
- (a) makes an issue of equity shares by way of capitalization of profits or reserves, other than by way of a dividend on shares;
 - (b) makes a rights issue of equity shares;
 - (c) consolidates its outstanding equity shares into a smaller number of shares;
 - (d) divides its outstanding equity shares including by way of stock split;
 - (e) re-classifies any of its equity shares into other securities of the issuer;
 - (f) is involved in such other similar events or circumstances, which in the opinion of the concerned stock exchange, requires adjustments.

Explanation.—For the purpose of sub-regulation (1), the term “stock exchange” means any of the recognized stock exchanges in which the equity shares of the same class of the issuer are listed and in which the highest trading volume in such equity shares has been recorded during the two weeks immediately preceding the relevant date.

Restrictions on allotment [Regulation 86]

- (1) Allotment under the qualified institutions placement shall be made subject to the following conditions:
- (a) Minimum of ten per cent of eligible securities shall be allotted to mutual funds:
Provided that if the mutual funds do not subscribe to said minimum percentage or any part thereof, such minimum portion or part thereof may be allotted to other qualified institutional buyers;
 - (b) No allotment shall be made, either directly or indirectly, to any qualified institutional buyer who is a promoter or any person related to promoters of the issuer:
Provided that a qualified institutional buyer who does not hold any shares in the issuer and who has acquired the said rights in the capacity of a lender shall not be deemed to be a person related to promoters.
- (2) In a qualified institutions placement of non-convertible debt instrument along with warrants, an investor can subscribe to the combined offering of non-convertible debt instruments with warrants or to the individual securities, that is, either non-convertible debt instruments or warrants.
- (3) The applicants in qualified institutions placement shall not withdraw their bids after the closure of the issue.

Explanation.—For the purpose of clause (b) of sub-regulation (1), a qualified institutional buyer who has any of the following rights shall be deemed to be a person related to the promoters of the issuer:

- (a) rights under a shareholders' agreement or voting agreement entered into with promoters or persons related to the promoters;
- (b) veto rights; or
- (c) right to appoint any nominee director on the board of the issuer.

Minimum number of allottees [Regulation 87]

- (1) The minimum number of allottees for each placement of eligible securities made under qualified institutions placement shall not be less than:
 - (a) two, where the issue size is less than or equal to two hundred and fifty crore rupees;
 - (b) five, where the issue size is greater than two hundred and fifty crore rupees;Provided that no single allottee shall be allotted more than fifty per cent of the issue size.
- (2) The qualified institutional buyers belonging to the same group or who are under same control shall be deemed to be a single allottee.

Explanation.—For the purpose of sub-regulation (2), the expression “qualified institutional buyers belonging to the same group” shall have the same meaning as derived from sub-section (11) of section 372 of the Companies Act, 1956.

Validity of the special resolution [Regulation 88]

- (1) Allotment pursuant to the special resolution referred to in clause (a) of regulation 82 shall be completed within a period of twelve months from the date of passing of the resolution.
- (2) The issuer shall not make subsequent qualified institutions placement until expiry of six months from the date of the prior qualified institutions placement made pursuant to one or more special resolutions.

Restrictions on amount raised [Regulation 89]

The aggregate of the proposed qualified institutions placement and all previous qualified institutions placements made by the issuer in the same financial year shall not exceed five times the net worth of the issuer as per the audited balance sheet of the previous financial year.

Tenure [Regulation 90]

The tenure of the convertible or exchangeable eligible securities issued through qualified institutions placement shall not exceed sixty months from the date of allotment.

Transferability of eligible securities [Regulation 91]

The eligible securities allotted under qualified institutions placement shall not be sold by the allottee for a period of one year from the date of allotment, except on a recognised stock exchange.

INSTITUTIONAL PLACEMENT PROGRAMME

Applicability [Regulation 91A]

- (1) The provisions of this Chapter shall apply to issuance of fresh shares and or offer for sale of shares in a listed issuer for the purpose of achieving minimum public shareholding in terms of rules 19(2) (b) and 19A of the Securities Contracts (Regulation) Rules, 1957.
- (2) Unless otherwise specified, no provisions of these regulations shall be applicable to the institutional placement programme except for the following:—
 - (a) regulations 2, 5, 12, 18, 19, 47, 48, 51, 59, 60, 61, 64, 65, 66 and 68;
 - (b) clauses (a) and (b) of sub-regulation (2) of regulation 4;
 - (c) clause (b) of regulation 7.

Definitions [Regulation 91B]

For the purpose of this Chapter:

- (a) “eligible securities” shall mean equity shares of same class listed and traded in the stock exchange(s);



- (b) “eligible seller” include listed issuer, promoter/promoter group of listed issuer;
- (c) “institutional placement programme” means a further public offer of eligible securities by an eligible seller, in which the offer, allocation and allotment of such securities is made only to qualified institutional buyers in terms of this Chapter.

Conditions for institutional placement programme [Regulation 91C]

- (1) An institutional placement programme, may be made only after a special resolution approving the institutional placement programme has been passed by the shareholders of the issuer in terms of section 81(1 A) of the Companies Act, 1956.
- (2) No partly paid-up securities shall be offered.
- (3) The issuer shall obtain an in-principle approval from the stock exchange(s).

Appointment of merchant banker [Regulation 91D]

An institutional placement programme shall be managed by merchant banker(s) registered with the Board who shall exercise due diligence.

Offer Document [Regulation 91E]

- (1) The institutional placement programme shall be made on the basis of the offer document which shall contain all material information, including those specified in Schedule XVIII.
- (2) The issuer shall, simultaneously while registering the offer document with the Registrar of Companies, file a copy thereof with the Board and with the stock exchange(s) through the lead merchant banker.
- (3) The issuer shall file the soft copy of the offer document with the Board as specified in Schedule V, along with the fee as specified in Schedule IV.
- (4) The offer document shall also be placed on the website of the concerned stock exchange and of the issuer clearly stating that it is in connection with institutional placement programme and that the offer is being made only to the qualified institutional buyers.
- (5) The merchant banker shall submit to the Board a due diligence certificate as per Form A of Schedule VI, stating that the eligible securities are being issued under institutional placement programme and that the issuer complies with requirements of this Chapter.

Pricing and allocation/allotment [Regulation 91F].

- (1) The eligible seller shall announce a floor price or price band at least one day prior to the opening of institutional placement programme.
- (2) The eligible seller shall have the option to make allocation/allotment as per any of the following methods—
 - (a) proportionate basis;
 - (b) price priority basis; or
 - (c) criteria as mentioned in the offer document.
- (3) The method chosen shall be disclosed in the offer document.
- (4) Allocation/allotment shall be overseen by stock exchange before final allotment.

Restrictions [Regulation 91G]

- (1) The promoter or promoter group shall not make institutional placement programme if the promoter or any person who is part of the promoter group has purchased or sold the eligible securities during the twelve weeks period prior to the date of the programme and they shall

not purchase or sell the eligible securities during the twelve weeks period after the date of the programme:

Provided that such promoter or promoter group may, within the period provided in sub-regulation (1), offer eligible securities held by them through institutional placement programme or offer for sale through stock exchange mechanism specified by the Board, subject to the condition that there shall be a gap of minimum two weeks between the two successive offer(s) and/or programme(s).

- (2) Allocation/allotment under the institutional placement programme shall be made subject to the following conditions:
 - (a) Minimum of twenty five per cent of eligible securities shall be allotted to mutual funds and insurance companies:

Provided that if the mutual funds and insurance companies do not subscribe to said minimum percentage or any part thereof, such minimum portion or part thereof may be allotted to other qualified institutional buyers;
 - (b) No allocation/allotment shall be made, either directly or indirectly, to any qualified institutional buyer who is a promoter or any person related to promoters of the issuer:

Provided that a qualified institutional buyer who does not hold any shares in the issuer and who has acquired the rights in the capacity of a lender shall not be deemed to be a person related to promoters.
- (3) The issuer shall accept bids using ASBA facility only.
- (4) The bids made by the applicants in institutional placement programme shall not be revised downwards or withdrawn.

Explanation.- For the purpose of clause (b) of sub-regulation (2), a qualified institutional buyer who has any of the following rights shall be deemed to be a person related to the promoters of the issuer:—

- (a) rights under a shareholders' agreement or voting agreement entered into with promoters or persons related to the promoters;
- (b) veto rights; or
- (c) right to appoint any nominee director on the board of the issuer.

Minimum number of allottees [Regulation 91H]

- (1) The minimum number of allottees for each offer of eligible Securities made under institutional placement programme shall not be less than ten;

Provided that no single allottee shall be allotted more than twenty five percent of the offer size.
- (2) The qualified institutional buyers belonging to the same group or who are under same control shall be deemed to be a single allottee.

Explanation.- For the purpose of sub-regulation (2), the expression "qualified institutional buyers belonging to the same group" shall have the same meaning as derived from sub-section (11) of section 372 of the Companies Act, 1956;

Restrictions on size of the offer [Regulation 91-I]

- (1) The aggregate of all the tranches of institutional placement programme made by the eligible seller shall not result in increase in public shareholding by more than ten per cent or such lesser per cent as is required to reach minimum public shareholding.



- (2) Where the issue has been oversubscribed, an allotment of not more than ten per cent of the offer size shall be made by the eligible seller.

Period of Subscription and display of demand [Regulation 91J]

- (1) The issue shall be kept open for a minimum of one day or maximum of two days.
- (2) The aggregate demand schedule shall be displayed by stock exchange(s) without disclosing the price.

Withdrawal of offer [Regulation 91K]

The eligible seller shall have, the right to withdraw the offer in cost it is not fully subscribed.

Transferability of eligible securities [Regulation 91L]

The eligible securities allotted under institutional placement programme shall not be sold by the allottee for a period of one year from the date of allocation/allotment, except on a recognised stock exchange

BONUS ISSUE

Conditions for bonus issue [Regulation 92]

Subject to the provisions of the Companies Act, 1956 or any other applicable law for the time being in force, a listed issuer may issue bonus shares to its members if:

- (a) it is authorised by its articles of association for issue of bonus shares, capitalisation of reserves, etc.:
Provided that if there is no such provision in the articles of association, the issuer shall pass a resolution at its general body meeting making provisions in the articles of association for capitalisation of reserve;
- (b) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- (c) it has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus;
- (d) the partly paid shares, if any outstanding on the date of allotment, are made fully paid up.

Restriction on bonus issue [Regulation 93]

- (1) No issuer shall make a bonus issue of equity shares [***] unless it has made reservation of equity shares of the same class in favour of the holders of 2[***] outstanding [compulsorily] convertible debt instruments 3[, if any in proportion to the convertible part thereof.
- (2) The equity shares so reserved for the holders of fully or partly\ compulsorily\ convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms or same proportion [of] which the bonus shares were issued.

Bonus shares only against reserves, etc. if capitalised in cash [Regulation 94]

- (1) The bonus issue shall be made out of free reserves built out of the genuine profits or securities premium collected in cash only and reserves created by revaluation of fixed assets shall not be capitalised for the purpose of issuing bonus shares.
- (2) Without prejudice to the provisions of sub-regulation (1), the bonus share shall not be issued in lieu of dividend.

Completion of bonus issue [Regulation 95]

- (1) An issuer, announcing a bonus issue after the approval of its board of directors and not requiring shareholders' approval for capitalisation of profits or reserves for making the bonus issue, shall

implement the bonus issue within fifteen days from the date of approval of the issue by its board of directors:

Provided that where the issuer is required to seek shareholders' approval for capitalisation of profits or reserves for making the bonus issue, the bonus issue shall be implemented within two months from the date of the meeting of its board of directors wherein the decision to announce the bonus issue was taken subject to shareholders' approval.

- (2) Once the decision to make a bonus issue is announced, the issue cannot be withdrawn.

ISSUE OF INDIAN DEPOSITORY RECEIPTS

Applicability [Regulation 96]

- (1) The provisions of this Chapter shall apply to an issue of Indian Depository Receipts (hereinafter referred to as "IDR") made in terms of section 605A of the Companies Act, 1956 and Companies (Issue of Indian Depository Receipts) Rules, 2004.
- (2) All provisions of these regulations shall be applicable in case of issue of IDR, except the disclosure requirements with respect to public issue and rights issue of specified securities as provided in these regulations and the following:
 - (a) clauses (a), (b), (c) and (f) of sub-regulation (2) of regulation 4;
 - (b) sub-regulations (1), (2) and (3) of regulation 6;
 - (c) clauses (c), (d) and (e) of sub-regulation (1) of regulation 8;
 - (d) sub-regulations (2) and (3) of regulation 8;
 - (e) regulations 10, 16, 17, 19, 20, 21, 22, 23, 24, 26, 27, 31, 41, 42, '[***] 45, 47, 49 and 68;
 - (f) sub-regulation (2) of regulation 11;
 - (g) sub-regulation (2) of regulation 28;
 - (h) clauses (b) and (c) of regulation 29;
 - (i) Parts III and IV of Chapter III;
 - (ia) regulation 43, except sub-regulation (3) thereof;
 - (j) Chapter IV;
 - (K) sub-regulation (3) of regulation 65;
 - (l) Chapters VII, VITI and IX.
- (3) Further, the applicability of regulation 60 shall be as follows:
 - (a) the applicability of sub-regulations (1) and (7) and Explanation II shall be restricted to any issue advertisements made in India or any research report circulated in India, pertaining to the IDR issue of the issuing company;
 - (b) the applicability of sub-regulations (2) and (3) shall be restricted to any public communications and publicity material issued or published in any media in India;
 - (c) the applicability of sub-regulations (5) and (6) shall be restricted to any material or information released in India and any issue advertisements and publicity materials issued or published in any media in India;
 - (d) the applicability of sub-regulation (13) shall be restricted to any product advertisement of an issuing company issued or published in any media in India;
 - (e) all other provisions of regulation 60 shall be applicable.



Eligibility [Regulation 97]

An issuing company making an issue of IDR shall also satisfy the following:

- (a) the issuing company is listed in its home country;
- (b) the issuing company is not prohibited to issue securities by any regulatory body;
- (c) the issuing company has track record of compliance with securities market regulations in its home country.

Explanation.—For the purpose of this regulation, the term “home country” means the country where the issuing company is incorporated and listed.

Conditions for issue of IDR [Regulation 98]

An issue of IDR shall be subject to the following conditions:

- (a) issue size shall not be less than fifty crore rupees;
- (b) procedure to be followed by each class of applicant for applying shall be mentioned in the prospectus;
- (c) minimum application amount shall be twenty thousand rupees;
- (d) at least fifty per cent of the IDR issued shall be allotted to qualified institutional buyers on proportionate basis as per illustration given in Part C of Schedule XI;
- (e) the balance fifty per cent may be allocated among the categories of non-institutional investors and retail individual investors including employees at the discretion of the issuer and the manner of allocation shall be disclosed in the prospectus. Allotment to investors within a category shall be on proportionate basis :

Provided that at least thirty per cent of the IDRs being offered in the public issue shall be available for allocation to retail individual investors and in case of under subscription in retail individual investor category, spillover to other categories to the extent of under subscription may be permitted.

Explanation — For the purpose of this regulation, “employee” shall mean a person who, —

- (a) is a resident of India, and
- (b) is a permanent and full-time employee or a director, whether whole time or part time, of the issuer or of the holding company or subsidiary company or of the material associate(s) of the issuer; whose financial statements are consolidated with the issuer’s financial statements, working in India and does not include promoters and an immediate relative of the promoter (i.e., any spouse of that person, or any parent, brother, sister or child of the person or of the spouse);
- (f) at any given time, there shall be only one denomination of IDR of the issuing company.

Minimum subscription [Regulation 99]

(1) For non-underwritten issues:

- (a) If the issuing company does not receive the minimum subscription of ninety per cent of the offer through offer document on the date of closure of the issue, or if the subscription level falls below ninety per cent after the closure of issue on account of cheques having being returned unpaid or withdrawal of applications, the issuing company shall forthwith refund the entire subscription amount received.
- (b) If the issuing company fails to refund the entire subscription amount within fifteen days from the date of the closure of the issue, it is liable to pay the amount with interest to the subscribers at the rate of fifteen per cent per annum for the period of delay.

- (2) For underwritten issues: If the issuing company does not receive the minimum subscription of ninety per cent of the offer through offer document including devolvment of underwriters within sixty days from the date of closure of the issue, the issuing company shall forthwith refund the entire subscription amount received with interest to the subscribers at the rate of fifteen per cent per annum for the period of delay beyond sixty days.

Fungibility [Regulation 100]

The Indian Depository Receipts shall not be automatically fungible into underlying equity shares of issuing company.

Filing of draft prospectus, due diligence certificates, payment of fees and issue advertisement for IDR [Regulation 101]

- (1) The issuing company making an issue of IDR shall enter into an agreement with a merchant banker on the lines of format of agreement specified in Schedule II.
- (2) Where the issue is managed by more than one merchant banker, the rights, obligations and responsibilities, relating inter alia to disclosures, allotment, refund and underwriting obligations, if any, of each merchant banker shall be predetermined and disclosed in the prospectus on the lines of format as specified in Schedule I.
- (3) The issuing company shall file a draft prospectus with the Board through a merchant banker along with the requisite fee, as prescribed in Companies (Issue of Indian Depository Receipts) Rules, 2004.
- (4) The prospectus filed with the Board under this regulation shall also be furnished to the Board in a soft copy on the lines specified in Schedule V.
- (5) The lead merchant bankers shall:
 - (a) submit a due diligence certificate as per format given in Part C of Schedule XIX to the Board along with the draft prospectus;
 - (b) certify that all amendments, suggestions or observations made by the Board have been incorporated in the prospectus;
 - (c) submit a fresh due diligence certificate as per format given in Part C of Schedule XIX, at the time of filing the prospectus with the Registrar of the Companies;
 - (d) furnish a certificate as per format given in Part C of Schedule XIX, immediately before the opening of the issue, certifying that no corrective action is required on its part;
 - (e) furnish a certificate as per format given in Part C of Schedule XIX, after the issue has opened but before it closes for subscription.
- (6) The issuing company shall make arrangements for mandatory collection centres as specified in Schedule III.
- (7) The issuing company shall issue an advertisement in one English national daily circulation and one Hindi national daily newspaper with wide circulation, soon after receiving final observations, if any, on the publicly filed draft prospectus with the board, which shall be on the lines of the format and contain the ; as given in Part A of Schedule XIII.

Display of bid data [Regulation 102]

The stock exchanges offering online bidding system for the book building process shall display on their website, the data pertaining to book built IDR issue, in the format specified in Part B(II) of Schedule XI, from the date of opening of the bids till at least three days after closure of bids.



Disclosures in prospectus and abridged prospectus [Regulation 103]

- (1) The prospectus shall contain all material disclosures which are true, correct and adequate so as to enable the applicants to take an informed investment decision.
- (2) Without prejudice to the generality of sub-regulation (1), the prospectus shall contain:
 - (a) the disclosures specified in Schedule to Companies (Issue of Indian Depository Receipts) Rules, 2004, and
 - (b) the disclosures in the manner as specified in Part A of Schedule XIX.

Post-issue reports [Regulation 104]

- (1) The merchant banker shall submit post-issue reports to the Board in accordance with sub-regulation (2).
- (2) The post-issue reports shall be submitted as follows:
 - (a) initial post-issue reports on the lines of Parts A and B of Schedule XVI, within three days of closure of the issue;
 - (b) final post-issue report on the lines of Parts C and D of Schedule XVI, within fifteen days of the date of finalization of basis of allotment or within fifteen days of refund of money in case of failure of issue.

Undersubscribed issue [Regulation 105]

In case of undersubscribed issue of IDR, the merchant banker shall furnish information in respect of underwriters who have failed to meet their underwriting development to the Board on the lines of the format specified in Schedule XVII.

Finalization of basis of allotment [Regulation 106]

The executive director or managing director of the stock exchange, where the IDR are proposed to be listed, along with the post-issue lead merchant bankers and registrars to the issue shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the allotment procedure as specified in Schedule XV.

RIGHTS ISSUE OF INDIAN DEPOSITORY RECEIPTS

Applicability [Regulation 106A]

- (1) In addition to compliance with Chapter X, a listed issuer offering IDR through a rights issue shall satisfy the conditions specified in this Chapter at the time of filing the offer document:

Provided that the provisions of the following regulations shall not be applicable in case of rights issue of IDRs:

 - (a) clauses (a), (b), (c), (d) and (e) of regulation 98;
 - (b) regulation 102; and
 - (c) regulation 103.
- (2) Every listed issuer offering IDRs through a rights issue shall prepare the offer document in accordance with the home country requirements along with an addendum containing disclosures as specified in Part A of Schedule XXI and regulation 106F and file the same with the Board and the stock exchanges on which the IDRs of the issuer are listed.

Eligibility [Regulation 106B]

No issuer shall make a rights issue of IDRs:

- (a) if at the time of undertaking the rights issue, the issuer is in breach of ongoing material obligations

under the IDR Listing Agreement as may be applicable to such issuer or material obligations under the deposit agreement entered into between the domestic depository and the issuer at the time of initial offering of IDRs; and

- (b) unless it has made an application to all the recognised stock exchanges in India, where its IDRs are already listed, for listing of the IDRs to be issued by way of rights and has chosen one of them as the designated stock exchange.

Renunciation by an IDR holder [Regulation 106C]

Unless the laws of the home jurisdiction of the issuer company otherwise provide, the rights offering shall be deemed to include a right exercisable by the person concerned to renounce the IDRs offered to the IDR holder in favour of any other person subject to applicable laws and the same shall be disclosed in the offer document.

Depository [Regulation 106D]

The domestic depository shall, in accordance with the depository agreement executed with the issuer at the time of initial offering of IDRs, take such steps as are necessary to enable the IDR holders to have entitlements under the rights offering and issue additional IDRs to such IDR holders, distribute the rights to the IDR Holders/renounces or arrange for the IDR holders/renounces to subscribe for any additional rights which are available due to lack of take-up by other holders of underlying shares.

Record Date [Regulation 106E]

- (1) A listed issuer making a rights issue of IDRs shall in accordance with provisions of the listing agreement, announce a record date for the purpose of determining the shareholders eligible to apply for IDRs in the proposed rights issue.
- (2) if the issuer withdraws the rights issue after announcing the record date, it shall notify the Board about the same and shall notify the same in one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where principal office of the issuer is situated in India. If the issuer withdraws the rights issue after announcing the record, date, it shall not make an application for offering of IDRs on a rights basis for a period of twelve months from the said record, date.

Disclosures in the offer document and the addendum for the rights offering [Regulation 106F]

- (1) The offer document for the rights offering shall contain disclosures as required under the home country regulations of the issuer.
- (2) Apart from the disclosures as required under the home country regulations, an additional wrap (addendum to offer document) shall be attached to the offer document to be circulated in India containing information as specified in Part A of Schedule XXI and other instructions as to the procedures and process to be followed with respect to rights issue of IDRs in India.
- (3) Without prejudice to the generality of sub-regulations (1) and (2), the offer document and the addendum attached with it, shall contain all material information, which are true, correct and adequate, so as to enable the applicants to take an informed investment decision.

Filing of draft offer document and the addendum for rights offering [Regulation 106G]

- (1) The issuer shall appoint one or more merchant bankers, one of whom shall be a lead merchant banker and shall also appoint other intermediaries, in consultation with the lead merchant banker, to carry out the obligations relating to the issue.
- (2) The issuer shall, through the lead merchant banker, file the draft offer document prepared in accordance with the home country requirements along with an addendum containing disclosures



as specified in Part A of Schedule XXI with the Board, as a confidential filing accompanied with fees as specified in Part A of Schedule IV.

- (3) The Board may specify changes or issue observations, if any, on the draft offer document and the addendum within thirty days or from the following, dates, whichever is later:
 - (a) the, date of receipt of the draft offer document prepared in accordance with the home country requirements along with an addendum under sub-regulation (2); or
 - (b) the, date of receipt of satisfactory reply from the lead merchant bankers, where the Board has sought any clarification or additional information from them; or
 - (c) the, date of receipt of clarification or information from any regulator or agency, where the Board has sought any clarification or information from such regulator or agency; or
 - (d) the date of receipt of a copy of in-principle approval letter issued by the recognised stock exchanges.
- (4) If the Board specifies changes or issues observations on the draft offer document and the addendum under sub-regulation (3), the issuer and the merchant banker shall file the revised draft offer document and the updated addendum after incorporating the changes suggested or specified by the Board.
- (5) The issuer shall also submit an undertaking from the Overseas Custodian and Domestic Depository addressed to the issuer, to comply with their obligations with respect to the said rights issue under their respective agreements entered into between them, along with the offer document.
- (6) The issuer shall ensure that the Compliance Officer, in charge of ensuring compliance with the obligations under this Chapter, functions from within the territorial limits of India.

Fast track issue [Regulation 106H]

- (1) Nothing contained in sub-regulations (1), (2), (3) and (4) of regulation 106G shall apply, if the issuer satisfies the following conditions:
 - (a) the issuer is in compliance in all material respects with the provisions of deposit agreement and the provisions of listing agreements (or listing conditions) applicable in all the jurisdictions wherever the issuer is listed, for a period of at least three years immediately preceding the date of filing of the offer document, and a certification to this effect is provided by the issuer;
 - (b) the offer document for the rights offering of the securities of the issuer has been filed and reviewed by the securities regulator in the home country of the issuer;
 - (c) there are no pending show-cause notices or prosecution proceedings against the issuer or its promoters, where applicable, or whole time directors on the reference date by the Board or the regulatory authorities in its home country restricting them from accessing the capital markets; and
 - (d) the issuer has redressed at least ninety five per cent of the complaints received from the IDR holders before the end of the three months period immediately preceding the month of date of filing the letter of offer with the designated stock exchange.
- (2) Where the conditions in sub-regulation (1) are satisfied, the issuer may opt for rights issue of IDRs by filing a copy of the offer document prepared in accordance with the home country requirements along with an addendum containing disclosures as specified in Part A of Schedule XXI with the Board for record purposes, before filing the same with the recognised stock exchanges.

Dispatch of abridged letter of offer and application form [Regulation 106 - I].

- (1) The abridged letter of offer, containing disclosures as specified in Part B of Schedule XXI, for a

rights offering, along with application form, shall be dispatched through registered post or speed post to all the eligible IDR holders at least three days before the date of opening of the issue and shall be made available on the website of the issuer with appropriate access restrictions at the same time it is made available to the holders of its equity shares:

Provided that a hard copy of the offer document for a rights offering along with the addendum shall be made available at the principal office of the issuer or lead merchant banker to any existing IDR holder who has made a request in this regard,

- (2) The eligible IDR holders who have not received the application form may apply in writing on a plain paper to the domestic depository, along with the requisite application money within the time frame for acceptance.
- (3) The eligible IDR holders making an application otherwise than on the application form shall not renounce their rights and shall not utilize the application form for any purpose including renunciation even if it is received subsequently.
- (4) Where any eligible IDR holder makes an application on an application form as well as on plain paper, such application is liable to be rejected.
- (5) The issue price and the ratio shall be decided simultaneously with record date in accordance with the home country regulations.

Period of subscription [Regulation 106J]

A rights issue shall be open for subscription in India for a period as applicable under the laws of its home country but in no case less than 10 days.

Pre-Issue Advertisement for rights issue [Regulation 106K]

- (1) The issuer shall issue an advertisement for the rights issue disclosing the following:
 - (a) the date of completion of dispatch of the abridged letter of offer and the application form;
 - (b) the centres other than principal office of the issuer in India where the eligible IDR holders may obtain duplicate copies of the application forms in case they do not receive the application form within a reasonable time after opening of the rights issue;
 - (c) a statement that if the eligible IDR holders have neither received the original application forms nor they are in a position to obtain the duplicate forms, they may make application in writing on a plain paper to subscribe to the rights issue;
 - (d) a format to enable the eligible IDR holders, to make the application on a plain paper specifying therein necessary particulars such as name, address, ratio of rights issue, issue price, number of IDRs held, ledger folio numbers, depository participant ID, client ID, number of IDRs entitled and applied for, amount to be paid along with application, and particulars of cheque, etc., to be drawn in favour of the issuer's account;
 - (e) a statement that the applications can be directly sent by the eligible IDR holders through registered post together with the application moneys to the issuer's designated official at the address given in the advertisement;
 - (f) a statement to the effect that if the eligible IDR holder makes an application on plain paper and also on application form both his applications shall be liable to be rejected at the option of the issuer.
- (2) The advertisement shall be made in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where principal office of the issuer is situated in India at least three days before the date of opening of the issue.



Utilization of funds raised in rights issue [Regulation 106L]

- (1) The issuer shall utilize funds raised in relation to the IDRs pursuant to the rights offering only upon completion of the allotment process.

ISSUE OF SPECIFIED SECURITIES BY SMALL AND MEDIUM ENTERPRISES

Applicability [Regulationw 106M]

- (1) An issuer whose post-issue face value capital does not exceed ten crore rupees shall issue its specified securities in accordance with provisions of this Chapter.
- (2) An issuer, whose post-issue face value capital is more than ten crore rupees aid up to twenty five crore rupees, may also issue specified securities in accordance with provisions of this Chapter.
- (3) The provisions of these regulations, in respect of the matters not specifically dealt or excluded under this Chapter, shall mutatis mutandis apply to any issue of specified securities under this Chapter :

Provided that provisions of sub-regulations (1), (2) and (3) of regulation 6, regulation 7, regulation 8, regulation 9, regulation 10, regulation 25, regulation '26, regulation 27 and sub-regulation (1) of regulation 49 of these regulations shall not apply to an issue of specified securities made under this Chapter.

Definitions [Regulation 106N]

- (1) In this Chapter, unless the context otherwise requires,—
 - (a) "Main Board" means a recognized stock exchange having nationwide trading terminals, other than SME exchange;
 - (b) "nominated investor" means a qualified institutional buyer or private equity fund, who enters into an agreement with the merchant banker to subscribe to the issue in case of under-subscription or to receive or deliver the specified securities in the market-making process.
Explanation—"private equity fund" means a fund registered with any regulatory authority or a fund established by any person registered with any regulatory authority;
 - (c) "SME exchange" means a trading platform of a recognized stock exchange having nationwide trading terminals permitted by the Board to list the specified securities issued in accordance with this Chapter and includes a stock exchange granted recognition for this purpose but does not include the Main Board.
- (2) All other words and expression used in this Chapter but not defined under sub-regulation (1) shall derive their meaning from regulation 2 of these regulations.

Filing of offer document and due diligence certificate [Regulation 106 O]

- (1) The issuer making a public issue or rights issue of specified securities under this Chapter shall not file the draft offer document with the Board:

Provided that the issuer shall file a copy of the offer document with the Board through a merchant banker, simultaneously with the filing of the prospectus with the SME exchange and the Registrar of Companies or letter of offer with the SME Exchange:

Provided further that the Board shall not issue any observation on the offer document.

- (2) The merchant banker shall submit a due-diligence certificate as per Form A of Schedule VI including additional confirmations as provided in Form H of Schedule VI along with the offer document of the Board.
- (3) The offer document shall be displayed from the date of filing in terms of sub-regulation (1) on the websites of the Board, the issuer, the merchant banker and the SME exchange where the specified securities offered through the offer document are proposed to be listed.

Underwriting by merchant bankers and underwriters [Regulation 106P]

- (1) The issue made under this Chapter shall be hundred per cent under written.

Explanation- The underwriting under this regulation shall be for the entire hundred per cent of the offer through offer document and shall not be restricted up to the minimum subscription level.

- (2) The merchant banker/s shall underwrite at least fifteen per cent of the issue size on his/their own account/s.
- (3) The issuer in consultation with merchant banker may appoint underwriters in accordance with Securities and Exchange Board of India (Underwriters) Regulations, 1993 and the merchant banker may enter into an agreement with nominated investor indicating therein the number of specified securities which they agree to subscribe at issue price in case of under-subscription.
- (4) If other underwriters fail to fulfill their underwriting obligations or other nominated investors fail to subscribe to unsubscribed portion, the merchant banker shall fulfill the underwriting obligations.
- (5) The underwriters other than the merchant banker and the nominated investors, who have entered into an agreement for subscribing to the issue in case of under-subscription, shall not subscribe to the issue made under this Chapter in any manner except for fulfilling their obligations under their respective agreements with the merchant banker in this regard.
- (6) All the underwriting and subscription arrangements made by the merchant banker shall be disclosed in the offer document.
- (7) The merchant banker shall file an undertaking to the Board that the issue has been hundred per cent underwritten along with the list of underwriters and nominated investors indicating the extent of underwriting or subscriptions commitment made by them, one day before the opening of issue.

Minimum Application Value [Regulation 106Q]

The issuer shall stipulate in the offer document, the minimum application size in terms of number of specified securities which shall not be less than one lakh rupees per application.

Minimum Number of Allottees [Regulation 106R]

No allotment shall be made pursuant to any initial public offer made under this Chapter, if the number of prospective allottees is less than fifty.

Listing of specified securities [Regulation 106S]

- (1) Specified securities issued in accordance with this Chapter shall be listed on SME exchange.
- (2) Where any listed issuer issues specified securities in accordance with provisions of this Chapter it shall migrate the specified securities already listed on any recognized stock exchange/s to the SME exchange.

Migration to SME exchange [Regulation 106T]

A listed issuer whose post-issue face value capital is less than twenty five crore rupees may migrate its specified securities to SME exchange if its shareholders approve such migration by passing a special resolution through postal ballot to this effect and if such issuer fulfils the eligibility criteria for listing laid down by the SME exchange :

Provided that the special resolution shall be acted upon if and only if the votes cast by shareholders other than promoters in favour of the proposal amount to at least two times the number of votes cast by shareholders other than promoter shareholders against the proposal.

Migration to Main Board [Regulation 106U]

- (1) An issuer, whose specified securities are listed on a SME Exchange and whose post issue face

value capital is more than ten crore rupees and up to twenty five crore rupees, may migrate its specified securities to Main Board if its shareholders approve such migration by passing a special resolution through postal ballot to this effect and if such issuer fulfils the eligibility criteria for listing laid down by the Main Board:

Provided that the special resolution shall be acted upon if and only if the votes cast by shareholder other than promoters in favour of the proposal amount to at least two times the number of votes cast by shareholders other than promoter shareholders against the proposal.

- (2) Where the post issue face value capital of an issuer listed on SME exchange is likely to increase beyond twenty five crore rupees by virtue of any further issue of capital by the issuer by way of rights issue, preferential issue, bonus issue, etc. the issuer shall migrate its specified securities listed on SME exchange to Main Board and seek listing of specified securities proposed to be issued on the Main Board subject to the fulfillment of the eligibility criteria for listing of specified securities laid down by the Main Board : Provided that no further issue of capital by the issuer shall be made unless—
 - (a) the shareholders of the issuer have approved the migration by passing a special resolution through postal ballot wherein the votes cast by shareholders other than promoters in favour of the proposal amount to at least two times the number of votes cast by shareholders other than promoter shareholders against the proposal;
 - (b) the issuer has obtained in-principle approval from the Main Board for listing of its entire specified securities on it.

Market Making [Regulation 106V]

- (1) The merchant banker shall ensure compulsory market, making through the stock brokers of SME exchange in the manner specified by the Board for a minimum period of three years from the date of listing of specified securities issued under this Chapter on SME exchange or from the date of migration from Main Board in terms of regulation 2[106T], as the case may be.
- (2) The merchant banker may enter into agreement with nominated investors for receiving or delivering the specified securities in the market making subject to the prior approval by the SME exchange where the specified securities are proposed to be listed.
- (3) The issuer shall disclose the details of arrangement of market making in the offer document.
- (4) The specified securities being bought or sold in the process of market making may be transferred to or from the nominated investor with whom the merchant banker has entered into an agreement for the market making :

Provided that the inventory of the market maker, as on the date of allotment of the specified securities, shall be at least five per cent of the specified securities proposed to be listed on SME exchange.

- (5) The market maker shall buy the entire shareholding of a shareholder of the issuer in one lot, where value of such shareholding is less than the minimum contract size allowed for trading on the SME exchange :

Provided that market maker shall not sell in lots less than the minimum contract size allowed for trading on the SME exchange.

- (6) Market maker shall not buy the shares from the promoters or persons belonging to promoter group of the issuer or any person who has acquired shares from such promoter or person belonging to promoter group, during the compulsory market making period laid down under sub-regulation (1).
- (7) The promoters' holding shall not be eligible for offering to the market maker under this Chapter during the period specified in sub-regulation (1):

Provided that the promoters' holding which is not locked-in as per these regulations can be traded with prior permission of the SME exchange, in the manner specified by the Board.

- (8) Subject to the agreement between the issuer and the merchant banker/s, the merchant banker/s who have the responsibility of market making may be represented on the board of the issuer.

MISCELLANEOUS

Directions by the Board [Regulation 107]

Without prejudice to the power under sections 11, 11A, 1 IB, 1 ID, sub-section (3) of section 12, Chapter VIA and section 24 of the Act or section 621 of the Companies Act, 1956, the Board may either suo motu or on receipt of information or on completion or pendency of any inspection, inquiry or investigation, in the interests of investors or the securities market, issue such directions or orders as it deems fit including any or all of the following:

- (a) directing the persons concerned not to access the securities market for a specified period;
- (b) directing the person concerned to sell or divest the securities;
- (c) any other direction which Board may deem fit and proper in the circumstances of the case:

Provided that the Board shall, either before or after issuing such direction or order, give a reasonable opportunity of being heard to the person concerned:

Provided further that if any interim direction or order is required to be issued, the Board may give post-decisional hearing to the person concerned.

Power to remove difficulty [Regulation 108]

In order to remove any difficulties in the application or interpretation of these regulations, the Board may issue clarifications through guidance notes or circulars after recording reasons in writing.

Power to relax strict enforcement of the regulations [Regulation 109]

The Board may, in the interest of investors or for the development of the securities market, relax the strict enforcement of any requirement of these regulations, if the Board is satisfied that:

- (a) the requirement is procedural in nature; or
- (b) any disclosure requirement is not relevant for a particular class of industry or issuer; or
- (c) the non-compliance was caused due to factors beyond the control of the issuer.

Amendments to other regulations [Regulation 110]

On and from the commencement of these regulations, the regulations mentioned in Schedule XX shall stand amended to the extent specified therein.

Repeal and Savings [Regulation 111]

- (1) On and from the commencement of these regulations, the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000 shall stand rescinded.
- (2) Notwithstanding such rescission:
 - (a) anything done or any action taken or purported to have been done or taken including observation made in respect of any draft offer document, any enquiry or investigation commenced or show cause notice issued in respect of the said Guidelines shall be deemed to have been done or taken under the corresponding provisions of these regulations;
 - (b) any offer document, whether draft or otherwise, filed or application made to the Board under the said Guidelines and pending before it shall be deemed to have been filed or made under the corresponding provisions of these regulations.



3.4 CLAUSE 49- CORPORATE GOVERNANCE

The company agrees to comply with the following provisions:

I. Board of Directors

(A) Composition of Board

- i. The Board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors.
- ii. Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case he is an executive director, at least half of the Board should comprise of independent directors.

Provided that where the non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors.

Explanation-For the purpose of the expression “related to any promoter” referred to in sub-clause (ii):

- a. If the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;
 - b. If the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it.”
- iii. For the purpose of the sub-clause (ii), the expression ‘independent director’ shall mean a non-executive director of the company who:
 - a. apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director;
 - b. is not related to promoters or persons occupying management positions at the board level or at one level below the board;
 - c. has not been an executive of the company in the immediately preceding three financial years;
 - d. is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following:
 - i. the statutory audit firm or the internal audit firm that is associated with the company, and
 - ii. the legal firm(s) and consulting firm(s) that have a material association with the company.
 - e. is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director;
 - f. is not a substantial shareholder of the company i.e. owning two percent or more of the block of voting shares.
 - g. is not less than 21 years of age

Explanation:

For the purposes of the sub-clause (iii):

- a. Associate shall mean a company which is an "associate" as defined in Accounting Standard (AS) 23, "Accounting for Investments in Associates in Consolidated Financial Statements", issued by the Institute of Chartered Accountants of India.
 - b. "Senior management" shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.
 - c. "Relative" shall mean "relative" as defined in section 2(41) and section 6 read with Schedule IA of the Companies Act, 1956.
- iv. Nominee directors appointed by an institution which has invested in or lent to the company shall be deemed to be independent directors.

Explanation:

"Institution" for this purpose means a public financial institution as defined in Section 4A of the Companies Act, 1956 or a "corresponding new bank" as defined in section 2(d) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 [both Acts]."

(B) Non executive directors' compensation and disclosures

All fees/compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and shall require previous approval of shareholders in general meeting. The shareholders' resolution shall specify the limits for the maximum number of stock options that can be granted to non-executive directors, including independent directors, in any financial year and in aggregate.

Provided that the requirement of obtaining prior approval of shareholders in general meeting shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act, 1956 for payment of sitting fees without approval of the Central Government.

(C) Other provisions as to Board and Committees

- i. The board shall meet at least four times a year, with a maximum time gap of four months between any two meetings. The minimum information to be made available to the board is given in **Annexure- I A**.
- ii. A director shall not be a member in more than 10 committees or act as Chairman of more than five committees across all companies in which he is a director. Furthermore it should be a mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

Explanation:

1. For the purpose of considering the limit of the committees on which a director can serve, all public limited companies, whether listed or not, shall be included and all other companies including private limited companies, foreign companies and companies under Section 25 of the Companies Act shall be excluded.
2. For the purpose of reckoning the limit under this sub-clause, Chairmanship/ membership of the Audit Committee and the Shareholders' Grievance Committee alone shall be considered.



- iii. The Board shall periodically review compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of non-compliances.
- iv. An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director within a period of not more than 180 days from the day of such resignation or removal, as the case may be:

Provided that where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director within the period of 180 days shall not apply

(D) Code of Conduct

- i. The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be posted on the website of the company.
- ii. All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by the CEO.

Explanation: For this purpose, the term "senior management" shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

II. Audit Committee

(A) Qualified and Independent Audit Committee

A qualified and independent audit committee shall be set up, giving the terms of reference subject to the following:

- i. The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.
- ii. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

Explanation 1: The term "financially literate" means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation 2: A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

- iii. The Chairman of the Audit Committee shall be an independent director;
- iv. The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;
- v. The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;
- vi. The Company Secretary shall act as the secretary to the committee.

(B) Meeting of Audit Committee

The audit committee should meet at least four times in a year and not more than four months shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

(C) Powers of Audit Committee

The audit committee shall have powers, which should include the following:

1. To investigate any activity within its terms of reference.
2. To seek information from any employee.
3. To obtain outside legal or other professional advice.
4. To secure attendance of outsiders with relevant expertise, if it considers necessary.

(D) Role of Audit Committee

The role of the audit committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
2. Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees.
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
4. Reviewing, with the management, the annual financial statements before submission to the board for approval, with particular reference to:
 - a. Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause (2AA) of section 217 of the Companies Act, 1956
 - b. Changes, if any, in accounting policies and practices and reasons for the same
 - c. Major accounting entries involving estimates based on the exercise of judgment by management
 - d. Significant adjustments made in the financial statements arising out of audit findings
 - e. Compliance with listing and other legal requirements relating to financial statements
 - f. Disclosure of any related party transactions
 - g. Qualifications in the draft audit report.
5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval
- 5A. Reviewing, with the management, the statement of uses / application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take up steps in this matter.
6. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.
7. Reviewing the adequacy of internal audit function, if any, including the structure of the internal



audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.

8. Discussion with internal auditors any significant findings and follow up there on.
9. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
10. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.
11. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.
12. To review the functioning of the Whistle Blower mechanism, in case the same is existing.
- 12A. nApproval of appointment of CFO (i.e., the whole-time Finance Director or any other person heading the finance function or discharging that function) after assessing the qualifications, experience & background, etc. of the candidate.
13. Carrying out any other function as is mentioned in the terms of reference of the Audit Committee.

Explanation (i): The term “related party transactions” shall have the same meaning as contained in the Accounting Standard 18, Related Party Transactions, issued by The Institute of Chartered Accountants of India.

Explanation (ii): If the company has set up an audit committee pursuant to provision of the Companies Act, the said audit committee shall have such additional functions / features as is contained in this clause.

(E) Review of information by Audit Committee

The Audit Committee shall mandatorily review the following information:

1. Management discussion and analysis of financial condition and results of operations;
2. Statement of significant related party transactions (as defined by the audit committee), submitted by management;
3. Management letters / letters of internal control weaknesses issued by the statutory auditors;
4. Internal audit reports relating to internal control weaknesses; and
5. The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee

III. Subsidiary Companies

- i. At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of a material non listed Indian subsidiary company.
- ii. The Audit Committee of the listed holding company shall also review the financial statements, in particular, the investments made by the unlisted subsidiary company.
- iii. The minutes of the Board meetings of the unlisted subsidiary company shall be placed at the Board meeting of the listed holding company. The management should periodically bring to the attention of the Board of Directors of the listed holding company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company.

Explanation 1: The term “material non-listed Indian subsidiary” shall mean an unlisted subsidiary, incorporated in India, whose turnover or net worth (i.e. paid up capital and free reserves) exceeds

20% of the consolidated turnover or net worth respectively, of the listed holding company and its subsidiaries in the immediately preceding accounting year.

Explanation 2: The term “significant transaction or arrangement” shall mean any individual transaction or arrangement that exceeds or is likely to exceed 10% of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the material unlisted subsidiary for the immediately preceding accounting year.

Explanation 3: Where a listed holding company has a listed subsidiary which is itself a holding company, the above provisions shall apply to the listed subsidiary insofar as its subsidiaries are concerned.

IV. Disclosures

(A) Basis of related party transactions

- i. A statement in summary form of transactions with related parties in the ordinary course of business shall be placed periodically before the audit committee.
- ii. Details of material individual transactions with related parties which are not in the normal course of business shall be placed before the audit committee.

Details of material individual transactions with related parties or others, which are not on an arm's length basis should be placed before the audit committee, together with Management's justification for the same..

(B) Disclosure of Accounting Treatment

Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management's explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction in the Corporate Governance Report.

(C) Board Disclosures – Risk management

The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.

(D) Proceeds from public issues, rights issues, preferential issues etc.

When money is raised through an issue (public issues, rights issues, preferential issues etc.), it shall disclose to the Audit Committee, the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and place it before the audit committee. Such disclosure shall be made only till such time that the full money raised through the issue has been fully spent. This statement shall be certified by the statutory auditors of the company. Furthermore, where the company has appointed a monitoring agency to monitor the utilisation of proceeds of a public or rights issue, it shall place before the Audit Committee the monitoring report of such agency, upon receipt, without any delay. The audit committee shall make appropriate recommendations to the Board to take up steps in this matter.

(E) Remuneration of Directors

- i. All pecuniary relationship or transactions of the non-executive directors vis-à-vis the company shall be disclosed in the Annual Report.



- ii. Further the following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the Annual Report:
 - a. All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc.
 - b. Details of fixed component and performance linked incentives, along with the performance criteria.
 - c. Service contracts, notice period, severance fees.
 - d. Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.
- iii. The company shall publish its criteria of making payments to non-executive directors in its annual report. Alternatively, this may be put up on the company's website and reference drawn thereto in the annual report.
- iv. The company shall disclose the number of shares and convertible instruments held by non-executive directors in the annual report.
- v. Non-executive directors shall be required to disclose their shareholding (both own or held by / for other persons on a beneficial basis) in the listed company in which they are proposed to be appointed as directors, prior to their appointment. These details should be disclosed in the notice to the general meeting called for appointment of such director

(F) Management

- i. As part of the directors' report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion & Analysis should include discussion on the following matters within the limits set by the company's competitive position:
 - i. Industry structure and developments.
 - ii. Opportunities and Threats.
 - iii. Segment-wise or product-wise performance.
 - iv. Outlook
 - v. Risks and concerns.
 - vi. Internal control systems and their adequacy.
 - vii. Discussion on financial performance with respect to operational performance.
 - Viii. Material developments in Human Resources / Industrial Relations front, including number of people employed.
- ii. Senior management shall make disclosures to the board relating to all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)

Explanation: For this purpose, the term "senior management" shall mean personnel of the company who are members of its. Core management team excluding the Board of Directors. This would also include all members of management one level below the executive directors including all functional heads.

(G) Shareholders

- i. In case of the appointment of a new director or re-appointment of a director the shareholders must be provided with the following information:
 - a. A brief resume of the director;
 - b. Nature of his expertise in specific functional areas;
 - c. Names of companies in which the person also holds the directorship and the membership of Committees of the Board; and
 - d. Shareholding of non-executive directors as stated in Clause 49 (IV) (E) (v) above
- ia. Disclosure of relationships between directors inter-se shall be made in the Annual Report, notice of appointment of a director, prospectus and letter of offer for issuances and any related filings made to the stock exchanges where the company is listed.
- ii. Quarterly results and presentations made by the company to analysts shall be put on company's web-site, or shall be sent in such a form so as to enable the stock exchange on which the company is listed to put it on its own web-site.
- iii. A board committee under the chairmanship of a non-executive director shall be formed to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. This Committee shall be designated as 'Shareholders/Investors Grievance Committee'.
- iv. To expedite the process of share transfers, the Board of the company shall delegate the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight.

V. CEO/CFO certification

The CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e. the whole-time Finance Director or any other person heading the finance function discharging that function shall certify to the Board that:

- a. They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief :
 - i. these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;
 - ii. these statements together present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.
- b. There are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violative of the company's code of conduct.
- c. They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.
- d. They have indicated to the auditors and the Audit committee
 - i. significant changes in internal control over financial reporting during the year;
 - ii. significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and
 - iii. instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system over financial reporting.



VI. Report on Corporate Governance

- i. There shall be a separate section on Corporate Governance in the Annual Reports of company, with a detailed compliance report on Corporate Governance. Non-compliance of any mandatory requirement of this clause with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted. The suggested list of items to be included in this report is given in **Annexure- I C** and list of non-mandatory requirements is given in **Annexure – I D**.
- ii. The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the format given in **Annexure I B**. The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the company

VII. Compliance

1. The company shall obtain a certificate from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance as stipulated in this clause and annex the certificate with the directors' report, which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchanges along with the annual report filed by the company.
2. The non-mandatory requirements given in **Annexure – ID** may be implemented as per the discretion of the company. However, the disclosures of the compliance with mandatory requirements and adoption (and compliance) / non-adoption of the non-mandatory requirements shall be made in the section on corporate governance of the Annual Report.

Annexure I A

Information to be placed before Board of Directors

1. Annual operating plans and budgets and any updates.
2. Capital budgets and any updates.
3. Quarterly results for the company and its operating divisions or business segments.
4. Minutes of meetings of audit committee and other committees of the board.
5. The information on recruitment and remuneration of senior officers just below the board level, including appointment or removal of Chief Financial Officer and the Company Secretary.
6. Show cause, demand, prosecution notices and penalty notices which are materially important
7. Fatal or serious accidents, dangerous occurrences, any material effluent or pollution problems.
8. Any material default in financial obligations to and by the company, or substantial nonpayment for goods sold by the company.
9. Any issue, which involves possible public or product liability claims of substantial nature, including any judgement or order which, may have passed strictures on the conduct of the company or taken an adverse view regarding another enterprise that can have negative implications on the company.
10. Details of any joint venture or collaboration agreement.
11. Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.
12. Significant labour problems and their proposed solutions. Any significant development in Human Resources/ Industrial Relations front like signing of wage agreement, implementation of Voluntary Retirement Scheme etc.
13. Sale of material nature, of investments, subsidiaries, assets, which is not in normal course of business.

14. Quarterly details of foreign exchange exposures and the steps taken by management to limit the risks of adverse exchange rate movement, if material.
15. Non-compliance of any regulatory, statutory or listing requirements and shareholders service such as non-payment of dividend, delay in share transfer etc.

Annexure I B

Format of Quarterly Compliance Report on Corporate Governance

Name of the Company: Quarter ending on:

Particulars	Clause of Listing agreement	Compliance Status Yes/No	Remarks
I. Board of Directors	49(1)		
(A) Composition of Board	49 (IA)		
(B) Non-executive Directors' compensation & disclosures	49 (IB)		
(C) Other provisions as to Board and Committees	49 (IC)		
(D) Code of Conduct	49 (ID)		
II. Audit Committee	49 (II)		
(A) Qualified & Independent Audit Committee	49 (IIA)		
(B) Meeting of Audit Committee	49 (IIB)		
(C) Powers of Audit Committee	49 (IIC)		
(D) Role of Audit Committee	49 II(D)		
(E) Review of Information by Audit Committee	49 (IIE)		
III. Subsidiary Companies	49 (III)		
IV. Disclosures	49 (IV)		
(A) Basis of related party transactions	49 (IV A)		
(B) Disclosure of Accounting Treatment	49 (IV B)		
(C) Board Disclosures	49 (IV C)		
(D) Proceeds from public issues, rights issues, preferential issues etc.	49 (IV D)		
(E) Remuneration of Directors	49 (IV E)		
(F) Management	49 (IV F)		
(G) Shareholders	49 (IV G)		
V. CEO/CFO Certification	49 (V)		
VI. Report on Corporate Governance	49 (VI)		
VII. Compliance	49 (VII)		

**Note:**

1. The details under each head shall be provided to incorporate all the information required as per the provisions of the Clause 49 of the Listing Agreement.
2. In the column No.3, compliance or non-compliance may be indicated by Yes/No/N.A.. For example, if the Board has been composed in accordance with the Clause 49 I of the Listing Agreement, "Yes" may be indicated. Similarly, in case the company has no related party transactions, the words "N.A." may be indicated against 49 (IV A)
3. In the remarks column, reasons for non-compliance may be indicated, for example, in case of requirement related to circulation of information to the shareholders, which would be done only in the AGM/EGM, it might be indicated in the "Remarks" column as – "will be complied with at the AGM". Similarly, in respect of matters which can be complied with only where the situation arises, for example, "Report on Corporate Governance" is to be a part of Annual Report only, the words "will be complied in the next Annual Report" may be indicated.

Annexure IC**Suggested List of Items to Be Included In the Report on Corporate Governance in the Annual Report of Companies**

1. A brief statement on company's philosophy on code of governance.
2. Board of Directors:
 - a. Composition and category of directors, for example, promoter, executive, nonexecutive, independent non-executive, nominee director, which institution represented as lender or as equity investor.
 - b. Attendance of each director at the Board meetings and the last AGM.
 - c. Number of other Boards or Board Committees in which he/she is a member or Chairperson.
 - d. Number of Board meetings held, dates on which held.
3. Audit Committee:
 - i. Brief description of terms of reference
 - ii. Composition, name of members and Chairperson
 - iii. Meetings and attendance during the year
4. Remuneration Committee:
 - i. Brief description of terms of reference
 - ii. Composition, name of members and Chairperson
 - iii. Attendance during the year
 - iv. Remuneration policy
 - v. Details of remuneration to all the directors, as per format in main report.
5. Shareholders Committee:
 - i. Name of non-executive director heading the committee
 - ii. Name and designation of compliance officer
 - iii. Number of shareholders' complaints received so far

- iv. Number not solved to the satisfaction of shareholders
- v. Number of pending complaints
- 6. General Body meetings:
 - i. Location and time, where last three AGMs held.
 - ii. Whether any special resolutions passed in the previous 3 AGMs
 - iii. Whether any special resolution passed last year through postal ballot – details of voting pattern
 - iv. Person who conducted the postal ballot exercise
 - v. Whether any special resolution is proposed to be conducted through postal ballot
 - vi. Procedure for postal ballot
- 7. Disclosures:
 - i. Disclosures on materially significant related party transactions that may have potential conflict with the interests of company at large.
 - ii. Details of non-compliance by the company, penalties, strictures imposed on the company by Stock Exchange or SEBI or any statutory authority, on any matter related to capital markets, during the last three years.
 - iii. Whistle Blower policy and affirmation that no personnel has been denied access to the audit committee.
 - iv. Details of compliance with mandatory requirements and adoption of the non-mandatory requirements of this clause
- 8. Means of communication.
 - i. Quarterly results
 - ii. Newspapers wherein results normally published
 - iii. Any website, where displayed
 - iv. Whether it also displays official news releases; and
 - v. The presentations made to institutional investors or to the analysts.
- 9. General Shareholder information:
 - i. AGM : Date, time and venue
 - ii. Financial year
 - iii. Date of Book closure
 - iv. Dividend Payment Date
 - v. Listing on Stock Exchanges
 - vi. Stock Code
 - vii. Market Price Data : High., Low during each month in last financial year
 - viii. Performance in comparison to broad-based indices such as BSE Sensex, CRISIL index etc.
 - ix. Registrar and Transfer Agents
 - x. Share Transfer System

- xi. Distribution of shareholding
- xii. Dematerialization of shares and liquidity
- xiii. Outstanding GDRs/ADRs/Warrants or any Convertible instruments, conversion date and likely impact on equity
- xvi. Plant Locations
- xv. Address for correspondence

Annexure I D

Non-Mandatory Requirements

1. The Board

The Board - A non-executive Chairman may be entitled to maintain a Chairman's office at the company's expense and also allowed reimbursement of expenses incurred in performance of his duties. Independent Directors may have a tenure not exceeding, in the aggregate, a period of nine years, on the Board of a company. The company may ensure that the person who is being appointed as an independent director has the requisite qualifications and experience which would be of use to the company and which, in the opinion of the company, would enable him to contribute effectively to the company in his capacity as an independent director."

[MAXIMUM TENURE OF INDEPENDENT DIRECTORS

Banking Regulation Act, 1949

In terms of Section 10A(2-A)(i) of the Banking Regulation Act, 1949 no director of a banking company, other than its chairman or whole-time director, by whatever name called, shall hold office continuously for a period exceeding eight years;

ICSI Recommendation

A Maximum tenure of 6 years in aggregate should be specified for independent directors and be made mandatory.]

2. Remuneration Committee

- i. The board may set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment.
- ii. To avoid conflicts of interest, the remuneration committee, which would determine the remuneration packages of the executive directors may comprise of at least three directors, all of whom should be non-executive directors, the Chairman of committee being an independent director.
- iii. All the members of the remuneration committee could be present at the meeting.
- iv. The Chairman of the remuneration committee could be present at the Annual General Meeting, to answer the shareholder queries. However, it would be up to the Chairman to decide who should answer the queries.

3. Shareholder Rights

A half-yearly declaration of financial performance including summary of the significant events in last six-months, may be sent to each household of shareholders.

4. Audit qualifications

Company may move towards a regime of unqualified financial statements.

5. Training of Board Members

A company may train its Board members in the business model of the company as well as the risk profile of the business parameters of the company, their responsibilities as directors, and the best ways to discharge them.

6. Mechanism for evaluating non-executive Board Members

The performance evaluation of non-executive directors could be done by a peer group comprising the entire Board of Directors, excluding the director being evaluated; and Peer Group evaluation could be the mechanism to determine whether to extend / continue the terms of appointment of non-executive directors.

7. Whistle Blower Policy

The company may establish a mechanism for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimization of employees who avail of the mechanism and also provide for direct access to the Chairman of the Audit committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization.



3.5 SEBI (SUBSTANTIAL ACQUISITION OF SHARES AND TAKEOVERS) REGULATIONS, 2011

F. No. LAD-NRO/GN/201 1-12/24/30181.—In exercise of the powers conferred under section 30 read with clause (h) of sub-section (2) of section 11 of the Securities and Exchange Board of India Act, 1992 the Securities and Exchange Board of India hereby, makes the following regulations, namely: —

PRELIMINARY

Short title, commencement and applicability [Regulation 1]

- (1) These regulations may be called the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
- (2) These regulations shall come into force on the thirtieth day from the date of their publication in the Official Gazette.
- (3) These regulations shall apply to direct and indirect acquisition of shares or voting rights in, or control over target company.

Definitions [Regulation 2]

- (1) In these regulations, unless the context otherwise requires, the terms defined herein shall bear the meanings assigned to them below, and their cognate expressions and variations shall be construed accordingly,—
 - (a) “acquirer” means any person who, directly or indirectly, acquires or agrees to acquire whether by himself, or through, or with persons acting in concert with him, shares or voting rights in, or control over a target company;
 - (b) “acquisition” means, directly or indirectly, acquiring or agreeing to acquire shares or voting rights in, or control over, a target company;
 - (c) “Act” means the Securities and Exchange Board of India Act, 1992;
 - (d) “Board” means the Securities and Exchange Board of India established under section 3 of the Act;
 - (e) “control” includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner:
Provided that a director or officer of a target company shall not be considered to be in control over such target company, merely by virtue of holding such position;
 - (f) “convertible security” means a security which is convertible into or exchangeable with equity shares of the issuer at a later date, with or without the option of the holder of the security, and includes convertible debt instruments and convertible preference shares;
 - (g) “disinvestment” means the direct or indirect sale by the Central Government or any State Government or by a government company, as the case may be, of shares or voting rights in, or control over, a target company, which is a public sector undertaking;
 - (h) “enterprise value” means the value calculated as market capitalization of a company plus debt, minority interest and preferred shares, minus total cash and cash equivalents;
 - (i) “financial year” means the period of twelve months commencing on the first day of the month of April;
 - (j) “frequently traded shares” means shares of a target company, in which the traded turnover on any stock exchange during the twelve calendar months preceding the calendar month in which the public announcement is made, is at least ten per cent of the total number of shares of such class of the target company:

Provided that where the share capital of a particular class of shares of the target company

is not identical throughout such period, the weighted average number of total shares of such class of the target company shall represent the total number of shares;

- (k) "identified date" means the date falling on the tenth working day prior to the commencement of the tendering period, for the purposes of determining the shareholders to whom the letter of offer shall be sent;
- (l) "immediate relative" means any spouse of a person, and includes parent, brother, sister or child of such person or of the spouse;
- (m) "listing agreement" means the agreement with the stock exchange governing the conditions of listing of shares of the target company;
- (n) "manager to the open offer" means a merchant banker referred to in regulation 12;
- (o) "maximum permissible non-public shareholding" means such percentage shareholding in the target company excluding the minimum public shareholding required under the Securities Contracts (Regulation) Rules, 1957;
- (p) "offer period" means the period between the date of entering into an agreement, formal or informal, to acquire shares, voting rights in, or control over a target company requiring a public announcement, or the date of the public announcement, as the case may be, and the date on which the payment of consideration to shareholders who have accepted the open offer is made, or the date on which open offer is withdrawn, as the case may be;
- (q) "persons acting in concert" means,—
 - (1) persons who, with a common objective or purpose of acquisition of shares or voting rights in, or exercising control over a target company, pursuant to an agreement or understanding, formal or informal, directly or indirectly co-operate for acquisition of shares or voting rights in, or exercise of control over the target company.
 - (2) Without prejudice to the generality of the foregoing, the persons falling within the following categories shall be deemed to be persons acting in concert with other persons within the same category, unless the contrary is established,—
 - (i) a company, its holding company, subsidiary company and any company under the same management or control;
 - (ii) a company, its directors, and any person entrusted with the management of the company;
 - (iii) directors of companies referred to in item (i) and (ii) of this sub-clause and associates of such directors;
 - (iv) promoters and members of the promoter group;
 - (v) immediate relatives;
 - (vi) a mutual fund, its sponsor, trustees, trustee company, and asset management company;
 - (vii) a collective investment scheme and its collective investment management company, trustees and trustee company;
 - (viii) a venture capital fund and its sponsor, trustees, trustee company and asset management company;
 - (viii a) An alternative investment fund and its sponsor, trustees, trustee company and manager;
 - (ix) a foreign institutional investor and its sub-accounts;
 - (x) a merchant banker and its client, who is an acquirer;
 - (xi) a portfolio manager and its client, who is an acquirer;



- (xii) banks, financial advisors and stock brokers of the acquirer, or of any company which is a holding company or subsidiary of the acquirer, and where the acquirer is an individual, of the immediate relative of such individual:

Provided that this sub-clause shall not apply to a bank whose sole role is that of providing normal commercial banking services or activities in relation to an open offer under these regulations;

- (xiii) an investment company or fund and any person who has an interest in such investment company or fund as a shareholder or unit holder having not less than 10 per cent of the paid-up capital of the investment company or unit capital of the fund, and any other investment company or fund in which such person or his associate holds not less than 10 per cent of the paid-up capital of that investment company or unit capital of that fund:

Provided that nothing contained in this sub-clause shall apply to holding of units of mutual funds registered with the Board;

Explanation.— For the purposes of this clause “associate” of a person means,—

- (a) any immediate relative of such person;
 - (b) trusts of which such person or his immediate relative is a trustee;
 - (c) partnership firm in which such person or his immediate relative is a partner; and
 - (d) members of Hindu undivided families of which such person is a coparcener;
- (r) “postal ballot” means a postal ballot as provided for under the Companies (Passing of the Resolution by Postal Ballot) Rules, 2001 made under the Companies Act, 1956;
 - (s) “Promoter” has the same meaning as in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 and includes a member of the promoter group;
 - (t) “Promoter group” has the same meaning as in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
 - (u) “public sector undertaking” means a target company in which, directly or indirectly, majority of shares or voting rights or control is held by the Central Government or any State Government or Governments, or partly by the Central Government and partly by one or more State Governments;
 - (v) “shares” means shares in the equity share capital of a target company carrying voting rights, and includes any security which entitles the holder thereof to exercise voting rights;
Explanation.—For the purpose of this clause shares will include all depository receipts carrying an entitlement to exercise voting rights in the target company;
 - (w) “specified” means as specified by the Board;
 - (x) “state-level financial institution” means a Financial Corporation established under section 3 or section 3A and institutions notified under section 46 of the State Financial Corporations Act, 1951, and includes a development corporation established as a company by a State Government with the object of development of industries or agricultural activities in the state;
 - (y) “stock exchange” means a stock exchange which has been granted recognition under section 4 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);
 - (z) “target company” means a company and includes a body corporate or corporation established under a Central legislation, State legislation or Provincial legislation for the time being in force, whose shares are listed on a stock exchange;

- (za) "tendering period" means the period within which shareholders may tender their shares in acceptance of an open offer to acquire shares made under these regulations;
 - (zb) "volume weighted average market price" means the product of the number of equity shares traded on a stock exchange and the price of each equity share divided by the total number of equity shares traded on the stock exchange;
 - (zc) "volume weighted average price" means the product of the number of equity shares bought and price of each such equity share divided by the total number of equity shares bought;
 - (zd) "weighted average number of total shares" means the number of shares at the beginning of a period, adjusted for shares cancelled, bought back or issued during the aforesaid period, multiplied by a time-weighting factor;
 - (ze) "working day" means any working day of the Board.
- (2) All other expressions unless defined herein shall have the same meaning as have been assigned to them under the Act or the Securities Contracts (Regulation) Act, 1956, or the Companies Act, 1956, or any statutory modification or re-enactment thereto, as the case may be.

SUBSTANTIAL ACQUISITION OF SHARES, VOTING RIGHTS OR CONTROL

Substantial acquisition of shares or voting rights [Regulation 3]

- (1) No acquirer shall acquire shares or voting rights in a target company which taken together with shares or voting rights, if any, held by him and by persons acting in concert with him in such target company, entitle them to exercise twenty-five per cent or more of the voting rights in such target company unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations.
- (2) No acquirer, who together with persons acting in concert with him, has acquired and holds in accordance with these regulations shares or voting rights in a target company entitling them to exercise twenty-five per cent or more of the voting rights in the target company but less than the maximum permissible non-public shareholding, shall acquire within any financial year additional shares or voting rights in such target company entitling them to exercise more than five per cent of the voting rights, unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations:

Provided that such acquirer shall not be entitled to acquire or enter into any agreement to acquire shares or voting rights exceeding such number of shares as would take the aggregate shareholding pursuant to the acquisition above the maximum permissible non-public shareholding.

Explanation.—For the purposes of determining the quantum of acquisition of additional voting rights under this sub-regulation,—

- (i) gross acquisitions alone shall be taken into account regardless of any intermittent fall in shareholding or voting rights whether owing to disposal of shares held or dilution of voting rights owing to fresh issue of shares by the target company.
 - (ii) in the case of acquisition of shares by way of issue of new shares by the target company or where the target company has made an issue of new shares in any given financial year, the difference between the pre-allotment and the post-allotment percentage voting rights shall be regarded as the quantum of additional acquisition .
- (3) For the purposes of sub-regulation (1) and sub-regulation (2), acquisition of shares by any person, such that the individual shareholding of such person acquiring shares exceeds the stipulated thresholds, shall also be attracting the obligation to make an open offer for acquiring shares of the target company irrespective of whether there is a change in the aggregate shareholding with persons acting in concert.



Acquisition of control [Regulation 4]

Irrespective of acquisition or holding of shares or voting rights in a target company, no acquirer shall acquire, directly or indirectly, control over such target company unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations.

Indirect acquisition of shares or control [Regulation 5]

- (1) For the purposes of regulation 3 and regulation 4, acquisition of shares or voting rights in, or control over, any company or other entity, that would enable any person and persons acting in concert with him to exercise or direct the exercise of such percentage of voting rights in, or control over, a target company, the acquisition of which would otherwise attract the obligation to make a public announcement of an open offer for acquiring shares under these regulations, shall be considered as an indirect acquisition of shares or voting rights in, or control over the target company.
- (2) Notwithstanding anything contained in these regulations, in the case of an indirect acquisition attracting the provisions of sub-regulation (1) where,—
 - (a) the proportionate net asset value of the target company as a percentage of the consolidated net asset value of the entity or business being acquired;
 - (b) the proportionate sales turnover of the target company as a percentage of the consolidated sales turnover of the entity or business being acquired; or
 - (c) the proportionate market capitalisation of the target company as a percentage of the enterprise value for the entity or business being acquired;

is in excess of eighty per cent, on the basis of the most recent audited annual financial statements, such indirect acquisition shall be regarded as a direct acquisition of the target company for all purposes of these regulations including without limitation, the obligations relating to timing, pricing and other compliance requirements for the open offer.

Explanation.— For the purposes of computing the percentage referred to in clause (c) of this sub-regulation, the market capitalisation of the target company shall be taken into account on the basis of the volume-weighted average market price of such shares on the stock exchange for a period of sixty trading days preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain, as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period.

Voluntary Offer [Regulation 6]

- (1) An acquirer, who together with persons acting in concert with him, holds shares or voting rights in a target company entitling them to exercise twenty-five per cent or more but less than the maximum permissible non-public shareholding, shall be entitled to voluntarily make a public announcement of an open offer for acquiring shares in accordance with these regulations, subject to their aggregate shareholding after completion of the open offer not exceeding the maximum permissible non-public shareholding:

Provided that where an acquirer or any person acting in concert with him has acquired shares of the target company in the preceding fifty-two weeks without attracting the obligation to make a public announcement of an open offer, he shall not be eligible to voluntarily make a public announcement of an open offer for acquiring shares under this regulation:

Provided further that during the offer period such acquirer shall not be entitled to acquire any shares otherwise than under the open offer.

- (2) An acquirer and persons acting in concert with him, who have made a public announcement under this regulation to acquire shares of a target company shall not be entitled to acquire any shares of the target company for a period of six months after completion of the open offer except pursuant to another voluntary open offer:

Provided that such restriction shall not prohibit the acquirer from making a competing offer upon any other person making an open offer for acquiring shares of the target company.

- (3) Shares acquired through bonus issue or stock splits shall not be considered for purposes of the dis-entitlement set out in this regulation.

Offer Size [Regulation 7]

- (1) The open offer for acquiring shares to be made by the acquirer and persons acting in concert with him under regulation 3 and regulation 4 shall be for at least twenty six per cent of total shares of the target company, as of tenth working day from the closure of the tendering period:

Provided that the total shares of the target company as of tenth working day from the closure of the tendering period shall take into account all potential increases in the number of outstanding shares during the offer period contemplated as of the date of the public announcement:

Provided further that the offer size shall be proportionately increased in case of an increase in total number of shares, after the public announcement, which is not contemplated on the date of the public announcement.

- (2) The open offer made under regulation 6 shall be for acquisition of at least such number of shares as would entitle the holder thereof to exercise an additional ten per cent of the total shares of the target company, and shall not exceed such number of shares as would result in the post-acquisition holding of the acquirer and persons acting in concert with him exceeding the maximum permissible non-public shareholding applicable to such target company:

Provided that in the event of a competing offer being made, the acquirer who has voluntarily made a public announcement of an open offer under regulation 6 shall be entitled to increase the number of shares for which the open offer has been made to such number of shares as he deems fit:

Provided further that such increase in offer size shall have to be made within a period of fifteen working days from the public announcement of a competing offer, failing which the acquirer shall not be entitled to increase the offer size.

- (3) Upon an acquirer opting to increase the offer size under sub-regulation (2), such open offer shall be deemed to have been made under sub-regulation (2) of regulation 3 and the provisions of these regulations shall apply accordingly.
- (4) In the event the shares accepted in the open offer were such that the shareholding of the acquirer taken together with persons acting in concert with him pursuant to completion of the open offer results in their shareholding exceeding the maximum permissible non-public shareholding, the acquirer shall be required to bring down the non-public shareholding to the level specified and within the time permitted under Securities Contract (Regulation) Rules, 1957.
- (5) The acquirer whose shareholding exceeds the maximum permissible non-public shareholding, pursuant to an open offer under these regulations, shall not be eligible to make a voluntary delisting offer under the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009, unless a period of twelve months has elapsed from the date of the completion of the offer period.
- (6) Any open offer made under these regulations shall be made to all shareholders of the target company, other than the acquirer, persons acting in concert with him and the parties to any underlying agreement including persons deemed to be acting in concert with such parties, for the sale of shares of the target company.

Offer Price [Regulation 8]

- (1) The open offer for acquiring shares under regulation 3, regulation 4, regulation 5 or regulation 6 shall be made at a price not lower than the price determined in accordance with sub-regulation (2) or sub-regulation (3), as the case may be.
- (2) In the case of direct acquisition of shares or voting rights in, or control over the target company, and indirect acquisition of shares or voting rights in, or control over the target company where



the parameters referred to in sub-regulation (2) of regulation 5 are met, the offer price shall be the highest of,—

- (a) the highest negotiated price per share of the target company for any acquisition under the agreement attracting the obligation to make a public announcement of an open offer;
 - (b) the volume-weighted average price paid or payable for acquisitions, whether by the acquirer or by any person acting in concert with him, during the fifty-two weeks immediately preceding the date of the public announcement;
 - (c) the highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, during the twenty-six weeks immediately preceding the date of the public announcement;
 - (d) the volume-weighted average market price of such shares for a period of sixty trading days immediately preceding the date of the public announcement as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, provided such shares are frequently traded;
 - (e) where the shares are not frequently traded, the price determined by the acquirer and the manager to the open offer taking into account valuation parameters including, book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies; and
 - (f) the per share value computed under sub-regulation (5), if applicable.
- (3) In the case of an indirect acquisition of shares or voting rights in, or control over the target company, where the parameter referred to in sub-regulation (2) of regulation 5 are not met, the offer price shall be the highest of,—
- (a) the highest negotiated price per share, if any, of the target company for any acquisition under the agreement attracting the obligation to make a public announcement of an open offer;
 - (b) the volume-weighted average price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, during the fifty-two weeks immediately preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain;
 - (c) the highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, during the twenty-six weeks immediately preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain;
 - (d) the highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, between the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain, and the date of the public announcement of the open offer for shares of the target company made under these regulations;
 - (e) the volume-weighted average market price of the shares for a period of sixty trading days immediately preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain, as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, provided such shares are frequently traded; and
 - (f) the per share value computed under sub-regulation (5).
- (4) In the event the offer price is incapable of being determined under any of the parameters specified in sub-regulation (3), without prejudice to the requirements of sub-regulation (5), the

offer price shall be the fair price of shares of the target company to be determined by the acquirer and the manager to the open offer taking into account valuation parameters including, book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies.

- (5) In the case of an indirect acquisition and open offers under sub-regulation (2) of regulation 5 where,—
- (a) the proportionate net asset value of the target company as a percentage of the consolidated net asset value of the entity or business being acquired;
 - (b) the proportionate sales turnover of the target company as a percentage of the consolidated sales turnover of the entity or business being acquired; or
 - (c) the proportionate market capitalization of the target company as a percentage of the enterprise value for the entity or business being acquired;

is in excess of fifteen per cent, on the basis of the most recent audited annual financial statements, the acquirer shall, notwithstanding anything contained in sub-regulation (2) or sub-regulation (3), be required to compute and disclose, in the letter of offer, the per share value of the target company taken into account for the acquisition, along with a detailed description of the methodology adopted for such computation.

Explanation.— For the purposes of computing the percentages referred to in clause (c) of this sub-regulation, the market capitalisation of the target company shall be taken into account on the basis of the volume-weighted average market price of such shares on the stock exchange for a period of sixty trading days preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain, as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period.

- (6) For the purposes of sub-regulation (2) and sub-regulation (3), where the acquirer or any person acting in concert with him has any outstanding convertible instruments convertible into shares of the target company at a specific price, the price at which such instruments are to be converted into shares, shall also be considered as a parameter under sub-regulation (2) and sub-regulation (3).
- (7) For the purposes of sub-regulation (2) and sub-regulation (3), the price paid for shares of the target company shall include any price paid or agreed to be paid for the shares or voting rights in, or control over the target company, in any form whatsoever, whether stated in the agreement for acquisition of shares or in any incidental, contemporaneous or collateral agreement, whether termed as control premium or as non-compete fees or otherwise.
- (8) Where the acquirer has acquired or agreed to acquire whether by himself or through or with persons acting in concert with him any shares or voting rights in the target company during the offer period, whether by subscription or purchase, at a price higher than the offer price, the offer price shall stand revised to the highest price paid or payable for any such acquisition:

Provided that no such acquisition shall be made after the third working day prior to the commencement of the tendering period and until the expiry of the tendering period.

- (9) The price parameters under sub-regulation (2) and sub-regulation (3) may be adjusted by the acquirer in consultation with the manager to the offer, for corporate actions such as issuances pursuant to rights issue, bonus issue, stock consolidations, stock splits, payment of dividend, demergers and reduction of capital, where the record date for effecting such corporate actions falls prior to three working days before the commencement of the tendering period:

Provided that no adjustment shall be made for dividend declared with a record date falling during such period except where the dividend per share is more than fifty per cent higher than the average of the dividend per share paid during the three financial years preceding the date of the public announcement.



- (10) Where the acquirer or persons acting in concert with him acquires shares of the target company during the period of twenty-six weeks after the tendering period at a price higher than the offer price under these regulations, the acquirer and persons acting in concert shall pay the difference between the highest acquisition price and the offer price, to all the shareholders whose shares were accepted in the open offer, within sixty days from the date of such acquisition:

Provided that this provision shall not be applicable to acquisitions under another open offer under these regulations or pursuant to the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009, or open market purchases made in the ordinary course on the stock exchanges, not being negotiated acquisition of shares of the target company whether by way of bulk deals, block deals or in any other form.

- (11) Where the open offer is subject to a minimum level of acceptances, the acquirer may, subject to the other provisions of this regulation, indicate a lower price, which will not be less than the price determined under this regulation, for acquiring all the acceptances despite the acceptance falling short of the indicated minimum level of acceptance, in the event the open offer does not receive the minimum acceptance.
- (12) In the case of any indirect acquisition, other than the indirect acquisition referred in sub-regulation (2) of regulation 5, the offer price shall stand enhanced by an amount equal to a sum determined at the rate of ten per cent per annum for the period between the earlier of the date on which the primary acquisition is contracted or the date on which the intention or the decision to make the primary acquisition is announced in the public domain, and the date of the detailed public statement, provided such period is more than five working days.
- (13) The offer price for partly paid up shares shall be computed as the difference between the offer price and the amount due towards calls-in-arrears including calls remaining unpaid with interest, if any, thereon.
- (14) The offer price for equity shares carrying differential voting rights shall be determined by the acquirer and the manager to the open offer with full disclosure of justification for the price so determined, being set out in the detailed public statement and the letter of offer:

Provided that such price shall not be lower than the amount determined by applying the percentage rate of premium, if any, that the offer price for the equity shares carrying full voting rights represents to the price parameter computed under clause (d) of sub-regulation 2, or as the case may be, clause (e) of sub-regulation 3, to the volume-weighted average market price of the shares carrying differential voting rights for a period of sixty trading days computed on the same terms as specified in the aforesaid provisions, subject to shares carrying full voting rights and the shares carrying differential voting rights, both being frequently traded shares.

- (15) In the event of any of the price parameters contained in this regulation not being available or denominated in Indian rupees, the conversion of such amount into Indian rupees shall be effected at the exchange rate as prevailing on the date preceding the date of public announcement and the acquirer shall set out the source of such exchange rate in the public announcement, the detailed public statement and the letter of offer.
- (16) For purposes of clause (e) of sub-regulation (2) and sub-regulation (4), the Board may, at the expense of the acquirer, require valuation of the shares by an independent merchant banker other than the manager to the open offer or an independent chartered accountant in practice having a minimum experience of ten years.

Mode of payment [Regulation 9]

- (1) The offer price may be paid, —
- (a) in cash;
 - (b) by issue, exchange or transfer of listed shares in the equity share capital of the acquirer or of any person acting in concert;
 - (c) by issue, exchange or transfer of listed secured debt instruments issued by the acquirer or any person acting in concert with a rating not inferior to investment grade as rated by a credit rating agency registered with the Board;

- (d) by issue, exchange or transfer of convertible debt securities entitling the holder thereof to acquire listed shares in the equity share capital of the acquirer or of any person acting in concert; or
- (e) a combination of the mode of payment of consideration stated in clause (a), clause (b), clause (c) and clause (d):

Provided that where any shares have been acquired or agreed to be acquired by the acquirer and persons acting in concert with him during the fifty-two weeks immediately preceding the date of public announcement constitute more than ten per cent of the voting rights in the target company and has been paid for in cash, the open offer shall entail an option to the shareholders to require payment of the offer price in cash, and a shareholder who has not exercised an option in his acceptance shall be deemed to have opted for receiving the offer price in cash:

Provided further that in case of revision in offer price the mode of payment of consideration may be altered subject to the condition that the component of the offer price to be paid in cash prior to such revision is not reduced.

- (2) For the purposes of clause (b), clause (d) and clause (e) of sub-regulation (1), the shares sought to be issued or exchanged or transferred or the shares to be issued upon conversion of other securities, towards payment of the offer price, shall conform to the following requirements, —

- (a) such class of shares are listed on a stock exchange and frequently traded at the time of the public announcement;
- (b) such class of shares have been listed for a period of at least two years preceding the date of the public announcement;
- (c) the issuer of such class of shares has redressed at least ninety five per cent of the complaints received from investors by the end of the calendar quarter immediately preceding the calendar month in which the public announcement is made;
- (d) the issuer of such class of shares has been in material compliance with the listing agreement for a period of at least two years immediately preceding the date of the public announcement:

Provided that in case where the Board is of the view that a company has not been materially compliant with the provisions of the listing agreement, the offer price shall be paid in cash only;

- (e) the impact of auditors' qualifications, if any, on the audited accounts of the issuer of such shares for three immediately preceding financial years does not exceed five per cent of the net profit or loss after tax of such issuer for the respective years; and
- (f) the Board has not issued any direction against the issuer of such shares not to access the capital market or to issue fresh shares.

- (3) Where the shareholders have been provided with options to accept payment in cash or by way of securities, or a combination thereof, the pricing for the open offer may be different for each option subject to compliance with minimum offer price requirements under regulation 8:

Provided that the detailed public statement and the letter of offer shall contain justification for such differential pricing.

- (4) In the event the offer price consists of consideration to be paid by issuance of securities, which requires compliance with any applicable law, the acquirer shall ensure that such compliance is completed not later than the commencement of the tendering period:

Provided that in case the requisite compliance is not made by such date, the acquirer shall pay the entire consideration in cash.

- (5) Where listed securities are offered as consideration, the value of such securities shall be higher of:



- (a) the average of the weekly high and low of the closing prices of such securities quoted on the stock exchange during the six months preceding the relevant date;
- (b) the average of the weekly high and low of the closing prices of such securities quoted on the stock exchange during the two weeks preceding the relevant date; and
- (c) the volume-weighted average market price for a period of sixty trading days preceding the date of the public announcement, as traded on the stock exchange where the maximum volume of trading in the shares of the company whose securities are being offered as consideration, are recorded during the six-month period prior to relevant date and the ratio of exchange of shares shall be duly certified by an independent merchant banker (other than the manager to the open offer) or an independent chartered accountant having a minimum experience of ten years.

Explanation.— For the purposes of this sub-regulation, the “relevant date” shall be the thirtieth day prior to the date on which the meeting of shareholders is held to consider the proposed issue of shares under sub-section (1A) of Section 81 of the Companies Act, 1956.

General exemptions [Regulation 10]

- (1) The following acquisitions shall be exempt from the obligation to make an open offer under regulation 3 and regulation 4 subject to fulfillment of the conditions stipulated therefore,—
 - (a) acquisition pursuant to inter se transfer of shares amongst qualifying persons, being,—
 - (i) immediate relatives;
 - (ii) persons named as promoters in the shareholding pattern filed by the target company in terms of the listing agreement or these regulations for not less than three years prior to the proposed acquisition;
 - (iii) a company, its subsidiaries, its holding company, other subsidiaries of such holding company, persons holding not less than fifty per cent of the equity shares of such company, other companies in which such persons hold not less than fifty per cent of the equity shares, and their subsidiaries subject to control over such qualifying persons being exclusively held by the same persons;
 - (iv) persons acting in concert for not less than three years prior to the proposed acquisition, and disclosed as such pursuant to filings under the listing agreement;
 - (v) shareholders of a target company who have been persons acting in concert for a period of not less than three years prior to the proposed acquisition and are disclosed as such pursuant to filings under the listing agreement, and any company in which the entire equity share capital is owned by such shareholders in the same proportion as their holdings in the target company without any differential entitlement to exercise voting rights in such company:

Provided that for purposes of availing of the exemption under this clause,—

- (i) If the shares of the target company are frequently traded, the acquisition price per share shall not be higher by more than twenty-five per cent of the volume-weighted average market price for a period of sixty trading days preceding the date of issuance of notice for the proposed inter se transfer under sub-regulation (5), as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, and if the shares of the target company are infrequently traded, the acquisition price shall not be higher by more than twenty-five percent of the price determined in terms of clause (e) of sub-regulation (2) of regulation 8; and
 - (ii) the transferor and the transferee shall have complied with applicable disclosure requirements set out in Chapter V.
 - (b) acquisition in the ordinary course of business by,—

- (i) an underwriter registered with the Board by way of allotment pursuant to an underwriting agreement in terms of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
 - (ii) a stock broker registered with the Board on behalf of his client in exercise of lien over the shares purchased on behalf of the client under the bye-laws of the stock exchange where such stock broker is a member;
 - (iii) a merchant banker registered with the Board or a nominated investor in the process of market making or subscription to the unsubscribed portion of issue in terms of Chapter XB of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
 - (iv) any person acquiring shares pursuant to a scheme of safety net in terms of regulation 44 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
 - (v) a merchant banker registered with the Board acting as a stabilising agent or by the promoter or pre-issue shareholder in terms of regulation 45 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
 - (vi) by a registered market-maker of a stock exchange in respect of shares for which he is the market maker during the course of market making;
 - (vii) a Scheduled Commercial Bank, acting as an escrow agent; and
 - (viii) invocation of pledge by Scheduled Commercial Banks or Public Financial Institutions as a pledgee.
- (c) acquisitions at subsequent stages, by an acquirer who has made a public announcement of an open offer for acquiring shares pursuant to an agreement of disinvestment, as contemplated in such agreement:

Provided that,—

- (i) both the acquirer and the seller are the same at all the stages of acquisition; and
 - (ii) full disclosures of all the subsequent stages of acquisition, if any, have been made in the public announcement of the open offer and in the letter of offer.
- (d) acquisition pursuant to a scheme,—
- (i) made under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985 or any statutory modification or re-enactment thereto;
 - (ii) of arrangement involving the target company as a transferor company or as a transferee company, or reconstruction of the target company, including amalgamation, merger or demerger, pursuant to an order of a court or a competent authority under any law or regulation, Indian or foreign; or
 - (iii) of arrangement not directly involving the target company as a transferor company or as a transferee company, or reconstruction not involving the target company's undertaking, including amalgamation, merger or demerger, pursuant to an order of a court or a competent authority under any law or regulation, Indian or foreign, subject to,—
 - (A) the component of cash and cash equivalents in the consideration paid being less than twenty-five per cent of the consideration paid under the scheme; and
 - (B) where after implementation of the scheme of arrangement, persons directly or indirectly holding at least thirty-three per cent of the voting rights in the combined entity are the same as the persons who held the entire voting rights before the implementation of the scheme.



- (e) acquisition pursuant to the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
 - (f) acquisition pursuant to the provisions of the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009;
 - (g) acquisition by way of transmission, succession or inheritance;
 - (h) acquisition of voting rights or preference shares carrying voting rights arising out of the operation of sub-section (2) of section 87 of the Companies Act, 1956.
- (2) The acquisition of shares of a target company, not involving a change of control over such target company, pursuant to a scheme of corporate debt restructuring in terms of the Corporate Debt Restructuring Scheme notified by the Reserve Bank of India vide circular no. B.P.BC 15/21.04, 114/2001 dated August 23, 2001, or any modification or re-notification thereto provided such scheme has been authorised by shareholders by way of a special resolution passed by postal ballot, shall be exempted from the obligation to make an open offer under regulation 3.
- (3) An increase in voting rights in a target company of any shareholder beyond the limit attracting an obligation to make an open offer under sub-regulation (1) of regulation 3, pursuant to buy-back of shares shall be exempt from the obligation to make an open offer provided such shareholder reduces his shareholding such that his voting rights fall to below the threshold referred to in sub-regulation (1) of regulation 3 within ninety days from the date on which the voting rights so increase.
- (4) The following acquisitions shall be exempt from the obligation to make an open offer under sub-regulation (2) of regulation 3,—
- (a) acquisition of shares by any shareholder of a target company, upto his entitlement, pursuant to a rights issue;
 - (b) acquisition of shares by any shareholder of a target company, beyond his entitlement, pursuant to a rights issue, subject to fulfillment of the following conditions,—
 - (i) the acquirer has not renounced any of his entitlements in such rights issue; and
 - (ii) the price at which the rights issue is made is not higher than the ex-rights price of the shares of the target company, being the sum of,—
 - (A) the volume weighted average market price of the shares of the target company during a period of sixty trading days ending on the day prior to the date of determination of the rights issue price, multiplied by the number of shares outstanding prior to the rights issue, divided by the total number of shares outstanding after allotment under the rights issue:
Provided that such volume weighted average market price shall be determined on the basis of trading on the stock exchange where the maximum volume of trading in the shares of such target company is recorded during such period; and
 - (B) the price at which the shares are offered in the rights issue, multiplied by the number of shares so offered in the rights issue divided by the total number of shares outstanding after allotment under the rights issue:
 - (c) increase in voting rights in a target company of any shareholder pursuant to buy-back of shares:
Provided that,—
 - (i) such shareholder has not voted in favour of the resolution authorising the buy-back of securities under section 77A of the Companies Act, 1956;
 - (ii) in the case of a shareholder resolution, voting is by way of postal ballot;
 - (iii) where a resolution of shareholders is not required for the buy-back, such shareholder, in his capacity as a director, or any other interested director has not voted in favour

of the resolution of the board of directors of the target company authorising the buy-back of securities under section 77A of the Companies Act, 1956; and

- (iv) the increase in voting rights does not result in an acquisition of control by such shareholder over the target company:

Provided further that where the aforesaid conditions are not met, in the event such shareholder reduces his shareholding such that his voting rights fall below the level at which the obligation to make an open offer would be attracted under sub-regulation (2) of regulation 3, within ninety days from the date on which the voting rights so increase, the shareholder shall be exempt from the obligation to make an open offer;

- (d) acquisition of shares in a target company by any person in exchange for shares of another target company tendered pursuant to an open offer for acquiring shares under these regulations;
 - (e) acquisition of shares in a target company from state-level financial institutions or their subsidiaries or companies promoted by them, by promoters of the target company pursuant to an agreement between such transferors and such promoter;
 - (f) acquisition of shares in a target company from a venture capital fund or Category I Alternative Investment Fund or a foreign venture capital investor registered with the Board, by promoters of the target company pursuant to an agreement between such venture capital fund or Category I Alternative Investment Fund or foreign venture capital investor and such promoters.
- (5) In respect of acquisitions under clause (a) of sub-regulation (1), and clauses (e) and (f) of sub-regulation (4), the acquirer shall intimate the stock exchanges where the shares of the target company are listed, the details of the proposed acquisition in such form as may be specified, at least four working days prior to the proposed acquisition, and the stock exchange shall forthwith disseminate such information to the public.
 - (6) In respect of any acquisition made pursuant to exemption provided for in this regulation, the acquirer shall file a report with the stock exchanges where the shares of the target company are listed, in such form as may be specified not later than four working days from the acquisition, and the stock exchange shall forthwith disseminate such information to the public.
 - (7) In respect of any acquisition of or increase in voting rights pursuant to exemption provided for in clause (a) of sub-regulation (1), sub-clause (iii) of clause (d) of sub-regulation (1), clause (h) of sub-regulation (1), sub-regulation (2), sub-regulation (3) and clause (c) of sub-regulation (4), clauses (a), (b) and (f) of sub-regulation (4), the acquirer shall, within twenty-one working days of the date of acquisition, submit a report in such form as may be specified along with supporting documents to the Board giving all details in respect of acquisitions, along with a non-refundable fee of rupees twenty five thousand by way of a banker's cheque or demand draft payable in Mumbai in favour of the Board.

Explanation.—For the purposes of sub-regulation (5), sub-regulation (6) and sub-regulation (7) in the case of convertible securities, the date of the acquisition shall be the date of conversion of such securities.

Exemptions by the Board [Regulation 11]

- (1) The Board may for reasons recorded in writing, grant exemption from the obligation to make an open offer for acquiring shares under these regulations subject to such conditions as the Board deems fit to impose in the interests of investors in securities and the securities market.
- (2) The Board may for reasons recorded in writing, grant a relaxation from strict compliance with any procedural requirement under Chapter III and Chapter IV subject to such conditions as the Board deems fit to impose in the interests of investors in securities and the securities market on being satisfied that,—
 - (a) the target company is a company in respect of which the Central Government or State



Government or any other regulatory authority has superseded the board of directors of the target company and has appointed new directors under any law for the time being in force, if,—

- (i) such board of directors has formulated a plan which provides for transparent, open, and competitive process for acquisition of shares or voting rights in, or control over the target company to secure the smooth and continued operation of the target company in the interests of all stakeholders of the target company and such plan does not further the interests of any particular acquirer;
 - (ii) the conditions and requirements of the competitive process are reasonable and fair;
 - (iii) the process adopted by the board of directors of the target company provides for details including the time when the open offer for acquiring shares would be made, completed and the manner in which the change in control would be effected; and
- (b) the provisions of Chapter III and Chapter IV are likely to act as impediment to implementation of the plan of the target company and exemption from strict compliance with one or more of such provisions is in public interest, the interests of investors in securities and the securities market.
- (3) For seeking exemption under sub-regulation (1), the acquirer shall, and for seeking relaxation under sub-regulation (2) the target company shall file an application with the Board, supported by a duly sworn affidavit, giving details of the proposed acquisition and the grounds on which the exemption has been sought.
- (4) The acquirer or the target company, as the case may be, shall along with the application referred to under sub-regulation (3) pay a non-refundable fee of rupees fifty thousand, by way of a banker's cheque or demand draft payable in Mumbai in favour of the Board.
- (5) The Board may after affording reasonable opportunity of being heard to the applicant and after considering all the relevant facts and circumstances, pass a reasoned order either granting or rejecting the exemption or relaxation sought as expeditiously as possible:

Provided that the Board may constitute a panel of experts to which an application for an exemption under sub-regulation (1) may, if considered necessary, be referred to make recommendations on the application to the Board.

- (6) The order passed under sub-regulation (5) shall be hosted by the Board on its official website.

OPEN OFFER PROCESS

Manager to the open offer [Regulation 12]

- (1) Prior to making a public announcement, the acquirer shall appoint a merchant banker registered with the Board, who is not an associate of the acquirer, as the manager to the open offer.

Explanation.—For the purposes of this regulation the term "associate" has the same meaning as in the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992.

- (2) The public announcement of the open offer for acquiring shares required under these regulations shall be made by the acquirer through such manager to the open offer.

Timing [Regulation 13]

- (1) The public announcement referred to in regulation 3 and regulation 4 shall be made in accordance with regulation 14 and regulation 15, on the date of agreeing to acquire shares or voting rights in, or control over the target company.
- (2) Such public announcement,—
- (a) in the case of market purchases, shall be made prior to placement of the purchase order with the stock broker to acquire the shares, that would take the entitlement to voting rights beyond the stipulated thresholds;

- (b) pursuant to an acquirer acquiring shares or voting rights in, or control over the target company upon converting convertible securities without a fixed date of conversion or upon conversion of depository receipts for the underlying shares of the target company shall be made on the same day as the date of exercise of the option to convert such securities into shares of the target company;
 - (c) pursuant to an acquirer acquiring shares or voting rights in, or control over the target company upon conversion of convertible securities with a fixed date of conversion shall be made on the second working day preceding the scheduled date of conversion of such securities into shares of the target company;
 - (d) pursuant to a disinvestment shall be made on the same day as the date of executing the agreement for acquisition of shares or voting rights in or control over the target company;
 - (e) in the case of indirect acquisition of shares or voting rights in, or control over the target company where none of the parameters referred to in sub-regulation (2) of regulation 5 are met, may be made at any time within four working days from the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain;
 - (f) in the case of indirect acquisition of shares or voting rights in, or control over the target company where any of the parameters referred to in sub-regulation (2) of regulation 5 are met shall be made on the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain;
 - (g) pursuant to an acquirer acquiring shares or voting rights in, or control over the target company, under preferential issue, shall be made on the date on which special resolution is passed for allotment of shares under sub-section (1A) of section 81 of the Companies Act, 1956;
 - (h) the public announcement pursuant to an increase in voting rights consequential to a buy-back not qualifying for exemption under regulation 10, shall be made not later than the ninetieth day from the date of such increase in the voting rights beyond the relevant threshold stipulated in regulation 3;
 - (i) the public announcement pursuant to any acquisition of shares or voting rights in or control over the target company where the specific date on which title to such shares, voting rights or control is acquired is beyond the control of the acquirer, shall be made not later than two working days from the date of receipt of intimation of having acquired such title.
- (3) The public announcement made under regulation 6 shall be made on the same day as the date on which the acquirer takes the decision to voluntarily make a public announcement of an open offer for acquiring shares of the target company.
- (4) Pursuant to the public announcement made under sub-regulation (1) and sub-regulation (3), a detailed public statement shall be published by the acquirer through the manager to the open offer in accordance with regulation 14 and regulation 15, not later than five working days of the public announcement:

Provided that the detailed public statement pursuant to a public announcement made under clause (e) of sub-regulation (2) shall be made not later than five working days of the completion of the primary acquisition of shares or voting rights in, or control over the company or entity holding shares or voting rights in, or control over the target company.

Explanation.— It is clarified that in the event the acquirer does not succeed in acquiring the ability to exercise or direct the exercise of voting rights in, or control over the target company, the acquirer shall not be required to make a detailed public statement of an open offer for acquiring shares under these regulations.



Publication [Regulation 14]

- (1) The public announcement shall be sent to all the stock exchanges on which the shares of the target company are listed, and the stock exchanges shall forthwith disseminate such information to the public.
- (2) A copy of the public announcement shall be sent to the Board and to the target company at its registered office within one working day of the date of the public announcement.
- (3) The detailed public statement pursuant to the public announcement referred to in sub-regulation (4) of regulation 13 shall be published in all editions of any one English national daily with wide circulation, any one Hindi national daily with wide circulation, and any one regional language daily with wide circulation at the place where the registered office of the target company is situated and one regional language daily at the place of the stock exchange where the maximum volume of trading in the shares of the target company are recorded during the sixty trading days preceding the date of the public announcement.
- (4) Simultaneously with publication of such detailed public statement in the newspapers, a copy of the same shall be sent to,—
 - (i) the Board through the manager to the open offer,
 - (ii) all the stock exchanges on which the shares of the target company are listed, and the stock exchanges shall forthwith disseminate such information to the public,
 - (iii) the target company at its registered office, and the target company shall forthwith circulate it to the members of its board.

Contents [Regulation 15]

- (1) The public announcement shall contain such information as may be specified, including the following,—
 - (a) name and identity of the acquirer and persons acting in concert with him;
 - (b) name and identity of the sellers, if any;
 - (c) nature of the proposed acquisition such as purchase of shares or allotment of shares, or any other means of acquisition of shares or voting rights in, or control over the target company;
 - (d) the consideration for the proposed acquisition that attracted the obligation to make an open offer for acquiring shares, and the price per share, if any;
 - (e) the offer price, and mode of payment of consideration; and
 - (f) offer size, and conditions as to minimum level of acceptances, if any.
- (2) The detailed public statement pursuant to the public announcement shall contain such information as may be specified in order to enable shareholders to make an informed decision with reference to the open offer.
- (3) The public announcement of the open offer, the detailed public statement, and any other statement, advertisement, circular, brochure, publicity material or letter of offer issued in relation to the acquisition of shares under these regulations shall not omit any relevant information, or contain any misleading information.

Filing of letter of offer with the Board [Regulation 16]

- (1) Within five working days from the date of the detailed public statement made under sub-regulation (4) of regulation 13, the acquirer shall, through the manager to the open offer, file with the Board, a draft of the letter of offer containing such information as may be specified along with a non-refundable fee, as per the following scale, by way of a banker's cheque or demand draft payable in Mumbai in favour of the Board,—

Sl. No.	Consideration payable under the Open Offer	Fee (₹)
a.	Upto ten crore rupees.	One lakh twenty five thousands rupees (₹ 1,25,000)
b.	More than ten crore rupees, but less than or equal to one thousand crore rupees.	One Lakh twenty five thousands rupees (₹1,25,000) plus 0.025 per cent of the portion of the offer size in excess of ten crore rupees (₹10,00,00,000).
c.	More than one thousand crore rupees, but less than or equal to five thousand crore rupees.	One crore twenty five lakh rupees (₹1,25,00,00,000) plus 0.03125 per cent of the portion of the offer size in excess of one thousand crore rupees (₹1000,00,00,000).
d.	More than five thousand crore rupees.	Two crore fifty lakh rupees (₹ 2,50,00,00,000) plus 0.01 per cent of the portion of the offer size in excess of five thousand crore rupees (₹ 5000,00,00,000), subject to a maximum of three crore rupees (₹ 3,00,00,00,000).

- (2) The consideration payable under the open offer shall be calculated at the offer price, assuming full acceptance of the open offer, and in the event the open offer is subject to differential pricing, shall be computed at the highest offer price, irrespective of manner of payment of the consideration:

Provided that in the event of consideration payable under the open offer being enhanced owing to a revision to the offer price or offer size the fees payable shall stand revised accordingly, and shall be paid within five working days from the date of such revision.

- (3) The manager to the open offer shall provide soft copies of the public announcement, the detailed public statement and the draft letter of offer in accordance with such specifications as may be specified, and the Board shall upload the same on its website.
- (4) The Board shall give its comments on the draft letter of offer as expeditiously as possible but not later than fifteen working days of the receipt of the draft letter of offer and in the event of no comments being issued by the Board within such period, it shall be deemed that the Board does not have comments to offer:

Provided that in the event the Board has sought clarifications or additional information from the manager to the open offer, the period for issuance of comments shall be extended to the fifth working day from the date of receipt of satisfactory reply to the clarification or additional information sought.

Provided further that in the event the Board specifies any changes, the manager to the open offer and the acquirer shall carry out such changes in the letter of offer before it is dispatched to the shareholders.

- (5) In the case of competing offers, the Board shall provide its comments on the draft letter of offer in respect of each competing offer on the same day.
- (6) In the event the disclosures in the draft letter of offer are inadequate the Board may call for a revised letter of offer and shall deal with the revised letter of offer in accordance with sub-regulation (4).

Provision of escrow [Regulation 17]

- (1) Not later than two working days prior to the date of the detailed public statement of the open offer for acquiring shares, the acquirer shall create an escrow account towards security for performance of his obligations under these regulations, and deposit in escrow account such aggregate amount as per the following scale:



Sl. No.	Consideration payable under the Open Offer	Escrow Amount
a.	On the first five hundred crore rupees	an amount equal to twenty-five per cent of the consideration
b.	On the balance consideration	an additional amount equal to ten per cent of the balance consideration

Provided that where an open offer is made conditional upon minimum level of acceptance, hundred percent of the consideration payable in respect of minimum level of acceptance or fifty per cent of the consideration payable under the open offer, whichever is higher, shall be deposited in cash in the escrow account.

- (2) The consideration payable under the open offer shall be computed as provided for in sub-regulation (2) of regulation 16 and in the event of an upward revision of the offer price or of the offer size, the value of the escrow amount shall be computed on the revised consideration calculated at such revised offer price, and the additional amount shall be brought into the escrow account prior to effecting such revision.
- (3) The escrow account referred to in sub-regulation (1) may be in the form of,—
 - (a) cash deposited with any scheduled commercial bank;
 - (b) bank guarantee issued in favour of the manager to the open offer by any scheduled commercial bank; or
 - (c) deposit of frequently traded and freely transferable equity shares or other freely transferable securities with appropriate margin:

Provided that securities sought to be provided towards escrow account under clause (c) shall be required to conform to the requirements set out in sub-regulation (2) of regulation 9.

- (4) In the event of the escrow account being created by way of a bank guarantee or by deposit of securities, the acquirer shall also ensure that at least one per cent of the total consideration payable is deposited in cash with a scheduled commercial bank as a part of the escrow account.
- (5) For such part of the escrow account as is in the form of a cash deposit with a scheduled commercial bank, the acquirer shall while opening the account, empower the manager to the open offer to instruct the bank to issue a banker's cheque or demand draft or to make payment of the amounts lying to the credit of the escrow account, in accordance with requirements under these regulations.
- (6) For such part of the escrow account as is in the form of a bank guarantee, such bank guarantee shall be in favour of the manager to the open offer and shall be kept valid throughout the offer period and for an additional period of thirty days after completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer.
- (7) For such part of the escrow account as is in the form of securities, the acquirer shall empower the manager to the open offer to realise the value of such escrow account by sale or otherwise, and in the event there is any shortfall in the amount required to be maintained in the escrow account, the manager to the open offer shall be liable to make good such shortfall.
- (8) The manager to the open offer shall not release the escrow account until the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, save and except for transfer of funds to the special escrow account as required under regulation 21.
- (9) In the event of non-fulfillment of obligations under these regulations by the acquirer the Board may direct the manager to the open offer to forfeit the escrow account or any amounts lying in the special escrow account, either in full or in part.

- (10) The escrow account deposited with the bank in cash shall be released only in the following manner,—
- (a) the entire amount to the acquirer upon withdrawal of offer in terms of regulation 23 as certified by the manager to the open offer:
Provided that in the event the withdrawal is pursuant to clause (c) of sub-regulation (1) of regulation 23, the manager to the open offer shall release the escrow account upon receipt of confirmation of such release from the Board;
 - (b) for transfer of an amount not exceeding ninety per cent of the escrow account, to the special escrow account in accordance with regulation 21;
 - (c) to the acquirer, the balance of the escrow account after transfer of cash to the special escrow account, on the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, as certified by the manager to the open offer;
 - (d) the entire amount to the acquirer upon the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, upon certification by the manager to the open offer, where the open offer is for exchange of shares or other secured instruments;
 - (e) the entire amount to the manager to the open offer, in the event of forfeiture for non-fulfillment of any of the obligations under these regulations, for distribution in the following manner, after deduction of expenses, if any, of registered market intermediaries associated with the open offer,—
 - (i) one third of the escrow account to the target company;
 - (ii) one third of the escrow account to the Investor Protection and Education Fund established under the Securities and Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009; and
 - (iii) one third of the escrow account to be distributed pro-rata among the shareholders who have accepted the open offer.

Other procedures [Regulation 18]

- (1) Simultaneously with the filing of the draft letter of offer with the Board under sub-regulation (1) of regulation 16, the acquirer shall send a copy of the draft letter of offer to the target company at its registered office address and to all stock exchanges where the shares of the target company are listed.
- (2) The letter of offer shall be dispatched to the shareholders whose names appear on the register of members of the target company as of the identified date, not later than seven working days from the receipt of comments from the Board or where no comments are offered by the Board, within seven working days from the expiry of the period stipulated in sub-regulation (4) of regulation 16:
Provided that where local laws or regulations of any jurisdiction outside India may expose the acquirer or the target company to material risk of civil, regulatory or criminal liabilities in the event the letter of offer in its final form were to be sent without material amendments or modifications into such jurisdiction, and the shareholders resident in such jurisdiction hold shares entitling them to less than five per cent of the voting rights of the target company, the acquirer may refrain from dispatch of the letter of offer into such jurisdiction:
Provided further that every person holding shares, regardless of whether he held shares on the identified date or has not received the letter of offer, shall be entitled to tender such shares in acceptance of the open offer.
- (3) Simultaneously with the dispatch of the letter of offer in terms of sub-regulation (2), the acquirer shall send the letter of offer to the custodian of shares underlying depository receipts, if any, of the target company.



- (4) Irrespective of whether a competing offer has been made, an acquirer may make upward revisions to the offer price, and subject to the other provisions of these regulations, to the number of shares sought to be acquired under the open offer, at any time prior to the commencement of the last three working days before the commencement of the tendering period.
- (5) In the event of any revision of the open offer, whether by way of an upward revision in offer price, or of the offer size, the acquirer shall,—
 - (a) make corresponding increases to the amount kept in escrow account under regulation 17 prior to such revision;
 - (b) make an announcement in respect of such revisions in all the newspapers in which the detailed public statement pursuant to the public announcement was made; and
 - (c) simultaneously with the issue of such an announcement, inform the Board, all the stock exchanges on which the shares of the target company are listed, and the target company at its registered office.

- (6) The acquirer shall disclose during the offer period every acquisition made by the acquirer or persons acting in concert with him of any shares of the target company in such form as may be specified, to each of the stock exchanges on which the shares of the target company are listed and to the target company at its registered office within twenty-four hours of such acquisition, and the stock exchanges shall forthwith disseminate such information to the public:

Provided that the acquirer and persons acting in concert with him shall not acquire or sell any shares of the target company during the period between three working days prior to the commencement of the tendering period and until the expiry of the tendering period.

- (7) The acquirer shall issue an advertisement in such form as may be specified, one working day before the commencement of the tendering period, announcing the schedule of activities for the open offer, the status of statutory and other approvals, if any, whether for the acquisition attracting the obligation to make an open offer under these regulations or for the open offer, unfulfilled conditions, if any, and their status, the procedure for tendering acceptances and such other material detail as may be specified:

Provided that such advertisement shall be,—

- (a) published in all the newspapers in which the detailed public statement pursuant to the public announcement was made; and
 - (b) simultaneously sent to the Board, all the stock exchanges on which the shares of the target company are listed, and the target company at its registered office.
- (8) The tendering period shall start not later than twelve working days from date of receipt of comments from the Board under sub-regulation (4) of regulation 16 and shall remain open for ten working days.
 - (9) Shareholders who have tendered shares in acceptance of the open offer shall not be entitled to withdraw such acceptance during the tendering period.
 - (10) The acquirer shall, within ten working days from the last date of the tendering period, complete all requirements under these regulations and other applicable law relating to the open offer including payment of consideration to the shareholders who have accepted the open offer.
 - (11) The acquirer shall be responsible to pursue all statutory approvals required by the acquirer in order to complete the open offer without any default, neglect or delay:

Provided that where the acquirer is unable to make the payment to the shareholders who have accepted the open offer within such period owing to non-receipt of statutory approvals required by the acquirer, the Board may, where it is satisfied that such non-receipt was not attributable to any willful default, failure or neglect on the part of the acquirer to diligently pursue such approvals, grant extension of time for making payments, subject to the acquirer agreeing to pay interest to the shareholders for the delay at such rate as may be specified:

Provided further that where the statutory approval extends to some but not all shareholders, the

acquirer shall have the option to make payment to such shareholders in respect of whom no statutory approvals are required in order to complete the open offer.

- (12) (a) The acquirer shall issue a post offer advertisement in such form as may be specified within five working days after the offer period, giving details including aggregate number of shares tendered, accepted, date of payment of consideration.
- (b) Such advertisement shall be,—
 - (i) published in all the newspapers in which the detailed public statement pursuant to the public announcement was made; and
 - (ii) simultaneously sent to the Board, all the stock exchanges on which the shares of the target company are listed, and the target company at its registered office.

Conditional offer [Regulation 19]

- (1) An acquirer may make an open offer conditional as to the minimum level of acceptance:
Provided that where the open offer is pursuant to an agreement, such agreement shall contain a condition to the effect that in the event the desired level of acceptance of the open offer is not received the acquirer shall not acquire any shares under the open offer and the agreement attracting the obligation to make the open offer shall stand rescinded.
- (2) Where an open offer is made conditional upon minimum level of acceptances, the acquirer and persons acting in concert with him shall not acquire, during the offer period, any shares in the target company except under the open offer and any underlying agreement for the sale of shares of the target company pursuant to which the open offer is made.

Competing offers [Regulation 20]

- (1) Upon a public announcement of an open offer for acquiring shares of a target company being made, any person, other than the acquirer who has made such public announcement, shall be entitled to make a public announcement of an open offer within fifteen working days of the date of the detailed public statement made by the acquirer who has made the first public announcement.
- (2) The open offer made under sub-regulation (1) shall be for such number of shares which, when taken together with shares held by such acquirer along with persons acting in concert with him, shall be at least equal to the holding of the acquirer who has made the first public announcement, including the number of shares proposed to be acquired by him under the offer and any underlying agreement for the sale of shares of the target company pursuant to which the open offer is made.
- (3) Notwithstanding anything contained in these regulations, an open offer made within the period referred to in sub-regulation (1) shall not be regarded as a voluntary open offer under regulation 6, and the provisions of these regulations shall apply accordingly.
- (4) Every open offer made under sub-regulation (1) and the open offer first made shall be regarded as competing offers for purposes of these regulations.
- (5) No person shall be entitled to make a public announcement of an open offer for acquiring shares, or enter into any transaction that would attract the obligation to make a public announcement of an open offer for acquiring shares under these regulations, after the period of fifteen working days referred to in sub-regulation (1) and until the expiry of the offer period for such open offer.
- (6) Unless the open offer first made is an open offer conditional as to the minimum level of acceptances, no acquirer making a competing offer may be made conditional as to the minimum level of acceptances.
- (7) No person shall be entitled to make a public announcement of an open offer for acquiring shares, or enter into any transaction that would attract the obligation to make a public announcement of an open offer under these regulations until the expiry of the offer period where,—



- (a) the open offer is for acquisition of shares pursuant to disinvestment, in terms of clause (d) of sub-regulation (2) of regulation 13; or
 - (b) the open offer is pursuant to a relaxation from strict compliance with the provisions of Chapter III or Chapter IV granted by the Board under sub-regulation (2) of regulation 11.
- (8) The schedule of activities and the tendering period for all competing offers shall be carried out with identical timelines and the last date for tendering shares in acceptance of the every competing offer shall stand revised to the last date for tendering shares in acceptance of the competing offer last made.
- (9) Upon the public announcement of a competing offer, an acquirer who had made a preceding competing offer shall be entitled to revise the terms of his open offer provided the revised terms are more favourable to the shareholders of the target company:
- Provided** that the acquirers making the competing offers shall be entitled to make upward revisions of the offer price at any time up to three working days prior to the commencement of the tendering period.
- (10) Except for variations made under this regulation, all the provisions of these regulations shall apply to every competing offer.

Payment of consideration [Regulation 21]

- (1) For the amount of consideration payable in cash, the acquirer shall open a special escrow account with a banker to an issue registered with the Board and deposit therein, such sum as would, together with cash transferred under clause (b) of sub-regulation (10) of regulation 17, make up the entire sum due and payable to the shareholders as consideration payable under the open offer, and empower the manager to the offer to operate the special escrow account on behalf of the acquirer for the purposes under these regulations.
- (2) Subject to provisos to sub-regulation (11) of regulation 18, the acquirer shall complete payment of consideration whether in the form of cash, or as the case may be, by issue, exchange or transfer of securities, to all shareholders who have tendered shares in acceptance of the open offer, within ten working days of the expiry of the tendering period.
- (3) Unclaimed balances, if any, lying to the credit of the special escrow account referred to in sub-regulation (1) at the end of seven years from the date of deposit thereof, shall be transferred to the Investor Protection and Education Fund established under the Securities and Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009.

Completion of acquisition [Regulation 22]

- (1) The acquirer shall not complete the acquisition of shares or voting rights in, or control over, the target company, whether by way of subscription to shares or a purchase of shares attracting the obligation to make an open offer for acquiring shares, until the expiry of the offer period:
- Provided** that in case of an offer made under sub-regulation (1) of regulation 20, pursuant to a preferential allotment, the offer shall be completed within the period as provided under sub-regulation (1) of regulation 74 of Securities and Exchange Board of India (Issue of Capital and Disclosure) Regulations, 2009.
- (2) Notwithstanding anything contained in sub-regulation (1), subject to the acquirer depositing in the escrow account under regulation 17, cash of an amount equal to one hundred per cent of the consideration payable under the open offer assuming full acceptance of the open offer, the parties to such agreement may after the expiry of twenty-one working days from the date of detailed public statement, act upon the agreement and the acquirer may complete the acquisition of shares or voting rights in, or control over the target company as contemplated.
 - (3) The acquirer shall complete the acquisitions contracted under any agreement attracting the obligation to make an open offer not later than twenty-six weeks from the expiry of the offer period:

Provided that in the event of any extraordinary and supervening circumstances rendering it

impossible to complete such acquisition within such period, the Board may for reasons to be published, may grant an extension of time by such period as it may deem fit in the interests of investors in securities and the securities market.

Withdrawal of open offer [Regulation 23]

- (1) An open offer for acquiring shares once made shall not be withdrawn except under any of the following circumstances,—
 - (a) statutory approvals required for the open offer or for effecting the acquisitions attracting the obligation to make an open offer under these regulations having been finally refused, subject to such requirements for approval having been specifically disclosed in the detailed public statement and the letter of offer;
 - (b) the acquirer, being a natural person, has died;
 - (c) any condition stipulated in the agreement for acquisition attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer, and such agreement is rescinded, subject to such conditions having been specifically disclosed in the detailed public statement and the letter of offer; or
 - (d) such circumstances as in the opinion of the Board, merit withdrawal.

Explanation.— For the purposes of clause (d) of sub-regulation (1), the Board shall pass a reasoned order permitting withdrawal, and such order shall be hosted by the Board on its official website.
- (2) In the event of withdrawal of the open offer, the acquirer shall through the manager to the open offer, within two working days,—
 - (a) make an announcement in the same newspapers in which the public announcement of the open offer was published, providing the grounds and reasons for withdrawal of the open offer; and
 - (b) simultaneously with the announcement, inform in writing to,—
 - (i) the Board;
 - (ii) all the stock exchanges on which the shares of the target company are listed, and the stock exchanges shall forthwith disseminate such information to the public; and
 - (iii) the target company at its registered office.

OTHER OBLIGATIONS

Directors of the target company [Regulation 24]

- (1) During the offer period, no person representing the acquirer or any person acting in concert with him shall be appointed as director on the board of directors of the target company, whether as an additional director or in a casual vacancy.

Provided that after an initial period of fifteen working days from the date of detailed public statement, appointment of persons representing the acquirer or persons acting in concert with him on the board of directors may be effected in the event the acquirer deposits in cash in the escrow account referred to in regulation 17, one hundred per cent of the consideration payable under the open offer.

Provided further that where the acquirer has specified conditions to which the open offer is subject in terms of clause (c) of sub-regulation (1) of regulation 23, no director representing the acquirer may be appointed to the board of directors of the target company during the offer period unless the acquirer has waived or attained such conditions and complies with the requirement of depositing cash in the escrow account.
- (2) Where an open offer is made conditional upon minimum level of acceptances, the acquirer and persons acting in concert shall, notwithstanding anything contained in these regulations, and regardless of the size of the cash deposited in the escrow account referred to regulation 17, not



be entitled to appoint any director representing the acquirer or any person acting in concert with him on the board of directors of the target company during the offer period.

- (3) During the pendency of competing offers, notwithstanding anything contained in these regulations, and regardless of the size of the cash deposited in the escrow account referred to in regulation 17, by any acquirer or person acting in concert with him, there shall be no induction of any new director to the board of directors of the target company:

Provided that in the event of death or incapacitation of any director, the vacancy arising therefrom may be filled by any person subject to approval of such appointment by shareholders of the target company by way of a postal ballot.

- (4) In the event the acquirer or any person acting in concert is already represented by a director on the board of the target company, such director shall not participate in any deliberations of the board of directors of the target company or vote on any matter in relation to the open offer.

Obligations of the acquirer [Regulation 25]

- (1) Prior to making the public announcement of an open offer for acquiring shares under these regulations, the acquirer shall ensure that firm financial arrangements have been made for fulfilling the payment obligations under the open offer and that the acquirer is able to implement the open offer, subject to any statutory approvals for the open offer that may be necessary.
- (2) In the event the acquirer has not declared an intention in the detailed public statement and the letter of offer to alienate any material assets of the target company or of any of its subsidiaries whether by way of sale, lease, encumbrance or otherwise outside the ordinary course of business, the acquirer, where he has acquired control over the target company, shall be debarred from causing such alienation for a period of two years after the offer period:

Provided that in the event the target company or any of its subsidiaries is required to so alienate assets despite the intention to alienate not having been expressed by the acquirer, such alienation shall require a special resolution passed by shareholders of the target company, by way of a postal ballot and the notice for such postal ballot shall inter alia contain reasons as to why such alienation is necessary.

- (3) The acquirer shall ensure that the contents of the public announcement, the detailed public statement, the letter of offer and the post-offer advertisement are true, fair and adequate in all material aspects and not misleading in any material particular, and are based on reliable sources, and state the source wherever necessary.
- (4) The acquirer and persons acting in concert with him shall not sell shares of the target company held by them, during the offer period.
- (5) The acquirer and persons acting in concert with him shall be jointly and severally responsible for fulfillment of applicable obligations under these regulations.

Obligations of the target company [Regulation 26]

- (1) Upon a public announcement of an open offer for acquiring shares of a target company being made, the board of directors of such target company shall ensure that during the offer period, the business of the target company is conducted in the ordinary course consistent with past practice.
- (2) During the offer period, unless the approval of shareholders of the target company by way of a special resolution by postal ballot is obtained, the board of directors of either the target company or any of its subsidiaries shall not,—
 - (a) alienate any material assets whether by way of sale, lease, encumbrance or otherwise or enter into any agreement therefor outside the ordinary course of business;
 - (b) effect any material borrowings outside the ordinary course of business;
 - (c) issue or allot any authorised but unissued securities entitling the holder to voting rights:

Provided that the target company or its subsidiaries may,—

- (i) issue or allot shares upon conversion of convertible securities issued prior to the public announcement of the open offer, in accordance with pre-determined terms of such conversion;
- (ii) issue or allot shares pursuant to any public issue in respect of which the red herring prospectus has been filed with the Registrar of Companies prior to the public announcement of the open offer; or
- (iii) issue or allot shares pursuant to any rights issue in respect of which the record date has been announced prior to the public announcement of the open offer;
- (d) implement any buy-back of shares or effect any other change to the capital structure of the target company;
- (e) enter into, amend or terminate any material contracts to which the target company or any of its subsidiaries is a party, outside the ordinary course of business, whether such contract is with a related party, within the meaning of the term under applicable accounting principles, or with any other person; and
- (f) accelerate any contingent vesting of a right of any person to whom the target company or any of its subsidiaries may have an obligation, whether such obligation is to acquire shares of the target company by way of employee stock options or otherwise.
- (3) In any general meeting of a subsidiary of the target company in respect of the matters referred to in sub-regulation (2), the target company and its subsidiaries, if any, shall vote in a manner consistent with the special resolution passed by the shareholders of the target company.
- (4) The target company shall be prohibited from fixing any record date for a corporate action on or after the third working day prior to the commencement of the tendering period and until the expiry of the tendering period.
- (5) The target company shall furnish to the acquirer within two working days from the identified date, a list of shareholders as per the register of members of the target company containing names, addresses, shareholding and folio number, in electronic form, wherever available, and a list of persons whose applications, if any, for registration of transfer of shares are pending with the target company:
Provided that the acquirer shall reimburse reasonable costs payable by the target company to external agencies in order to furnish such information.
- (6) Upon receipt of the detailed public statement, the board of directors of the target company shall constitute a committee of independent directors to provide reasoned recommendations on such open offer, and the target company shall publish such recommendations:
Provided that such committee shall be entitled to seek external professional advice at the expense of the target company.
- (7) The committee of independent directors shall provide its written reasoned recommendations on the open offer to the shareholders of the target company and such recommendations shall be published in such form as may be specified, at least two working days before the commencement of the tendering period, in the same newspapers where the public announcement of the open offer was published, and simultaneously, a copy of the same shall be sent to,—
 - (i) the Board;
 - (ii) all the stock exchanges on which the shares of the target company are listed, and the stock exchanges shall forthwith disseminate such information to the public; and
 - (iii) to the manager to the open offer, and where there are competing offers, to the manager to the open offer for every competing offer.
- (8) The board of directors of the target company shall facilitate the acquirer in verification of shares tendered in acceptance of the open offer.
- (9) The board of directors of the target company shall make available to all acquirers making



competing offers, any information and co-operation provided to any acquirer who has made a competing offer.

- (10) Upon fulfillment by the acquirer, of the conditions required under these regulations, the board of directors of the target company shall without any delay register the transfer of shares acquired by the acquirer in physical form, whether under the agreement or from open market purchases, or pursuant to the open offer.

Obligations of the manager to the open offer [Regulation 27]

- (1) Prior to public announcement being made, the manager to the open offer shall ensure that,—
 - (a) the acquirer is able to implement the open offer; and
 - (b) firm arrangements for funds through verifiable means have been made by the acquirer to meet the payment obligations under the open offer.
- (2) The manager to the open offer shall ensure that the contents of the public announcement, the detailed public statement and the letter of offer and the post-offer advertisement are true, fair and adequate in all material aspects, not misleading in any material particular, are based on reliable sources, state the source wherever necessary, and are in compliance with the requirements under these regulations.
- (3) The manager to the open offer shall furnish to the Board a due diligence certificate along with the draft letter of offer filed under regulation 16.
- (4) The manager to the open offer shall ensure that market intermediaries engaged for the purposes of the open offer are registered with the Board.
- (5) The manager to the open offer shall exercise diligence, care and professional judgment to ensure compliance with these regulations.
- (6) The manager to the open offer shall not deal on his own account in the shares of the target company during the offer period.
- (7) The manager to the open offer shall file a report with the Board within fifteen working days from the expiry of the tendering period, in such form as may be specified, confirming status of completion of various open offer requirements.

DISCLOSURES OF SHAREHOLDING AND CONTROL

Disclosure-related provisions [Regulation 28]

- (1) The disclosures under this Chapter shall be of the aggregated shareholding and voting rights of the acquirer or promoter of the target company or every person acting in concert with him.
- (2) For the purposes of this Chapter, the acquisition and holding of any convertible security shall also be regarded as shares, and disclosures of such acquisitions and holdings shall be made accordingly.
- (3) For the purposes of this Chapter, the term "encumbrance" shall include a pledge, lien or any such transaction, by whatever name called.
- (4) Upon receipt of the disclosures required under this Chapter, the stock exchange shall forthwith disseminate the information so received.

Disclosure of acquisition and disposal [Regulation 29]

- (1) Any acquirer who acquires shares or voting rights in a target company which taken together with shares or voting rights, if any, held by him and by persons acting in concert with him in such target company, aggregating to five per cent or more of the shares of such target company, shall disclose their aggregate shareholding and voting rights in such target company in such form as may be specified.
- (2) Any acquirer, who together with persons acting in concert with him, holds shares or voting rights entitling them to five per cent or more of the shares or voting rights in a target company, shall disclose every acquisition or disposal of shares of such target company representing two per

cent or more of the shares or voting rights in such target company in such form as may be specified.

- (3) The disclosures required under sub-regulation (1) and sub-regulation (2) shall be made within two working days of the receipt of intimation of allotment of shares, or the acquisition of shares or voting rights in the target company to,—
 - (a) every stock exchange where the shares of the target company are listed; and
 - (b) the target company at its registered office.
- (4) For the purposes of this regulation, shares taken by way of encumbrance shall be treated as an acquisition, shares given upon release of encumbrance shall be treated as a disposal, and disclosures shall be made by such person accordingly in such form as may be specified:

Provided that such requirement shall not apply to a scheduled commercial bank or public financial institution as pledgee in connection with a pledge of shares for securing indebtedness in the ordinary course of business.

Continual disclosures [Regulation 30]

- (1) Every person, who together with persons acting in concert with him, holds shares or voting rights entitling him to exercise twenty-five per cent or more of the voting rights in a target company, shall disclose their aggregate shareholding and voting rights as of the thirty-first day of March, in such target company in such form as may be specified.
- (2) The promoter of every target company shall together with persons acting in concert with him, disclose their aggregate shareholding and voting rights as of the thirty-first day of March, in such target company in such form as may be specified.
- (3) The disclosures required under sub-regulation (1) and sub-regulation (2) shall be made within seven working days from the end of each financial year to,—
 - (a) every stock exchange where the shares of the target company are listed; and
 - (b) the target company at its registered office.

Disclosure of encumbered shares [Regulation 31]

- (1) The promoter of every target company shall disclose details of shares in such target company encumbered by him or by persons acting in concert with him in such form as may be specified.
- (2) The promoter of every target company shall disclose details of any invocation of such encumbrance or release of such encumbrance of shares in such form as may be specified.
- (3) The disclosures required under sub-regulation (1) and sub-regulation (2) shall be made within seven working days from the creation or invocation or release of encumbrance, as the case may be to,—
 - (a) every stock exchange where the shares of the target company are listed; and
 - (b) the target company at its registered office.

MISCELLANEOUS

Power to issue directions [Regulation 32]

- (1) Without prejudice to its powers under Chapter VIA and section 24 of the Act, the Board may, in the interest of investors in securities and the securities market, issue such directions as it deems fit under section 11 or section 11B or section 11D of the Act, including,—
 - (a) directing divestment of shares acquired in violation of these regulations, whether through public auction or in the open market, or through an offer for sale under the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, and directing the appointment of a merchant banker for such divestiture;
 - (b) directing transfer of the shares, or any proceeds of a directed sale of shares acquired in violation of these regulations to the Investor Protection and Education Fund established

under the Securities and Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009;

- (c) directing the target company or any depository not to give effect to any transfer of shares acquired in violation of these regulations;
 - (d) directing the acquirer or any person acting in concert, or any nominee or proxy not to exercise any voting or other rights attached to shares acquired in violation of these regulations;
 - (e) debarring any person who has violated these regulations from accessing the capital market or dealing in securities for such period as may be directed, having regard to the nature and gravity of the violation;
 - (f) directing the acquirer to make an open offer for acquiring shares of the target company at such offer price as determined by the Board in accordance with these regulations;
 - (g) directing the acquirer not to cause, and the target company not to effect, any disposal of assets of the target company or any of its subsidiaries contrary to the contents of the letter of offer, where the conditions set out in the proviso to sub-regulation (2) of regulation 25 are not met;
 - (h) directing the acquirer who has failed to make an open offer or has delayed the making of an open offer, to make the open offer and to pay interest at such rate as considered appropriate by the Board along with the offer price;
 - (i) directing the acquirer who has failed to make payment of the open offer consideration to shareholders, not to make any open offer or enter into any transaction that would attract the obligation to make an open offer in respect of shares of any target company for such period as the Board may deem fit;
 - (j) directing the acquirer who has made an open offer but has delayed making payment of the open offer consideration to shareholders, to pay interest at such rate as considered appropriate by the Board for the delayed period;
 - (k) directing any person to cease and desist from exercising control acquired over any target company without complying with the requirements under these regulations;
 - (l) directing divestiture of such number of shares as would result in the shareholding of an acquirer and persons acting in concert with him being limited to the maximum permissible non-public shareholding or below.
- (2) In any proceedings initiated by the Board, the Board shall comply with principles of natural justice before issuing directions to any person.
- (3) The Board may, for failure to carry out the requirements of these regulations by any intermediary registered with the Board, initiate appropriate proceedings in accordance with applicable regulations.

Power to remove difficulties [Regulation 33]

In order to remove any difficulties in the interpretation or application of the provisions of these regulations, the Board shall have the power to issue directions through guidance notes or circulars:

Provided that where any direction is issued by the Board in a specific case relating to interpretation or application of any provision of these regulations, it shall be done only after affording a reasonable opportunity of being heard to the concerned persons and after recording reasons for the direction.

Amendment to other regulations [Regulation 34]

The regulations specified in the Schedule shall be amended in the manner and to the extent stated therein.

Repeal and Savings [Regulation 35]

- (1) The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, stand repealed from the date on which these regulations come into force.

- (2) Notwithstanding such repeal,—
 - (a) anything done or any action taken or purported to have been done or taken including comments on any letter of offer, exemption granted by the Board, fees collected, any adjudication, enquiry or investigation commenced or show-cause notice issued under the repealed regulations, prior to such repeal, shall be deemed to have been done or taken under the corresponding provisions of these regulations;
 - (b) the previous operation of the repealed regulations or anything duly done or suffered thereunder, any right, privilege, obligation or liability acquired, accrued or incurred under the repealed regulations, any penalty, forfeiture or punishment incurred in respect of any offence committed against the repealed regulations, or any investigation, legal proceeding or remedy in respect of any such right, privilege, obligation, liability, penalty, forfeiture or punishment as aforesaid, shall remain unaffected as if the repealed regulations has never been repealed;
 - (c) any open offer for which a public announcement has been made under the repealed regulations shall be required to be continued and completed under the repealed regulations.
- (3) After the repeal of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, any reference thereto in any other regulations made, guidelines or circulars issued thereunder by the Board shall be deemed to be a reference to the corresponding provisions of these regulations.

Study Note - 4

THE COMPETITION ACT, 2002 AND ITS ROLE IN CORPORATE GOVERNANCE



This Study Note includes

- 4.1 Preliminary
- 4.2 Prohibition of certain Agreements, Abuse of Dominant position and Regulation of Combination
- 4.3 Competition commission of India
- 4.4 Duties, Powers and Functions of Commission
- 4.5 Duties of Director General
- 4.6 Penalties
- 4.7 Competition Advocacy
- 4.8 Finance, Accounts and Audit
- 4.9 Competition Appellate Tribunal
- 4.10 Miscellaneous
- 4.11 MRTP Act vs. Competition Act
- 4.12 Competition Act, 2002 and Corporate Governance

4.1 PRELIMINARY

Short title, extent and commencement [Section 1]

- (1) This Act may be called The Competition Act, 2002.
- (2) It extends to the whole of India except the State of Jammu and Kashmir.
- (3) It shall come into force on such date' as the Central Government may, by notification in the Official Gazette, appoint:

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

Definitions [Section 2]

In this Act, unless the context otherwise requires,-

- (a) "acquisition" means, directly or indirectly, acquiring or agreeing to acquire-
 - (i) Shares, voting rights or assets of any enterprise; or
 - (ii) control over management or control over assets of any enterprise;
- (b) "agreement" includes any arrangement or understanding or action in concert,-
 - (i) whether or not, such arrangement, understanding or action is formal or in writing; or
 - (ii) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;
- (ba) "Appellate Tribunal" means the Competition Appellate Tribunal established under sub-section (1) of Section 53A;

- (c) "cartel" includes an association of producers, sellers, distributors, traders or service providers who, by agreement amongst themselves, limit, control or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services;
- (d) "Chairperson" means the Chairperson of the Commission appointed under sub-section (1) of section 8;
- (e) "Commission" means the Competition Commission of India established under sub-section (1) of section 7;
- (f) "consumer" means any person who--
 - (i) buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment when such use is made with the approval of such person, whether such purchase of goods is for resale or for any commercial purpose or for personal use;
 - (ii) hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such services other than the person who hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first mentioned person whether such hiring or availing of services is for any commercial purpose or for personal use;
- (g) "Director General" means the Director General appointed under sub-section (1) of section 16 and includes any Additional, Joint, Deputy or Assistant Directors General appointed under that section;
- (h) "enterprise" means a person or a department of the Government, who or which is, or has been, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services, of any kind, or in investment, or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, either directly or through one or more of its units or divisions or subsidiaries, whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or at different places, but does not include any activity of the Government relating to the sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space.

Explanation.- For the purposes of this clause,-

- (a) "activity" includes profession or occupation;
- (b) "article" includes a new article and "service" includes a new service; (c) "unit" or "division", in relation to an enterprise, includes-
 - (i) a plant or factory established for the production, storage, supply, distribution, acquisition or control of any article or goods;
 - (ii) any branch or office established for the provision of any service;
- (i) "goods" means goods as defined in the Sale of Goods Act, 1930 (3 of 1930) and includes-
 - (A) products manufactured, processed or mined;
 - (B) debentures, stocks and shares after allotment;



- (C) in relation to goods supplied, distributed or controlled in India, goods imported into India;
- (j) "Member" means a Member of the Commission appointed under sub-section (1) of section 8 and includes the Chairperson;
- (k) "notification" means a notification published in the Official Gazette; (1) "person" includes-
- (i) an individual;
 - (ii) a Hindu undivided family;
 - (iii) a company;
 - (iv) a firm;
 - (v) an association of persons or a body of individuals, whether incorporated or not, in India or outside India;
 - (vi) any corporation established by or under any Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956);
 - (vii) any body corporate incorporated by or under the laws of a country outside India;
 - (viii) a cooperative society registered under any law relating to cooperative societies;
 - (ix) a local authority;
 - (x) every artificial juridical person, not falling within any of the preceding sub-clauses;
- (m) "practice" includes any practice relating to the carrying on of any trade by a person or an enterprise;
- (n) "prescribed" means prescribed by rules made under this Act;
- (o) "Price", in relation to the sale of any goods or to the performance of any services, includes every valuable consideration, whether direct or indirect, of deferred, and includes any consideration which in effect relates to any goods or to the performance of any services although ostensibly relating to any other matter or thing;
- (p) "public financial institution" means a public financial institution specified under section 4A of the Companies Act, 1956 (1 of 1956) and includes a State Financial, Industrial or Investment Corporation;
- (q) "regulations" means the regulations made by the Commission under section 64;
- (r) "relevant market" means the market which may be determined by the Commission with reference to the relevant product market of the relevant geographic market or with reference to both the markets;
- (s) "relevant geographic market" means a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and can be distinguished from the conditions prevailing in the neighbouring areas;
- (t) "relevant product market" means a market comprising all those products or services which are regarded as interchangeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices and intended use;
- (u) "service" means service of any the description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial matters such as banking, communication, education, financing, insurance, chit funds, real estate, transport, storage material treatment, processing, supply of electrical or other energy, boarding, lodging, entertainment, amusement, construction, repair, conveying of news or information and advertising;

- (v) "shares" means shares in the share capital of a company carrying voting rights and includes-
 - (i) any security which entitles the holder to receive shares with voting rights;
 - (ii) stock except where a distinction between stock and share is expressed or implied;
- (w) "statutory authority" means any authority, board, corporation, council, institute, university or any other body corporate, established by or under anti. Central, State or Provincial. Act for the purposes of regulating production or supply of goods or provision of any services or markets therefor or any matter connected therewith or incidental thereto;
- (x) "trade" means any trade, business, industry, profession or occupation relating to the production, supply, distribution, storage or control of goods and includes the provision of any services;
- (y) "turnover" includes value of sale of goods or services;
- (z) words and expressions used but not defined in this Act and defined in the Companies Act, 1956 (1 of 1956) shall have the same meanings respectively assigned to them in that Act.

4.2 PROHIBITION OF CERTAIN AGREEMENTS, ABUSE OF DOMINANT POSITION AND REGULATION OF COMBINATIONS

Anti-competitive agreements [Section 3]

- (1) No enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India.
- (2) Any agreement entered into in contravention of the provisions contained in sub-section (1) shall be void.
- (3) Any agreement entered into between enterprises or associations of enterprises or persons or associations of persons or between any person and enterprise or practice carried on, or decision taken by, any association of enterprises or association of persons, including cartels, engaged in identical or similar trade of goods or provision of services, which-
 - (a) directly or indirectly determines purchase or sale prices;
 - (b) limits or controls production, supply, markets, technical development, investment or provision of services;
 - (c) shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods or services, or number of customers in the market or any other similar way;
 - (d) directly or indirectly results in bid rigging or collusive bidding,

shall be presumed to have an appreciable adverse effect on competition:

Provided that nothing contained in this sub-section shall apply to any agreement entered into by way of joint ventures if such agreement increases efficiency in Production supply, distribution, storage, acquisition or control of goods or provision of services.

Explanation.- For the purposes of this sub-section, "bid rigging" means any agreement, between enterprises or persons referred to in sub-section (3) engaged in identical or similar production or trading of goods or provision of services, which has the effect of eliminating or reducing competition for bids or adversely affecting or manipulating the process for bidding.

- (4) Any agreement amongst enterprises or persons at different stages or levels of the production



chain in different markets, in respect of production, supply, distribution, Storage, sale or price of, or trade in goods or provision of services, including-

- (a) tie-in arrangement;
- (b) exclusive supply agreement;
- (c) exclusive distribution agreement;
- (d) refusal to deal;
- (e) resale price maintenance,

shall be an agreement in contravention of sub-section (1) if such agreement causes or is likely to cause an appreciable adverse effect on competition in India.

Explanation.- For the purposes of this sub-section,-

- (a) "tie-in arrangement" includes any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods;
- (b) "exclusive supply agreement" includes any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person;
- (c) "exclusive distribution agreement" includes any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area or market for the disposal or sale of the goods;
- (d) "refusal to deal" includes any agreement which restricts, or is likely to restrict, or likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought;
- (e) "resale price maintenance" includes any agreement to sell goods on condition that the prices to be charged on the resale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged.

(5) Nothing contained in this section shall restrict-

- (i) the right of any person to restrain any infringement of, or to impose reasonable conditions, as may be necessary for protecting any of his rights which have been or may be conferred upon him under-
 - (a) the Copyright Act, 1957 (14 of 1957);
 - (b) the Patents Act, 1970 (39 of 1970);
 - (c) the Trade and Merchandise Marks Act, 1958 (43 of 1958) or the Trade Marks Act, 1999 (47 of 1999);
 - (d) the Geographical Indications of Goods (Registration and Protection) Act, 1999 (48 of 1999);
 - (e) the Designs Act, 2000 (16 of 2000);
 - (f) the Semiconductor Integrated Circuits Layout Design Act, 2000 (37 of 2000);
- (ii) the right of any person to export goods from India to the extent to which the agreement relates exclusively to the production, supply, distribution or control of goods or provision of services for such export.

Abuse of dominant position [Section 4]

- (1) No enterprise or group shall abuse its dominant position.
- (2) There shall be an abuse of dominant position [under sub-section (1), if an enterprise or a group].
 - (a) directly or indirectly, imposes unfair or discriminatory -
 - (i) Condition in purchase or sale of goods or service; or
 - (ii) Price in purchase or sale (including predatory price) of goods or service.

Explanation.- For the purposes of this clause, the unfair or discriminatory condition in purchase or sale of goods or service referred to in sub-clause (i) and unfair or discriminatory price in purchase or sale of goods (including predatory price) or service referred to in sub-clause (ii) shall not include such discriminatory condition or price which may be adopted to meet the competition; or

- (b) limits or restricts-
 - (i) Production of goods or provision of services or market therefor; or
 - (ii) technical or scientific development relating to goods or services to the prejudice of consumers; or
- (c) indulges in practice or practices resulting in denial of market access [in any manner]; or
- (d) makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts; or
- (e) uses its dominant position in one relevant market to enter into, or protect, other relevant market.

Explanation.- For the purposes of this section, the expression-

- (a) "dominant position" means a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to-
 - (i) operate independently of competitive forces prevailing in the relevant market; or
 - (ii) affect its competitors or consumers or the relevant market in its favour.
- (b) "predatory price" means the sale of goods or provision of services, at a price which is below the cost, as may be determined by regulations, of production of the goods or provision of services, with a view to reduce competition or eliminate the competitors.
- (c) "group" shall have the same meaning as assigned to it in clause (b) of the Explanation to section 5.

Combination [Section 5]

The acquisition of one or more enterprises by one or more persons or merger or amalgamation of enterprises shall be a combination of such enterprises and persons or enterprises, if-

- (a) any acquisition where-
 - (i) the parties to the acquisition, being the acquirer and the enterprise, whose control, shares, voting rights or assets have been acquired or are being acquired jointly have,-
 - (A) either, in India, the assets of the value of more than rupees one thousand crores or turnover more than rupees three thousand crores; or
 - (B) in India or outside India, in aggregate, the assets of the value of more than five hundred million US dollars, including at least rupees five hundred crores in India, or



- turnover more than fifteen hundred million US dollars, including at least rupees fifteen hundred crores in India; or
- (ii) the group, to which the enterprise whose control, shares, assets or voting rights have been acquired or are being acquired, would belong after the acquisition, jointly have or would jointly have,-
 - (A) either in India, the assets of the value of more than rupees four thousand crores or turnover more than rupees twelve thousand crores; or
 - (B) in India or outside India, in aggregate, the assets of the value of more than two billion US dollars, including at least rupees five hundred crores in India, or turnover more than six billion US dollars, including at least rupees fifteen hundred crores in India; or]
 - (b) acquiring of control by a person over an enterprise when such person has already direct or indirect control over another enterprise engaged in production, distribution or trading of a similar or identical or substitutable goods or provision of a similar or identical or substitutable service, if-
 - (i) the enterprise over which control has been acquired along with the enterprise over which the acquirer already has direct or indirect control jointly have,-
 - (A) either in India, the assets of the value of more than rupees one thousand crores or turnover more than rupees three thousand crores; or
 - (B) in India or outside India, in aggregate, the assets of the value of more than five hundred million US dollars, including at least rupees five hundred crores in India, or turnover more than fifteen hundred million US dollars, including at least rupees fifteen hundred crores in India; or]
 - (ii) the group, to which enterprise whose control has been acquired, or is being acquired, would belong after the acquisition, jointly have or would jointly have,-
 - (A) either in India, the assets of the value of more than rupees four thousand crores or turnover more than rupees twelve thousand crores; or
 - (B) in India or outside India, in aggregate, the assets of the value of more than two billion US dollars, including at least rupees five hundred crores in India, or turnover more than six billion US dollars, including at least rupees fifteen hundred crores in India; or
 - (c) any merger or amalgamation in which-
 - (i) the enterprise remaining after merger or the enterprise created as a result of the amalgamation, as the case may be, have,-
 - (A) either in India, the assets of the value of more than rupees one thousand crores or turnover more than rupees three thousand crores; or
 - (B) in India or outside India, in aggregate, the assets of the value of more than five hundred million US dollars, including at least rupees five hundred crores in India, or turnover more than fifteen hundred million US dollars, including at least rupees fifteen hundred crores in India; or
 - (ii) the group, to which the enterprise remaining after the merger or the enterprise created as a result of the amalgamation, would belong after the merger or the amalgamation, as the case may be, have or would have,-
 - (A) either in India, the assets of the value of more than rupees four thousand crores or turnover more than rupees twelve thousand crores; or
 - (B) in India or outside India, in aggregate, the assets of the value of more than two billion US dollars, including at least rupees five hundred crores in India, or turnover more than six billion US dollars, including at least rupees fifteen hundred crores in India;

Explanation. – For the purposes of this section,-

- (a) “control” includes controlling the affairs or management by –
 - (i) one or more enterprises, either jointly or singly, over another enterprise or group;
 - (ii) one or more groups, either jointly or singly, over another group or enterprise;
- (b) “group” means two or more enterprises which, directly or indirectly, are in a position to-
 - (i) exercise twenty-six per cent. or more of the voting rights in the other enterprise; or
 - (ii) appoint more than fifty per cent. of the members of the board of directors in the other enterprise; or
 - (iii) control the management or affairs of the other enterprise;
- (c) the value of assets shall be determined by taking the book value of the assets as shown, in the audited books of account of the enterprise, in the financial year immediately preceding the financial year in which the date of proposed merger falls, as reduced by any depreciation, and the value of assets shall include the brand value, value of goodwill, or value of copyright, patent, permitted use, collective mark, registered proprietor, registered trade mark, registered user, homonymous geographical indication, geographical indications, design or layout design or similar other commercial rights, if any, referred to in sub-section (5) of section 3.

Regulation of combinations [Section 6]

- (1) No person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void.
- (2) Subject to the provisions contained in sub-section (1), any person or enterprise, who or which proposes to enter into a combination, [shall] give notice to the Commission, in the form as may be specified, and the fee which may be determined, by regulations, disclosing the details of the proposed combination, within [thirty days] of-
 - (a) approval of the proposal relating to merger or amalgamation, referred to in clause (c) of section 5, by the board of directors of the enterprises concerned with such merger or amalgamation, as the case may be;
 - (b) execution of any agreement or other document for acquisition referred to in clause (a) of section 5 or acquiring of control referred to in clause (b) of that section.
- (2A) No combination shall come into effect until two hundred and ten days have passed from the day on which the notice has been given to the Commission under sub-section (2) or the Commission has passed orders under section 31, whichever is earlier.
- (3) The Commission shall, after receipt of notice under sub-section (2), deal with such notice in accordance with the provisions contained in sections 29, 30 and 31.
- (4) The provisions of this section shall not apply to share subscription or financing facility or any acquisition, by a public financial institution, foreign institutional investor, bank or venture capital fund, pursuant to any covenant of a loan agreement or investment agreement.
- (5) The public financial institution, foreign institutional investor, bank or venture capital fund, referred to in sub-section (4), shall, within seven days from the date of the acquisition, file, in the form as may be specified by regulations, with the Commission the details of the acquisition including the details of control, the circumstances for exercise of such control and the consequences of default arising out of such loan agreement or investment agreement, as the case may be.

Explanation.-For the purposes of this section, the expression-



- (a) "foreign institutional investor" has the same meaning as assigned to it in clause (a) of the Explanation to section 115AD of the Income-tax Act, 1961(43 of 1961);
- (b) "Venture capital fund" has the same meaning as assigned to it in clause (b) of the Explanation to clause (23 FB) of section 10 of the Income-tax Act, 1961(43 of 1961);.

4.3 COMPETITION COMMISSION OF INDIA

Establishment of Commission [Section 7]

- (1) With effect from such date as the Central Government may, by notification, appoint, there shall be established, for the purposes of this Act, a Commission to be called the "Competition Commission of India".
- (2) The Commission shall be a body corporate by the name aforesaid having perpetual succession and a common seal with power, subject to the provisions of this Act, to acquire, hold and dispose of property, both movable and immovable, and to contract and shall, by the said name, sue or be sued.
- (3) The head office of the Commission shall be at such place as the Central Government may decide from time to time.
- (4) The Commission may establish offices at other places in India.

Composition of Commission [Section 8]

- (1) The Commission shall consist of a Chairperson and not less than two and not more than six other Members to be appointed by the Central Government.
- (2) The Chairperson and every other Member shall be a person of ability, integrity and standing and who has special knowledge of, and such professional experience of not less than fifteen years in, international trade, economics, business, commerce, law, finance, accountancy, management, industry, public affairs or competition matters, including competition law and policy, which in the opinion of the Central Government, may be useful to the Commission.
- (3) The Chairperson and other Members shall be whole time Members.

Selection Committee for Chairperson and Members of Commission [Section 9]

- (1) The Chairperson and other Members of the Commission shall be appointed by the Central Government from a panel of names recommended by a Selection Committee consisting of-
 - (a) the Chief Justice of India or his nominee - Chairperson;
 - (b) the Secretary in the Ministry of Corporate Affairs - Member;
 - (c) the Secretary in the Ministry of Law and Justice - Member;
 - (d) two experts of repute who have special - Member.
- Knowledge of, and professional experience in
International trade, economics, business,
commerce, law, finance, accountancy,
management, industry, public affairs or
competition matters including competition law
and policy

- (2) The term of the Selection Committee and the manner of selection of panel of names shall be such as may be prescribed.

Term of office of Chairperson and other Members [Section 10]

- (1) The Chairperson and every other Member shall hold office as such for a term of five years from the date on which he enters upon his office and shall be eligible for reappointment:
[Provided that the Chairperson or other Members shall not hold office as such after he has attained the age of sixty-five years.]
- (2) A vacancy caused by the resignation or removal of the Chairperson or any other Member under section 11 or by death or otherwise shall be filled by fresh appointment in accordance with the provisions of sections 8 and 9.
- (3) The Chairperson and every other Member shall, before entering upon his office, make and subscribe to an oath of office and of secrecy in such form, manner and before such authority, as may be prescribed.
- (4) In the event of the occurrence of a vacancy in the office of the Chairperson by reason of his death, resignation or otherwise, the senior-most Member shall act as the Chairperson, until the date on which a new Chairperson, appointed in accordance with the provisions of this Act to fill such vacancy, enters upon his office.
- (5) When the Chairperson is unable to discharge his functions owing to absence, illness or any other cause, the senior-most Member shall discharge the functions of the Chairperson until the date on which the Chairperson resumes the charge of his functions.

Resignation, removal and suspension of Chairperson and other members [Section 11]

- (1) The Chairperson or any other Member may, by notice in writing under his hand addressed to the Central Government, resign his office:

Provided that the Chairperson or a Member shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor enters upon his office or until the expiry of his term of office, whichever is the earliest.
- (2) Notwithstanding anything contained in sub-section (1), the Central Government may, by order, remove the Chairperson or any other Member from his office if such Chairperson or Member, as the case may be,-
 - (a) is, or at any time has been, adjudged as an insolvent; or
 - (b) has engaged at any time, during his term of office, in any paid employment; or
 - (c) has been convicted of an offence which, in the opinion of the Central Government, involves moral turpitude; or
 - (d) has acquired such financial or other interest as is likely to affect prejudicially his functions as a Member; or
 - (e) has so abused his position as to render his continuance in office prejudicial to the public interest; or
 - (f) has become physically or mentally incapable of acting as a Member.
- (3) Notwithstanding anything contained in [sub-section (2)], no Member shall be removed from his office on the ground specified in clause (d) or clause (e) of that sub-section unless the Supreme Court, on a reference being made to it in this behalf by the Central Government, has, on an inquiry, held by it in accordance with such procedure as may be prescribed in this behalf by the Supreme Court, reported that the Member, ought on such ground or grounds to be removed.



Restriction on employment of Chairperson and other Members in certain cases [Section 12]

The Chairperson and other Members shall not, for a period of 8[two years] from the date on which they cease to hold office, accept any employment in, or connected with the management or administration of, any enterprise which has been a party to a proceeding before the Commission under this Act:

Provided that nothing contained in this section shall apply to any employment under the Central Government or a State Government or local authority or in any statutory authority or any corporation established by or under any Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956).

Administrative powers of Chairperson [Section 13]

The Chairperson shall have the powers of general superintendence, direction and control in respect of all administrative matters of the Commission:

Provided that the Chairperson may delegate such of his powers relating to administrative matters of the Commission, as he may think fit, to any other Member or officer of the Commission.

Salary and allowances and other terms and conditions of service of Chairperson and other Members [Section 14]

- (1) The salary, and the other terms and conditions of service, of the Chairperson and other Members, including travelling expenses, house rent allowance and conveyance facilities, sumptuary allowance and medical facilities shall be such as may be prescribed.
- (2) The salary, allowances and other terms and conditions of service of the Chairperson or a Member shall not be varied to his disadvantage after appointment.

Vacancy, etc. not to invalidate proceedings of Commission [Section 15]

No act or proceeding of the Commission shall be invalid merely by reason of -

- (a) any vacancy in, or any defect in the constitution of, the Commission; or
- (b) any defect in the appointment of a person acting as a Chairperson or as a Member; or
- (c) any irregularity in the procedure of the Commission not affecting the merits of the case.

Appointment of Director General, etc [Section 16]

- (1) The Central Government may, by notification, appoint a Director General for the purposes of assisting the Commission in conducting inquiry into contravention of any of the provisions of this Act and for performing such other functions as are, or may be, provided by or under this Act.
- (1A) The number of other Additional, Joint, Deputy or Assistant Directors General or such officers or other employees in the office of Director General and the manner of appointment of such Additional, Joint, Deputy or Assistant Directors General or such officers or other employees shall be such as may be prescribed.
- (2) Every Additional, Joint, Deputy and Assistant Directors General or "[such officers or other employees,] shall exercise his powers, and discharge his functions, subject to the general control, supervision and direction of the Director General.
- (3) The salary, allowances and other terms and conditions of serv Director General and Additional, Joint, Deputy and Assistant Directors General or, "[such officers or other employees,] shall be such as may be prescribed.
- (4) The Director General and Additional, Joint, Deputy and Assistant Directors General or [such officers or other employees,] shall be appointed from amongst persons of integrity and outstanding ability and who have experience in investigation, and knowledge of accountancy, management, business, public administration, international trade, law or economics and such other qualifications as may be prescribed.

Appointment of Secretary, experts, professionals and officers and other employees of Commission [Section 17]

- (1) The Commission may appoint a Secretary and such officers and other employees as it considers necessary for the efficient performance of its functions under this Act.
- (2) The salaries and allowances payable to, and other terms and conditions of service of, the Secretary and officers and other employees of the Commission and the number of such officers and other employees shall be such as may be prescribed.
- (3) The Commission may engage, in accordance with the procedure specified by regulations, such number of experts and professionals of integrity and outstanding ability, who have special knowledge of, and experience in, economics, law, business or such other disciplines related to competition, as it deems necessary to assist the Commission in the discharge of its functions under this Act.]

4.4 DUTIES, POWERS AND FUNCTIONS OF COMMISSION

Duties of Commission [Section 18]

Subject to the provisions of this Act, it shall be the duty of the Commission to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interests of consumers and ensure freedom of trade carried on by other participants, in markets in India:

Provided that the Commission may, for the purpose of discharging its duties or performing its functions under this Act, enter into any memorandum or arrangement with the prior approval of the Central Government, with any agency of any foreign country.

Inquiry into certain agreements and dominant position of enterprise [Section 19]

- (1) The Commission may inquire into any alleged contravention of the provisions contained in sub-section (1) of section 3 or sub-section (1) of section 4 either on its own motion or on-
 - (a) [receipt of any information, in such manner and] accompanied by such fee as may be determined by regulation, from any person, consumer or their association or trade association; or
 - (b) a reference made to it by the Central Government or a State Government or a statutory authority.
- (2) Without prejudice to the provisions contained in sub-section (1), the powers and functions of the Commission shall include the powers and functions specified in sub-sections (3) to (7).
- (3) The Commission shall, while determining whether an agreement has an appreciable adverse effect on competition under section 3, have due regard to all or any of the following factors, namely:-
 - (a) creation of barriers to new entrants in the market;
 - (b) driving existing competitors out of the market;
 - (c) foreclosure of competition by hindering entry into the market;
 - (d) accrual of benefits to consumers;
 - (e) improvements in production or distribution of goods or provision of services;
 - (f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.



- (4) The Commission shall, while inquiring whether an enterprise enjoys a dominant position or not under section 4, have due regard to all or any of the following factors, namely:-
- (a) market share of the enterprise;
 - (b) size and resources of the enterprise;
 - (c) size and importance of the competitors;
 - (d) economic power of the enterprise including commercial advantages over competitors;
 - (e) vertical integration of the enterprises or sale or service network of such enterprises;
 - (f) dependence of consumers on the enterprise;
 - (g) monopoly or dominant position whether acquired as a result of any statute or by virtue of being a Government company or a public sector undertaking or otherwise;
 - (h) entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or service for consumers;
 - (i) countervailing buying power;
 - (j) market structure and size of market;
 - (k) social obligations and social costs;
 - (l) relative advantage, by way of the contribution to the economic development, by the enterprise enjoying a dominant position having or likely to have an appreciable adverse effect on competition;
 - (m) any other factor which the Commission inquiry
- (5) For determining whether a market constitutes a "relevant market" for the purposes of this Act, the Commission shall have due regard to the "relevant geographic market" and "relevant product market".
- (6) The Commission shall, while determining the "relevant geographic market", have due regard to all or any of the following factors, namely:-
- (a) regulatory trade barriers;
 - (b) local specification requirements;
 - (c) national procurement policies;
 - (d) adequate distribution facilities;
 - (e) transport costs;
 - (f) language;
 - (g) consumer preferences;
 - (h) need for secure or regular supplies or rapid aftersales services.
- (7) The Commission shall, while determining the "relevant product market", have due regard to all or any of the following factors, namely:-
- (a) physical characteristics or enduse of goods;
 - (b) price of goods or service;
 - (c) consumer preferences;

- (d) exclusion of inhouse production;
- (e) existence of specialised producers;
- (f) classification of industrial products.

Inquiry into combination by Commission [Section 20]

- (1) The Commission may, upon its own knowledge or information relating to acquisition referred to in clause (a) of section 5 or acquiring of control referred to in clause (b) of section 5 or merger or amalgamation referred to in clause (c) of that section, inquire into whether such a combination has caused or is likely to cause an appreciable adverse effect on competition in India:

Provided that the Commission shall not initiate any inquiry under this sub-section after the expiry of one year from the date on which such combination has taken effect.

- (2) The Commission shall, on receipt of a notice under sub-section (2) of section 6 [* * *], inquire whether a combination referred to in that notice or reference has caused or is likely to cause an appreciable adverse effect on competition in India.
- (3) Notwithstanding anything contained in section 5, the Central Government shall, on the expiry of a period of two years from the date of commencement of this Act and thereafter every two years, in consultation with the Commission, by notification, enhance or reduce, on the basis of the wholesale price index or fluctuations in exchange rate of rupee or foreign currencies, the value of assets or the value of turnover, for the purposes of that section.
- (4) For the purposes of determining whether a combination would have the effect of or is likely to have an appreciable adverse effect on competition in the relevant market, the Commission shall have due regard to all or any of the following factors, namely:-
 - (a) actual and potential level of competition through imports in the market;
 - (b) extent of barriers to entry into the market;
 - (c) level of combination in the market; .o
 - (d) degree of countervailing power in the market;
 - (e) likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;
 - (f) extent of effective competition likely to sustain in a market;
 - (g) extent to which substitutes are available or are likely to be available in the market;
 - (h) market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;
 - (i) likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market;
 - (j) nature and extent of vertical integration in the market;
 - (k) possibility of a failing business;
 - (l) nature and extent of innovation;
 - (m) relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition;
 - (n) whether the benefits of the combination outweigh the adverse impact of the combination, if any.



Reference by statutory authority [Section 21]

- (1) Where in the course of a proceeding before any statutory authority an issue is raised by any party that any decision which such statutory authority has taken or proposes to take is or would be, contrary to any of the provisions of this Act, then such statutory authority may make a reference in respect of such issue to the Commission:

Provided that any statutory authority, may, suo motu, make such a reference to the Commission.

- (2) On receipt of a reference under sub-section (1), the Commission shall give its opinion, within sixty days of receipt of such reference, to such statutory authority which shall consider the opinion of the Commission and thereafter, give its findings recording reasons therefore on the issues referred to in the said opinion.

Reference by Commission [Section 21A]

- (1) Where in the course of a proceeding before the Commission an issue is raised by any party that any decision which, the Commission has taken during such proceeding or proposes to take, is or would be contrary to any provision of this Act whose implementation is entrusted to a statutory authority, then the Commission may make a reference in respect of such issue to the statutory authority:

Provided that the Commission, may, suo motu, make such a reference to the statutory authority.

- (2) On receipt of a reference under sub-section (1), the statutory authority shall give its opinion, within sixty days of receipt of such reference, to the Commission which shall consider the opinion of the statutory authority, and thereafter give its findings recording reasons therefore on the issues referred to in the said opinion.

Meetings of Commission [Section 22]

- (1) The Commission shall meet at such times and places, and shall observe such rules and procedure in regard to the transaction of business at its meetings as may be provided by regulations.
- (2) The Chairperson, if for any reason, is unable to attend a meeting of the Commission, the senior-most Member present at the meeting, shall preside at the meeting.
- (3) All questions which come up before any meeting of the Commission shall be decided by a majority of the Members present and voting, and in the event of an equality of votes, the Chairperson or in his absence, the Member presiding, shall have a second or/casting vote:

Provided that the quorum for such meeting shall be three Members.

SECTION 23. [* * *]

SECTION 24. [* * *]

SECTION 25. [* * *]

Procedure for inquiry under section 19 [Section 26]

- (1) On receipt of a reference from the Central Government or a State Government or a statutory authority or on its own knowledge or information received under section 19, if the Commission is of the opinion that there exists a prima facie case, it shall direct the Director General to cause an investigation to be made into the matter:

Provided that if the subject matter of an information received is, in the opinion of the Commission, substantially the same as or has been covered by any previous information received, then the new information may be clubbed with the previous information.

- (2) Where on receipt of a reference from the Central Government or a State Government or a statutory authority or information received under section 19, the Commission is of the opinion

that there exists no prima facie case, it shall close the matter forthwith and pass such orders as it deems fit and send a copy of its order to the Central Government or the State Government or the statutory authority or the parties concerned, as the case may be.

- (3) The Director General shall, on receipt of direction under sub-section (1), submit a report on his findings within such period as may be specified by the Commission.
- (4) The Commission may forward a copy of the report referred to in sub section (3) to the parties concerned:

Provided that in case the investigation is caused to be made based on reference received from the Central Government or the State Government or the statutory authority, the Commission shall forward a copy of the report referred to in sub-section (3) to the Central Government or the State Government or the statutory authority, as the case may be.

- (5) If the report of the Director General referred to in sub-section (3) recommends that there is no contravention of the provisions of this Act, the Commission shall invite objections or suggestions from the Central Government or the State Government or the statutory authority or the parties concerned, as the case may be, on such report of the Director General.
- (6) If, after consideration of the objections and suggestions referred to in sub section (5), if any, the Commission agrees with the recommendation of the Director General, it shall close the matter forthwith and pass such orders as it deems fit and communicate its order to the Central Government or the State Government or the statutory authority or the parties concerned, as the case may be.
- (7) If, after consideration of the objections or suggestions referred to in sub section (5), if any, the Commission is of the opinion that further investigations is called for, it may direct further investigation in the matter by the Director General or cause further inquiry to be made by in the matter or itself proceed with further inquiry in the matter in accordance with the provisions of this Act.
- (8) If the report of the Director General referred to in sub-section (3) recommends that there is contravention of any of the provisions of this Act, and the Commission is of the opinion that further inquiry is called for, it shall inquire into such contravention in accordance with the provisions of this Act.

Orders by Commission after inquiry into agreements or abuse of dominant Position [Section 27]

Where after inquiry the Commission finds that any agreement referred to in section 3 or action of an enterprise in a dominant position, is in contravention of section 3 or section 4, as the case may be, it may pass all or any of the following orders, namely:-

- (a) direct any enterprise or association of enterprises or person or association of persons, as the case may be, involved in such agreement, or abuse of dominant position, to discontinue and not to reenter such agreement or discontinue such abuse of dominant position, as the case may be;
- (b) impose such penalty, as it may deem fit which shall be not more than ten per cent. of the average of the turnover for the last three preceding financial years, upon each of such person or enterprises which are parties to such agreements or abuse:

Provided that in case any agreement referred to in section 3 has been entered into by a cartel, the Commission may impose upon each producer, seller, distributor, trader or service provider included in that cartel, a penalty of up to three times of its profit for each year of the continuance of such agreement or ten per cent. of its turnover for each year of the continuance of such agreement, whichever is higher.



- (c) [* * *]
- (d) direct that the agreements shall stand modified to the extent and in the manner as may be specified in the order by the Commission;
- (e) direct the enterprises concerned to abide by such other/orders as the Commission may pass and comply with the directions, including payment of costs, if any;
- (f) [***]
- (g) pass such other [order or issue such directions] as it may deem fit.

[Provided that while passing orders under this section, if the Commission comes to a finding, that an enterprise in contravention to section 3 or section 4 of the Act is a member of a group as defined in clause(b) of the Explanation to section 5 of the Act, and other members of such a group are also responsible for, or have contributed to, such a contravention, then it may pass orders, under this section, against such members of the group.]

Division of enterprise enjoying dominant position [Section 28]

- (1) The [Commission] may, notwithstanding anything contained in any other law for the time being in force, by order in writing, direct division of an enterprise enjoying dominant position to ensure that such enterprise does not abuse its dominant position.
- (2) In particular, and without prejudice to the generality of the foregoing powers, the order referred to in sub-section (1) may provide for all or any of the following matters, namely:-
 - (a) the transfer or vesting of property, rights, liabilities or obligations;
 - (b) the adjustment of contracts either by discharge or reduction of any liability or obligation or otherwise;
 - (c) the creation, allotment, surrender or cancellation of any shares, stocks or securities;
 - (d) [* * *]
 - (e) the formation or winding up of an enterprise or the amendment of the memorandum of association or articles of association or any other instruments regulating the business of any enterprise;
 - (f) the extent to which, and the circumstances in which, provisions of the order affecting an enterprise may be altered by the enterprise and the registration thereof;
 - (g) any other matter which may be necessary to give effect to the division of the. enterprise.
- (3) Notwithstanding anything contained in any other law for the time being in force or in any contract or in any memorandum or articles of association, an officer of a company who ceases to hold office as such in consequence of the division of an enterprise shall not be entitled to claim any compensation for such cesser.

Procedure for investigation of combination [Section 29]

- (1) Where the Commission is of the [prima facie] opinion that a combination is likely to cause, or has caused an appreciable adverse effect on competition within the relevant market in India, it shall issue a notice to show cause to the parties to combination calling upon them to respond within thirty days of the receipt of the notice, as to why investigation in respect of such combination should not be conducted.
- 1(A) After receipt of the response of the parties to the combination under sub-section (1), the Commission may call for a report from the Director General and such report shall be submitted by the Director General within such time as the Commission may direct.

- (2) The Commission, if it is prima facie of the opinion that the combination has, or is likely to have, an appreciable adverse effect on competition, it shall, within seven working days from the date of receipt of the response of the parties to the combination, `[or the receipt of the report from Director General called under sub section (1A), whichever is later] direct the parties to the said combination to publish details of the combination within ten working days of such direction, in such manner, as it thinks appropriate, for bringing the combination to the knowledge or information of the public and persons affected or likely to be affected by such combination.
- (3) The Commission may invite any person or member of the public, affected or likely to be affected by the said combination, to file his written objections, if any, before the Commission within fifteen working days from the date on which the details of the combination were published under sub-section (2).
- (4) The Commission may, within fifteen working days from the expiry of the period specified in sub-section (3), call for such additional or other information as it may deem fit from the parties to the said combination.
- (5) The additional or other information called for by the Commission shall be furnished by the parties referred to in sub-section (4) within fifteen days from the expiry of the period specified in sub-section (4).
- (6) After receipt of all information and within a period of fortyfive working days from the expiry of the period specified in sub-section (5), the Commission shall proceed to deal with the case in accordance with the provisions contained in section 31.

Procedure in case of notice under sub-section (2) of section 6 [Section 30]

Where any person or enterprises has given a notice under sub-section (2) of section 6, the Commission shall examine such notice and form its prima facie opinion as provided in sub-section (1) of section 29 and proceed as per provisions contained in that section.

Orders of Commission on certain combinations [Section 31]

- (1) Where the Commission is of the opinion that any combination does not, or is not likely to, have an appreciable adverse effect on competition, it shall, by order, approve that combination including the combination in respect of which a notice has been given under sub-section (2) of section 6.
- (2) Where the Commission is of the opinion that the combination has, or is likely to have, an appreciable adverse effect on competition, it shall direct that the combination shall not take effect.
- (3) Where the Commission is of the opinion that the combination has, or is likely to have, an appreciable adverse effect on competition but such adverse effect can be eliminated by suitable modification to such combination, it may propose appropriate modification to the combination, co the parties to such combination.
- (4) The parties, who accept the modification proposed by the Commission under sub-section (3), shall carry out such modification within the period specified by the Commission.
- (5) If the parties to the combination, who have accepted the modification under sub-section (4), fail to carry out the modification within the period specified by the Commission, such combination shall be deemed to have an appreciable adverse effect on competition and the Commission shall deal with such combination in accordance with the provisions of this Act.
- (6) If the parties to the combination do not accept the modification proposed by the Commission under sub-section (3), such parties may, within thirty working days of the modification proposed by the Commission, submit amendment to the modification proposed by the Commission under that sub-section.



- (7) If the Commission agrees with the amendment submitted by the parties under sub-section (6), it shall, by order, approve the combination.
- (8) If the Commission does not accept the amendment submitted under sub-section (6), then, the parties shall be allowed a further period of thirty working days within which such parties shall accept the modification proposed by the Commission under sub-section (3).
- (9) If the parties fail to accept the modification proposed by the Commission within thirty working days referred to in sub-section (6) or within a further period of thirty working days referred to in sub-section (8), the combination shall be deemed to have an appreciable adverse effect on competition and be dealt with in accordance with the provisions of this Act.
- (10) Where the Commission has directed under sub-section (2) that the combination shall not take effect or the combination is deemed to have an appreciable adverse effect on competition under sub-section (9), then, without prejudice to any penalty which may be imposed or any prosecution which may be initiated under this Act, the Commission may order that-
 - (a) the acquisition referred to in clause (a) of section 5; or
 - (b) the acquiring of control referred to in clause (b) of section 5; or
 - (c) the merger or amalgamation referred to in clause (c) of section 5, shall not be given effect to:Provided that the Commission may, if it considers appropriate, frame a scheme to implement its order under this sub-section.
- (11) If the Commission does not, on the expiry of a period of [two hundred and ten days from the date of notice given to the Commission under sub-section (2) of section 6], pass an order or issue direction in accordance with the provisions of sub-section (1) or sub-section (2) or sub-section (7), the combination shall be deemed to have been approved by the Commission.

Explanation.-For the purposes of determining the period of [two hundred and ten] days specified in this sub-section, the period of thirty working days specified in sub-section (6) and a further period of thirty working days specified in sub-section (8) shall be excluded.
- (12) Where any extension of time is sought by the parties to the combination, the period of ninety working days shall be reckoned after deducting the extended time granted at the request of the parties.
- (13) Where the Commission has ordered a combination to be void, the acquisition or acquiring of control or merger or amalgamation referred to in section 5, shall be dealt with by the authorities under any other law for the time being in force as if such acquisition or acquiring of control or merger or amalgamation had not taken place and the parties to the combination shall be dealt with accordingly.
- (14) Nothing contained in this Chapter shall affect any proceeding initiated or which may be initiated under any other law for the time being in force.

Acts taking place outside India but having an effect on competition in India [Section 32]

The Commission shall, notwithstanding that,-

- (a) an agreement referred to in section 3 has been entered into outside India; or
- (b) any party to such agreement is outside India; or
- (c) any enterprise abusing the dominant position is outside India; or
- (d) a combination has taken place outside India; or
- (e) any party to combination is outside India; or

- (f) any other matter or practice or action arising out of such agreement or dominant position or combination is outside India,

have power to inquire [in accordance with the provisions contained in sections 19, 20, 26, 29 and 30 of the Act] into such agreement or abuse of dominant position or combination if such agreement or dominant position or combination has, or is likely to have, an appreciable adverse effect on competition in the relevant market in India [and pass such orders as it may deem fit in accordance with the provisions of this Act.]

Power to issue interim orders [Section 33]

Where during an inquiry, the Commission is satisfied that an act in contravention of sub-section (1) of section 3 or sub-section (1) of section 4 or section 6 has been committed and continues to be committed or that such act is about to be committed, the Commission may, by order, temporarily restrain any party from carrying on such act until the conclusion of such inquiry or until further orders, without giving notice to such party, where it deems it necessary.

Omitted by competition (Amendment) Act, 2007 [Section 34]

Appearance before Commission [Section 35]

A person or an enterprise or the Director General may either appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of his or its officers to present his or its case before the Commission.

Explanation.- For the purposes of this section,—

- (a) “chartered accountant” means a chartered accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (b) “company secretary” means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 (56 of 1980) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (c) “cost accountant” means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 (23 of 1959) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (d) “legal practitioner” means an advocate, vakil or an attorney of any High Court, and includes a pleader in practice.

Power of Commission to regulate its own procedure [Section 36]

- (1) In the discharge of its functions, the Commission shall be guided by the principals of natural justice and, subject to the other provisions of this Act and of any rules made by the Central Government, the Commission shall have the powers to regulate its own procedure.
- (2) The Commission shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a Civil Court under the Code of Civil Procedure, 1908 (5 of 1908), while trying a suit, in respect of the following matters, namely:—
 - (a) summoning and enforcing the attendance of any person and examining him on oath;
 - (b) requiring the discovery and production of documents;
 - (c) receiving evidence on affidavits;
 - (d) issuing commissions for the examination of witnesses or documents;
 - (e) requisitioning, subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872 (1 of 1872), any public record or document or copy of such record or document from any office;



- (3) The Commission may call upon such experts, from the fields of economics, commerce, accountancy, international trade or from any other discipline as it deems necessary to assist the Commission in the conduct of any inquiry by it.
- (4) The Commission may direct any person—
 - (a) to produce before the Director General or the Secretary or an officer authorised by it, such books, or other documents in the custody or under the control of such person so directed as may be specified or described in the direction, being documents relating to any trade, the examination of which may be required for the purposes of this Act;
 - (b) to furnish to the Director General or the Secretary or any officer authorised by it, as respects the trade or such other information as may be in his possession in relation to the trade carried on by such person, as may be required for the purposes of this Act.

Omitted by competition (Amendment) Act, 2007 [Section 37]

Rectification of orders [Section 38]

- (1) With a view to rectifying any mistake apparent from the record, the Commission may amend any order passed by it under the provisions of this Act.
- (2) Subject to the other provisions of this Act, the Commission may make—
 - (a) an amendment under sub-section (1) of its own motion;
 - (b) an amendment for rectifying any such mistake which has been brought to its notice by any party to the order.

Explanation : For the removal of doubts, it is hereby declared that the Commission shall not, while rectifying any mistake apparent from record, amend substantive part of its order passed under the provisions of this Act.

Execution of orders of Commission imposing monetary penalty [Section 39]

- (1) If a person fails to pay any monetary penalty imposed on him under this Act, the Commission shall proceed to recover such penalty, in such manner as may be specified by the regulations.
- (2) In a case where the Commission is of the opinion that it would be expedient to recover the penalty imposed under this Act in accordance with the provisions of the Income-tax Act, 1961(43 Of 1961), it may make a reference to this effect to the concerned income tax authority under that Act for recovery of the penalty as tax due under the said Act.
- (3) Where a reference has been made by the Commission under sub-section (2) for recovery of penalty, the person upon whom the penalty has been imposed shall be deemed to be the assessee in default under the Income Tax Act, 1961(43 Of 1961), and the provisions contained in sections 221 to 227, 228A, 229, 231 and 232 of the said Act and the Second Schedule to that Act and any rules made thereunder shall, in so far as may be, apply as if the said provisions were the provisions of this Act and referred to sums by way of penalty imposed under this Act instead of to income-tax and sums imposed by way of penalty, fine and interest under the Income Tax Act 1961(43 Of 1961) and to the Commission instead of the Assessing Officer.

Explanation 1 : Any reference to sub-section (2) or sub-section (6) of section 220 of the income tax Act, 1961(43 Of 1961), in the said provisions of that Act or the rules made thereunder shall be construed as references to sections 43 to 45 of this Act.

Explanation 2: The Tax Recovery Commissioner and the Tax Recovery Officer referred to in the Income-tax Act, 1961(43 Of 1961) shall be deemed to be the Tax Recovery Commissioner and the Tax Recovery Officer for the purposes of recovery of sums imposed by way of penalty under this Act and reference made by the Commission under sub-section (2) would amount to drawing of

a certificate by the Tax Recovery Officer as far as demand relating to penalty under this Act.

Explanation 3 : Any reference to appeal in Chapter XVIII and the Second Schedule to the Income-tax Act, 1961(43 Of 1961), shall be construed as a reference to appeal before the Competition Appellate Tribunal under section 53B of this Act.

Omitted by competition (Amendment) Act, 2007 [Section 40]

4.5 DUTIES OF DIRECTOR GENERAL

Director General to investigate contravention [Section 41]

- (1) The Director General shall, when so directed by the Commission, assist the Commission in investigating into any contravention of the provisions of this Act or any rules or regulations made thereunder.
- (2) The Director General shall have all the powers as are conferred upon the Commission under subsection (2) of section 36.
- (3) Without prejudice to the provisions of sub-section (2), sections 240 and 240A of the Companies Act, 1956 (1 of 1956), so far as may be, shall apply to an investigation made by the Director General or any other person investigating under his authority, as they apply to an inspector appointed under that Act.

Explanation : For the purposes of this section, -

- (a) the words 'the Central Government' under section 240 of the Companies Act, 1956 (1 of 1956) shall be construed as "the Commission";
- (b) the word "Magistrate" under section 240A of the Companies Act, 1956 (1 of 1956) shall be construed as "the Chief Metropolitan Magistrate, Delhi".

4.6 PENALTIES

Contravention of orders of Commission [Section 42]

- (1) The Commission may cause an inquiry to be made into compliance of its orders or directions made in exercise of its powers under the Act.
- (2) If any person, without reasonable cause, fails to comply with the orders or directions of the Commission issued under sections 27, 28, 31, 32, 33, 42A and 43A of the Act, he shall be punishable with fine which may extend to rupees one lakh for each day during which such non-compliance occurs subject to a maximum of rupees ten crore, as the Commission may determine.
- (3) If any person does not comply with the orders or directions issued, or fails to pay the fine imposed under sub-section (2), he shall, without prejudice to any proceeding under section 39, be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to rupees twenty five crore, or with both, as the Chief Metropolitan Magistrate, Delhi may deem fit:

Provided that the Chief Metropolitan Magistrate, Delhi shall not take cognizance of any offence under this section save on a complaint filed by the Commission or any of its officers authorised by it.

Compensation in case of contravention of orders of Commission [Section 42A]

Without prejudice to the provisions of this Act, any person may make an application to the Appellate Tribunal for an order for the recovery of compensation from any enterprise for any loss or damage shown to have been suffered, by such person as a result of the said enterprise violating directions



issued by the Commission or contravening, without any reasonable ground, any decision or order of the Commission issued under sections 27, 28, 31, 32, and 33 or any condition or restriction subject to which any approval, sanction, direction or exemption in relation to any matter has been accorded, given, made or granted under this Act or delaying in carrying out such orders or directions of the Commission.

Penalty for failure to comply with directions of Commission and Director General [Section 43]

If any person fails to comply, without reasonable cause, with a direction given by—

- (a) the Commission under sub-sections (2) and (4) of section 36; or
- (b) the Director General while exercising powers referred to in sub-section (2) of section 41,

such person shall be punishable with fine which may extend to rupees one lakh for each day during which such failure continues subject to a maximum of rupees one crore, as may be determined by the Commission.

Power to impose penalty for non-furnishing of information on combinations [Section 43A]

If any person or enterprise who fails to give notice to the Commission under sub-section (2) of section 6, the Commission shall impose on such person or enterprise a penalty which may extend to one percent of the total turnover or the assets, whichever is higher, of such combination.

Penalty for making false statement or omission to furnish material information [Section 44]

If any person, being a party to a combination,—

- (a) makes a statement which is false in any material particular, or knowing it to be false; or
- (b) omits to state any material particular knowing it to be material, such person shall be liable to a penalty which shall not be less than rupees fifty lakhs but which may extend to rupees one crore, as may be determined by the Commission.

Penalty for offences in relation to furnishing of information [Section 45]

- (1) Without prejudice to the provisions of section 44, if a person, who furnishes or is required to furnish under this Act any particulars, documents or any information,—
 - (a) makes any statement or furnishes any document which he knows or has reason to believe to be false in any material particular; or
 - (b) omits to state any material fact knowing it to be material; or
 - (c) willfully alters, suppresses or destroys any document which is required to be furnished as aforesaid,

such person shall be punishable with fine which may be extend to rupees one crore as may be determined by the Commission.

- (2) Without prejudice to the provisions of sub-section (1), the Commission may also pass such other order as it deems fit.

Power to impose lesser penalty [Section 46]

The Commission may, if it is satisfied that any producer, seller, distributor, trader or service provider included in any cartel, which is alleged to have violated section 3, has made a full and true disclosure in respect of the alleged violations and such disclosure is vital, impose upon such producer, seller, distributor, trader or service provider a lesser penalty as it may deem fit, than leviable under this Act or the rules or the regulations:

Provided that lesser penalty shall not be imposed by the Commission in cases where the report of the investigation directed under section 26 has been received before making of such disclosure:

Provided further that lesser penalty shall be imposed by the Commission only in respect of a producer, seller, distributor, trader or service provider included in the cartel, who has made the full, true and vital disclosures under this section:

Provided also that lesser penalty shall not be imposed by the Commission if the person making the disclosure does not continue to cooperate with the Commission till the completion of the proceedings before the Commission:

Provided also that the Commission may, if it is satisfied that such producer, seller, distributor, trader or service provider included in the cartel had in the course of proceedings,—

- (a) not complied with the condition on which the lesser penalty was imposed by the Commission; or
- (b) had given false evidence; or
- (c) the disclosure made is not vital,

and thereupon such producer, seller, distributor, trader or service provider may be tried for the offence with respect to which the lesser penalty was imposed and shall also be liable to the imposition of penalty to which such person has been liable, had lesser penalty not been imposed.

Crediting sums realised by way of penalties to Consolidated Fund of India [Section 47]

All sums realised by way of penalties under this Act shall be credited to the Consolidated Fund of India.

Contravention by companies [Section 48]

- (1) Where a person committing contravention of any of the provisions of this Act or of any rule, regulation, order made or direction issued thereunder is a company, every person who, at the time the contravention was committed, was in charge of, and was responsible to the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to any punishment if he proves that the contravention was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such contravention.

- (2) Notwithstanding anything contained in sub-section (1), where a contravention of any of the provisions of this Act or of any rule, regulation, order made or direction issued thereunder has been committed by a company and it is proved that the contravention has taken place with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that contravention and shall be liable to be proceeded against and punished accordingly.

Explanation : For the purposes of this section,—

- (a) “Company” means a body corporate and includes a firm or other association of individuals: and
- (b) “Director”, in relation to a firm, means a partner in the firm.

4.7 COMPETITION ADVOCACY

Competition Advocacy [Section 49]

- (1) The Central Government may, in formulating a policy on competition (including review of laws related to competition), or any other matter, and a State Government may, in formulating a



policy on competition or on any other matter, as the case may be, make a reference to the Commission for its opinion on possible effect of such policy on competition and on receipt of such a reference, the Commission shall, within sixty days of making such reference, give its opinion to the Central Government or the State Government as the case may be, which may thereafter take further action as it deems fit.

- (2) The opinion given by the Commission under sub-section (1) shall not be binding upon the Central Government or the state Government as the case may be in formulating such policy.
- (3) The Commission shall take suitable measures for the promotion of competition advocacy, creating awareness and imparting training about competition issues.

4.8 FINANCE, ACCOUNTS AND AUDIT

Grants by Central Government [Section 50]

The Central Government may, after due appropriation made by Parliament by law in this behalf, make to the Commission grants of such sums of money as the Government may think fit for being utilised for the purposes of this Act.

Constitution of Fund [Section 51]

- (1) There shall be constituted a fund to be called the "Competition Fund" and there shall be credited thereto—
 - (a) All Government grants received by the Commission;
 - (b) Omitted vide Amendment Act 2007;
 - (c) The fees received under this Act;
 - (d) The interest accrued on the amounts referred to in clauses (a) and (c).
- (2) The Fund shall be applied for meeting—
 - (a) the salaries and allowances payable to the Chairperson and other Members and the administrative expenses including the salaries, allowances and pension payable to the Director General, Additional Joint Deputy or Assistant Directors General, the Registrar and officers and other employees of the Commission;
 - (b) The other expenses of the Commission in connection with the discharge of its functions and for the purposes of this Act.
- (3) The Fund shall be administered by a committee of such Members of the Commission as may be determined by the Chairperson.
- (4) The committee appointed under sub-section (3) shall spend monies out of the Fund for carrying out the objects for which the Fund has been constituted.

Accounts and Audit [Section 52]

- (1) The Commission shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor-General of India.
- (2) The accounts of the Commission shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Commission to the Comptroller and Auditor-General of India.

Explanation.- For the removal of doubts, it is hereby declared that the orders of the Commission,

being matters appealable to the Appellate Tribunal or the Supreme Court, shall not be subject to audit under this section.

- (3) The Comptroller and Auditor-General of India and any other person appointed by him in connection with the audit of the accounts of the Commission shall have the same rights, privileges and authority in connection with such audit as the Comptroller and Auditor-General of India generally has, in connection with the audit of the Government accounts and, in particular, shall have the right to demand the production of books, accounts, connected vouchers and other documents and papers and to inspect any of the offices of the Commission.
- (4) The accounts of the Commission as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf together with the audit report thereon shall be forwarded annually to the Central Government and that Government shall cause the same to be laid before each House of Parliament.

Furnishing of returns, etc., to Central Government [Section 53]

- (1) The Commission shall furnish to the Central Government at such time and in such form and manner as may be prescribed or as the Central Government may direct, such returns and statements and such particulars in regard to any proposed or existing measures for the promotion of competition advocacy, creating awareness and imparting training about competition issues, as the Central Government may, from time to time, require.
- (2) The Commission shall prepare once in every year, in such form and at such time as may be prescribed, an annual report giving a true and full account of its activities during the previous year and copies of the report shall be forwarded to the Central Government.
- (3) A copy of the report received under sub-section (2) shall be laid, as soon as may be after it is received, before each House of Parliament.

4.9 COMPETITION APPELLATE TRIBUNAL

Establishment of Appellate Tribunal [Section 53A]

- (1) The Central Government shall, by notification, establish an Appellate Tribunal to be known as Competition Appellate Tribunal –
 - (a) to hear and dispose of appeals against any direction issued or decision made or order passed by the Commission under sub-sections (2) and (6) of section 26, section 27, section 28, section 31, section 32, section 33, section 38, section 39, section 43, section 43A, section 44, section 45 or section 46 of the Act;
 - (b) to adjudicate on claim for compensation that may arise from the findings of the Commission or the orders of the Appellate Tribunal in an appeal against any finding of the Commission or under section 42A or under subsection (2) of section 53Q of this Act, and pass orders for the recovery of compensation under section 53N of this Act.
- (2) The Headquarter of the Appellate Tribunal shall be at such place as the Central Government may, by notification, specify.

Appeal to Appellate Tribunal [Section 53B]

- (1) The Central Government or the State Government or a local authority or enterprise or any person, aggrieved by any direction, decision or order referred to in clause (a) of section 53A may prefer an appeal to the Appellate Tribunal.
- (2) Every appeal under sub-section (1) shall be filed within a period of sixty days from the date on which a copy of the direction or decision or order made by the Commission is received by the



Central Government or the State Government or a local authority or enterprise or any person referred to in that sub-section and it shall be in such form and be accompanied by such fee as may be prescribed:

Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of sixty days if it is satisfied that there was sufficient cause for not filing it within that period.

- (3) On receipt of an appeal under sub-section (1), the Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the direction, decision or order appealed against.
- (4) The Appellate Tribunal shall send a copy of every order made by it to the Commission and the parties to the appeal.
- (5) The appeal filed before the Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal within six months from the date of receipt of the appeal.

Composition of Appellate Tribunal [Section 53C]

The Appellate Tribunal shall consist of a Chairperson and not more than two other members to be appointed by the Central Government.

Qualifications for appointment of Chairperson and Members of Appellate Tribunal [Section 53D]

- (1) The Chairperson of the Appellate Tribunal shall be a person, who is, or has been a Judge of the Supreme Court or the Chief Justice of a High Court.
- (2) A member of the Appellate Tribunal shall be a person of ability, integrity and standing having special knowledge of, and professional experience of not less than twenty five years in, competition matters including competition law and policy, international trade, economics, business, commerce, law, finance, accountancy, management, industry, public affairs, administration or in any other matter which in the opinion of the Central Government, may be useful to the Appellate Tribunal.

Selection Committee [Section 53E]

- (1) The Chairperson and members of the Appellate Tribunal shall be appointed by the Central Government from a panel of names recommended by a Selection Committee consisting of –
 - (a) the Chief Justice of India or his nominee Chairperson;
 - (b) the Secretary in the Ministry of Corporate Affairs Member;
 - (c) the Secretary in the Ministry of Law and Justice Member.
- (2) The terms of the Selection Committee and the manner of selection of panel of names shall be such as may be prescribed.

Term of office of Chairperson and Members of Appellate Tribunal [Section 53F]

The Chairperson or a member of the Appellate Tribunal shall hold office as such for a term of five years from the date on which he enters upon his office, and shall be eligible for re-appointment:

Provided that no Chairperson or other member of the Appellate Tribunal shall hold office as such after he has attained, -

- (a) in the case of the Chairperson, the age of sixty-eight years;
- (b) in the case of any other member of the Appellate Tribunal, the age of sixty-five years.

Terms and conditions of service of chairperson and Members of Appellate Tribunal [Section 53G]

- (1) The salaries and allowances and other terms and conditions of service of the Chairperson and other members of the Appellate Tribunal shall be such as may be prescribed.
- (2) The salaries, allowances and other terms and conditions of service of the Chairperson and other members of the Appellate Tribunal shall not be varied to their disadvantage after their appointment.

Vacancies [Section 53H]

If, for any reason other than temporary absence, any vacancy occurs in the office of the Chairperson or a member of the Appellate Tribunal, the Central Government shall appoint another person in accordance with the provisions of this Act to fill the vacancy and the proceedings may be continued before the Appellate Tribunal from the stage at which the vacancy is filled.

Resignation of Chairperson and Members of Appellate Tribunal [Section 53-I]

The Chairperson or a member of the Appellate Tribunal may, by notice in writing under his hand addressed to the Central Government, resign his office:

Provided that the Chairperson or a member of the Appellate Tribunal 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.

Member of Appellate Tribunal to act as its Chairperson in certain cases [Section 53J]

- (1) In the event of the occurrence of any vacancy in the office of the Chairperson of the Appellate Tribunal by reason of his death or resignation, the senior-most Member of the Appellate Tribunal shall act as the Chairperson of the Appellate Tribunal until the date on which a new Chairperson appointed in accordance with the provisions of this Act to fill such vacancy enters upon his office.
- (2) When the Chairperson of the Appellate Tribunal is unable to discharge his functions owing to absence, illness or any other cause, the senior-most member or, as the case may be, such one of the Members of the Appellate Tribunal, as the Central Government may, by notification, authorize in this behalf, shall discharge the functions of the Chairperson until the date on which the Chairperson resumes his duties.

Removal and suspension of Chairperson and Members of Appellate Tribunal [Section 53K]

- (1) The Central Government may, in consultation with the Chief Justice of India, remove from office the Chairperson or any other member of the Appellate Tribunal, who-
 - (a) has been adjudged an insolvent; or
 - (b) has engaged at any time, during his terms of office, in any paid employment; or
 - (c) has been convicted of an offence which, in the opinion of the Central Government, involves moral turpitude; or
 - (d) has become physically or mentally incapable of acting as such Chairperson or other Member of the Appellate Tribunal; or
 - (e) has acquired such financial or other interest as is likely to affect prejudicially his functions as such Chairperson or Member of the Appellate Tribunal; or
 - (f) has so abused his position as to render his continuance in office prejudicial to the public interest.
- (2) Notwithstanding anything contained in sub-section (1), no Chairperson or a Member of the Appellate Tribunal shall be removed from his office on the ground specified in clause (e) or clause (f) of sub-section (1) except by an order made by the Central Government after an inquiry made



in this behalf by a Judge of the Supreme Court in which such Chairperson or member had been informed of the charges against him and given a reasonable opportunity of being heard in respect of those charges.

Restriction on employment of Chairperson and other Members of Appellate Tribunal in certain cases [Section 53L]

The Chairperson and other members of the Appellate Tribunal shall not, for a period of two years from the date on which they cease to hold office, accept any employment in, or connected with the management or administration of, any enterprise which has been a party to a proceeding before the Appellate Tribunal under this Act:

Provided that nothing contained in this section shall apply to any employment under the Central Government or a State Government or local authority or in any statutory authority or any corporation established by or under any Central, State or Provincial Act or a Government Company as defined in section 617 of the Companies Act, 1956.

Staff of Appellate Tribunal [Section 53M]

- (1) The Central Government shall provide the Appellate Tribunal with such officers and other employees as it may think fit.
- (2) The officers and other employees of the Appellate Tribunal shall discharge their functions under the general superintendence and control of the Chairperson of the Appellate Tribunal.
- (3) The salaries and allowances and other conditions of service of the officers and other employees of the Appellate Tribunal shall be such as may be prescribed.

Awarding compensation [Section 53N]

- (1) Without prejudice to any other provisions contained in this Act, the Central Government or a State Government or a local authority or any enterprise or any person may make an application to the Appellate Tribunal to adjudicate on claim for compensation that may arise from the findings of the Commission or the orders of the Appellate Tribunal in an appeal against any findings of the Commission or under section 42A or under sub-section (2) of section 53Q of the Act, and to pass an order for the recovery of compensation from any enterprise for any loss or damage shown to have been suffered, by the Central Government or a State Government or a local authority or any enterprise or any person as a result of any contravention of the provisions of Chapter II, having been committed by enterprise.
- (2) Every application made under sub-section (1) shall be accompanied by the findings of the Commission, if any, and also be accompanied with such fees as may be prescribed.
- (3) The Appellate Tribunal may, after an inquiry made into the allegations mentioned in the application made under sub-section (1), pass an order directing the enterprise to make payment to the applicant, of the amount determined by it as realisable from the enterprise as compensation for the loss or damage caused to the applicant as a result of any contravention of the provisions of Chapter II having been committed by such enterprise:

Provided that the Appellate Tribunal may obtain the recommendations of the Commission before passing an order of compensation.

- (4) Where any loss or damage referred to in sub-section (1) is caused to numerous persons having the same interest, one or more of such persons may, with the permission of the Appellate Tribunal, make an application under that sub-section for and on behalf of, or for the benefit of, the persons so interested, and thereupon, the provisions of rule 8 of Order 1 of the First Schedule to the Code of Civil Procedure, 1908, shall apply subject to the modification that every reference therein to a suit or decree shall be construed as a reference to the application before the Appellate Tribunal and the order of the Appellate Tribunal thereon.

Explanation.- For the removal of doubts, it is hereby declared that—

- (a) an application may be made for compensation before the Appellate Tribunal only after either the Commission or the Appellate Tribunal on appeal under clause (a) of sub-section(1) of section 53A of the Act, has determined in a proceeding before it that violation of the provisions of the Act has taken place, or if provisions of section 42A or sub-section(2) of section 53Q of the Act are attracted.
- (b) enquiry to be conducted under sub-section(3) shall be for the purpose of determining the eligibility and quantum of compensation due to a person applying for the same, and not for examining afresh the findings of the Commission or the Appellate Tribunal on whether any violation of the Act has taken place.

Procedures and powers of Appellate Tribunal [Section 53O]

- (1) The Appellate Tribunal shall not be bound by the procedure laid down in the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act and of any rules made by the Central Government, the Appellate Tribunal shall have power to regulate its own procedure including the places at which they shall have their sittings.
- (2) The Appellate Tribunal shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the following matters, namely:-
 - (a) summoning and enforcing the attendance of any person and examining him on oath;
 - (b) requiring the discovery and production of documents;
 - (c) receiving evidence on affidavit;
 - (d) subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872 (1 of 1872), requisitioning any public record or document or copy of such record or document from any office;
 - (e) issuing commissions for the examination of witnesses or documents;
 - (f) reviewing its decisions;
 - (g) dismissing a representation for default or deciding it ex parte;
 - (h) setting aside any order of dismissal of any representation for default or any order passed by it ex parte;
 - (i) any other matter which may be prescribed.
- (3) Every proceedings before the Appellate Tribunal shall be deemed to be judicial proceedings within the meaning of sections 193 and 228, and for the purposes of section 196, of the Indian Penal Code (45 of 1860) and the Appellate Tribunal shall be deemed to be a civil court for the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

Execution of orders of Appellate Tribunal [Section 53P]

- (1) Every order made by the Appellate Tribunal shall be enforced by it in the same manner as if it were a decree made by a court in a suit pending therein, and it shall be lawful for the Appellate Tribunal to send, in case of its inability to execute such order, to the court within the local limits of whose jurisdiction,-
 - (a) in the case of an order against a company, the registered office of the company is situated;or



- (b) in the case of an order against any other person, place where the person concerned voluntarily resides or carries on business or personally works for gain, is situated.
- (2) Notwithstanding anything contained in sub-section (1), the Appellate Tribunal may transmit any order made by it to a civil court having local jurisdiction and such civil court shall execute the order as if it were a decree made by that court.

Contravention of orders of Appellate Tribunal [Section 53Q]

- (1) Without prejudice to the provisions of this Act, if any person contravenes, without any reasonable ground, any order of the Appellate Tribunal, he shall be liable for a penalty of not exceeding rupees one crore or imprisonment for a term up to three years or with both as the Chief Metropolitan Magistrate, Delhi may deem fit:

Provided that the Chief Metropolitan Magistrate, Delhi shall not take cognizance of any offence punishable under this sub-section, save on a complaint made by an officer authorized by the Appellate Tribunal.

- (2) Without prejudice to the provisions of this Act, any person may make an application to the Appellate Tribunal for an order for the recovery of compensation from any enterprise for any loss or damage shown to have been suffered, by such person as a result of the said enterprise contravening, without any reasonable ground, any order of the Appellate Tribunal or delaying in carrying out such orders of the Appellate Tribunal.

Vacancy in Appellate Tribunal not to invalidate acts or proceedings [Section 53R]

No act or proceeding of the Appellate Tribunal shall be questioned or shall be invalid merely on the ground of existence of any vacancy or defect in the constitution of the Appellate Tribunal.

Right to legal representation [Section 53S]

- (1) A person preferring an appeal to the Appellate Tribunal may either appear in person or authorize one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to present his or its case before the Appellate Tribunal.
- (2) The Central Government or a State Government or a local authority or any enterprise preferring an appeal to the Appellate Tribunal may authorize one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to act as presenting officers and every person so authorized may present the case with respect to any appeal before the Appellate Tribunal.
- (3) The Commission may authorize one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to act as presenting officers and every person so authorized may present the case with respect to any appeal before the Appellate Tribunal.

Explanation.- The expressions "chartered accountant" or "company secretary" or "cost accountant" or "legal practitioner" shall have the meanings respectively assigned to them in the Explanation to section 35.

Appeal to Supreme Court [Section 53T]

The Central Government or any State Government or the Commission or any statutory authority or any local authority or any enterprise or any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal to them;

Provided that the Supreme court may, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed after the expiry of the said period of sixty days.

Power to Punish for contempt [Section 53U]

The Appellate Tribunal shall have, and exercise, the same jurisdiction, powers and authority in respect of contempt of itself as a High Court has and may exercise and, for this purpose, the provisions of the Contempt of Courts Act, 1971 shall have effect subject to modifications that,—

- (a) the reference therein to a High Court shall be construed as including a reference to the Appellate Tribunal;
- (b) the references to the Advocate-General in section 15 of the said Act shall be construed as a reference to such Law Officer as the Central Government may, by notification, specify in this behalf.

4.10 MISCELLANEOUS

Power to exempt [Section 54]

The Central Government may, by notification, exempt from the application of this Act, or any provision thereof, and for such period as it may specify in such notification—

- (a) any class of enterprises if such exemption is necessary in the interest of security of the State or public interest;
- (b) any practice or agreement arising out of and in accordance with any obligation assumed by India under any treaty, agreement or convention with any other country or countries;
- (c) any enterprise which performs a sovereign function on behalf of the Central Government or a State Government.

Provided that in case an enterprise is engaged in any activity including the activity relatable to the sovereign functions of the Government, the Central Government may grant exemption only in respect of activity relatable to the sovereign functions.

Power of Central Government to issue directions [Section 55]

- (1) Without prejudice to the foregoing provisions of this Act, the Commission shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on questions of policy, other than those relating to technical and administrative matters, as the Central Government may give in writing to it from time to time:

Provided that the Commission shall, as far as practicable, be given an opportunity to express its views before any direction is given under this sub-section.

- (2) The decision of the Central Government whether a question is one of policy or not shall be final.

Power of Central Government to supersede Commission [Section 56]

- (1) If at any time the Central Government is of the opinion—
 - (a) that on account of circumstances beyond the control of the Commission, it is unable to discharge the functions or perform the duties imposed on it by or under the provisions of this Act; or
 - (b) that the Commission has persistently made default in complying with any direction given by the Central Government under this Act or in the discharge of the functions or performance of the duties imposed on it by or under the provisions of this Act and as a result of such default the financial position of the Commission or the administration of the Commission has suffered; or
 - (c) that circumstances exist which render it necessary in the public interest so to do,



the Central Government may, by notification and for reasons to be specified therein, supersede the Commission for such period, not exceeding six months, as may be specified in the notification:

Provided that before issuing any such notification, the Central Government shall give a reasonable opportunity to the Commission to make representations against the proposed supersession and shall consider representations, if any, of the Commission.

- (2) Upon the publication of a notification under sub-section (1) superseding the Commission,—
 - (a) The Chairperson and other Members shall as from the date of supersession, vacate their offices as such;
 - (b) All the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of the Commission shall, until the Commission is reconstituted under sub-section (3), be exercised and discharged by the Central Government or such authority as the Central Government may specify in their behalf;
 - (c) All properties owned or controlled by the Commission shall, until the Commission is reconstituted under sub-section (3), vest in the Central Government.
- (3) On or before the expiration of the period of supersession specified in the notification issued under subsection (1), the Central Government shall reconstitute the Commission by a fresh appointment of its Chairperson and other Members and in such case any person who had vacated his office under clause (a) of sub-section (2) shall not be deemed to be disqualified for re-appointment.
- (4) The Central Government shall cause a notification issued under sub-section (1) and a full report of any action taken under this section and the circumstances leading to such action to be laid before each House of Parliament at the earliest.

Restriction on disclosure of information [Section 57]

No information relating to any enterprise, being an information which has been obtained by or on behalf of the Commission or the Appellate Tribunal for the purposes of this Act, shall, without the previous permission in writing of the enterprise, be disclosed otherwise than in compliance with or for the purposes of this Act or any other law for the time being in force.

Chairperson, Members, Director General, Secretary, officers and other employees, etc., to be public servants [Section 58]

The Chairperson and other Members and the Director General, Additional, Joint, Deputy or Assistant Directors General and Secretary and officers and other employees of the Commission and the Chairperson, Members, officers and other employees of the Appellate Tribunal shall be deemed, while acting or purporting to act in pursuance of any of the provisions of this Act, to be public servants within the meaning of section 21 of the Indian Penal Code.

Protection of action taken in good faith [Section 59]

No suit, prosecution or other legal proceedings shall lie against the Central Government or Commission or any officer of the Central Government or the Chairperson or any Member or the Director-General, Additional, Joint, Deputy or Assistant Directors General or the Secretary or officers or other employees of the Commission or the Chairperson, members, officers and other employees of the Appellate Tribunal for anything which is in good faith done or intended to be done under this Act or the rules or regulations made thereunder.

Act to have overriding effect [Section 60]

The provisions of this Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force.

Exclusion of jurisdiction of civil courts [Section 61]

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which the Commission or the Appellate Tribunal is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

Application of other laws not barred [Section 62]

The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

Power to make rules [Section 63]

- (1) The Central Government may, by notification, make rules to carry out the provisions of this Act;
- (2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:-
 - (a) the term of the Selection Committee and the manner of selection of panel of names under sub-section (2) of Section 9;
 - (b) the form and manner in which and the authority before whom the oath of office and of secrecy shall be made and subscribed to under sub-section (3) of section 10;
 - (c) Omitted.
 - (d) the salary and the other terms and conditions of service including travelling expenses, house rent allowance and conveyance facilities, sumptuary allowance and medical facilities to be provided to the Chairperson and other Members under sub-section (1) of section 14;
 - (da) the number of Additional, Joint, Deputy or Assistant Directors General or such officers or other employees in the office of Director General and the manner in which such Additional, Joint, Deputy or Assistant Directors General or such officers or other employees may be appointed under sub-section (1A) of section 16;]
 - (e) the salary, allowances and other terms and conditions of service of the Director General, Additional, Joint, Deputy or Assistant Directors General or [such officers or other employees] under sub-section (3) of section 16;
 - (f) the qualifications for appointment of the Director General, Additional, Joint, Deputy or Assistant Directors General or [such officers or other employees] under sub-section (4) of section 16;
 - (g) the salaries and allowances and other terms and conditions of service of the [Secretary] and officers and other employees payable, and the number of such officers and employees under sub-section (2) of section 17;
 - (h) [***] Omitted
 - (i) [***] Omitted
 - (j) [***] Omitted
 - (k) the form in which the annual statement of accounts shall be prepared under sub-section (1) of section 52;
 - (1) the time within which and the form and manner in which the Commission may furnish returns, statements and such particulars as the Central Government may require under sub-section (1) of section 53;
 - (m) the form in which and the time within which the annual report shall be prepared under sub-



section (2) of section 53;

- (ma) the form in which an appeal may be filed before the Appellate Tribunal under sub-section (2) of section 53B and the fees payable in respect of such appeal;
 - (mb) the term of the Selection Committee and the manner of selection of panel of names under sub-section(2) of section 53E;
 - (mc) the salaries and allowances and other terms and conditions of service of the Chairperson and other Members of the Appellate Tribunal under sub-section (1) of section 53G;
 - (md) the salaries and allowances and other conditions of service of the officers and other employees of the Appellate Tribunal under sub-section (3) of section 53M;
 - (me) the fee which shall be accompanied with every application made under sub-section (2) of section 53N;
 - (mf) the other matters under clause (i) of sub-section(2) of section 53O in respect of which the Appellate Tribunal shall have powers under the Code of Civil Procedure, 1908 (5 of 1908) while trying a suit;
 - (n) the manner in which the monies transferred to the Competition Commission of India or the Appellate Tribunal shall be dealt with by the Commission or the Appellate Tribunal, as the case may be, under the fourth proviso to sub-section (2) of section 66;
 - (o) any other matter which is to be, or may be, prescribed, or in respect of which provision is to be, or may be, made by rules.
- (3) Every notification issued under sub-section(3) of section 20 and section 54 and every rule made under this Act by the Central Government shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session, or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the notification or rule, or both Houses agree that the notification should not be issued or rule should not be made, the notification or rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that notification or rule, as the case may be.

Power to make regulations [Section 64]

- (1) The Commission may, by notification, make regulations consistent with this Act and the rules made thereunder to carry out the purposes of this Act.
- (2) In particular, and without prejudice to the generality of the foregoing provisions, such regulations may provide for all or any of the following matters, namely:-
 - (a) the cost of production to be determined under clause (b) of the Explanation to section 4;
 - (b) the form of notice as may be specified and the fee which may be determined under sub-section (2) of section 6;
 - (c) the form in which details of the acquisition shall be filed under sub-section(5) of Section 6;
 - (d) the procedures to be followed for engaging the experts and professionals under sub-section (3) of section 17;
 - (e) the fee which may be determined under clause (a) of sub-section (1) of section 19;
 - (f) the rules of procedure in regard to the transaction of business at the meetings of the Commission under sub-section (1) of section 22;

- (g) the manner in which penalty shall be recovered under sub-section (1) of section 39;
 - (h) any other matter in respect of which provision is to be, or may be, made by regulations.
- (3) Every regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the regulation, or both Houses agree that the regulation should not be made, the regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that regulation.

Power to remove difficulties [Section 65]

- (1) If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order published in the Official Gazette, make such provisions, not inconsistent with the provisions of this Act as may appear to it to be necessary for removing the difficulty :

Provided that no such order shall be made under this section after the expiry of a period of two years from the commencement of this Act.

- (2) Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

Repeal and Saving [Section 66]

- (1) The Monopolies and Restrictive Trade Practices Act, 1969 is hereby repealed and the Monopolies and Restrictive Trade Practices Commission established under sub-section (1) of section 5 of the said Act shall stand dissolved.

-Deleted by Competition (Amendment) Act 2009

Explanation.—Deleted by Competition (Amendment) Act 2009

- (1A) The repeal of the Monopolies and Restrictive Trade Practices Act, 1969 shall, however, not affect—
- (a) the previous operation of the Act so repealed or anything duly done or suffered thereunder; or
 - (b) any right, privilege, obligations or liability acquired, accrued or incurred under the Act so repealed; or
 - (c) any penalty confiscation or punishment incurred in respect of any contravention under the Act so repealed; or
 - (d) any proceeding or remedy in respect of any such right, privilege obligation, liability, penalty, confiscation or punishment as aforesaid and any such proceeding or remedy may be instituted, continued or enforced and any such penalty, confiscation or punishment may be imposed or made as if that Act had not been repealed.
2. On dissolution of the MRTP Commission, the person appointed as the Chairman of the MRTP Commission and every other person appointed as members and Director General of Investigation and Registration, Additional, Joint, Deputy or Assistant Director General of Investigation and Registration and any officer and other employee of that Commission and holding office as such immediately before such dissolution shall vacate their respective offices and such Chairman and other Members shall be entitled to claim compensation not exceeding three months' pay and allowance for the premature termination of term of their office or of any contract of service.

Provided that the Director General of Investigation and Registration, Additional, Joint, Deputy or assistant Director General of Investigation and Registration or any officer or other employee who



has been, immediately before the dissolution of the MTRP commission appointed on deputation basis to the MRTP Commission, shall, on such dissolution, stand reverted to his parent cadre, Ministry or Department, as the case may be.

Provided further that the Director General of Investigation and Registration, Additional, Joint, Deputy or Assistant Director General of Investigation and Registration or any officer or other employee who has been, immediately before the dissolution of the Monopolies and Restrictive Trade Commission, employed on regular basis by the Monopolies and Restrictive Trade Commission, shall become, on and from such dissolution, the officer and employee, respectively, of the Competition Commission of India or the Appellate Tribunal, in such manner as may be specified by the Central Government, with the same right and privileges as to pension, gratuity and other like matters as would have been admissible to him if the rights in relation to such Monopolies and Restrictive Trade Practices Commission had not been transferred to, and vested in, the Competition Commission of India or the Appellate tribunal, as the case may be, and shall continue to do so unless and until his employment in the Competition Commission of India or the Appellate Tribunal, as the case may be, is duly terminated or until his remuneration, terms and conditions of employment are duly altered by the Competition Commission of India or the Appellate Tribunal, as the case may be.

Provided also that notwithstanding anything contained in the Industrial Disputes Act 1947 or in any other law for the time being in force, the transfer of the services of any Director General of Investigation and Registration, Additional, Joint, Deputy or Assistant Director General of Investigation and Registration or any officer or other employee employed in the Monopolies and Restrictive Trade Practices Commission, to the Competition Commission of India or the Appellate tribunal as the case may be, shall not entitle such the Director General of Investigation and Registration, Additional, Joint, Deputy or Assistant Director General of Investigation and Registration or any officer or other employee any compensation under this Act or any other law for the time being in force and no such claim shall be entertained by any court, tribunal or other authority.

Provided also that where the MRTP Commission has established a provident fund, superannuation, welfare or other fund for the benefit of the Director General of Investigation and Registration, Additional, Joint, Deputy or Assistant Director General of Investigation and Registration or any officers and other employee employed in the Monopolies and Restrictive Trade Commission, the monies relatable to the officers and other employees whose services have been transferred by or under this Act to the Competition Commission of India or the Appellate Tribunal, as the case may be, shall, out of the monies standing on the dissolution of MRTP commission to the credit of such provident fund, superannuation, welfare or other fund, stand transferred to and vest in, the Competition Commission of India or the Appellate Tribunal as the case may be, and such monies which stand so transferred shall be dealt with by the said commission or the Tribunal as the case may be, in such manner as may be prescribed.

- (3) All cases pertaining to monopolistic trade practices or restrictive trade practices pending (including such case, in which any unfair trade practice has also been alleged) before the MRTP Commission shall, on the commencement of the Competition (Amendment) Act 2009 referred to the Appellate Tribunal and shall be adjudicated by the Appellate Tribunal in accordance with the provisions of the repealed Act as if that Act had not been repealed.

Explanation.-For removal of doubts, it is hereby declared that all cases referred to in this sub-section, sub-section(4) and sub-section(5) shall be deemed to include all applications made for the losses or damages under section 12B of the MRTP Act,1969 as it stood before its repeal.

- (4) Subject to the provisions of sub section (3), all cases pertaining to unfair trade practices other than those referred to in clause (x) of sub section(1) of section 36A of MRTP Act 1969 and pending before the MRTP commission immediately before the commencement of the Competition

(Amendment) Act 2009, shall, on such commencement, shall, stand transferred to the National Commission constituted under the Consumer Protection Act 1986 and the National Commission shall dispose of such cases as if they were cases filed under this Act.

Provided that the National Commission may if it considers appropriate transfer any case transferred to it under this sub-section, to the concerned State Commission established under section 9 of the Consumer Protection Act, 1986 and the state Commission shall dispose of such case as if it was filed under that Act.

Provided further that all the cases relating to the unfair trade practices pending, before the National Commission under this sub section on or before the date on which the Competition (Amendment) Bill, 2009 receives the assent of the President, shall, on and from that date, stand transferred to the Appellate Tribunal and be adjudicated by the Appellate Tribunal in accordance with the provisions of the repealed Act as if that Act has not been repealed.

- (5) All cases pertaining to the unfair trade practices referred to in clause(x) of sub-section(1) of section 36A of MRTP Act, 1969 and pending before the MRTP Commission shall, on commencement of the Competition (Amendment) Act, 2009 stand transferred to the Appellate Tribunal and the Appellate Tribunal shall dispose of such cases as if they were cases filed under that Act.
- (6) All investigation or proceedings other than those relating to unfair trade practice pending before the Directorate General of Investigation and Registration on or before the commencement of this Act shall, on such commencement, stand transferred to the Competition Commission of India, and the Competition Commission of India may conduct or order for conduct of such investigation or proceedings in the manner as it deems fit.
- (7) All investigation or proceedings, relating to unfair trade practices, other than those referred to in clause(x) sub section (1) of section 36A of the MRTP Act, 1969 and pending before the Director General of Investigation and Registration on or before the commencement of this Act shall on such commencement, stand transferred to the National Commission constituted under the Consumer Protection Act, 1986 and the National Commission may conduct or order for conduct of such investigation or proceedings in the manner as it deems fit.

Provided that all investigations or proceedings, relating to unfair trade practice pending before the National Commission, on or before the date on which the Competition (Amendment) Bill, 2009 receives the assent of the President shall, on and from that date, stand standard transferred to the Appellate Tribunal and the Appellate Tribunal may conduct or order for conduct of such investigation or proceedings in the manner as it deems fit.

- (8) All investigation or proceedings relating to unfair trade practices referred to in clause(x) of sub section of section 36A of the MRTP Act, 1969 and pending before the Director General of Investigation and Registration on or before the commencement of this Act shall, on such commencement stand transferred to the Competition Commission of India and the Competition Commission of India may conduct or order for conduct of such investigation or proceedings in the manner as it deems fit.
- (9) Save as otherwise provided under sub section (3) to (8), all cases or proceeding pending before the MRTP commission shall abate.

- (10) The mention of the particular matters referred to in sub-section 3 to 8 shall not be held to prejudice or affect the general application of section 6 of the General Clauses Act, 1897 with regard to the effect of repeal.

4.11 MRTP ACT, 1969 & COMPETITION ACT, 2002

The Difference between the MRTP Act 1969 and The Competition Act 2002 is as follows - The MRTP Act was enacted in the Pre Liberalisation era whereas the Competition Act is enacted in the Post Liberalisation era; The Object of the old Act was to prevent the economic concentration in one Common detriment, curbing unfair trade practices, and to check monopolistic activities, on the other hand the object of the new Act is to promote and Sustaining Competition in the market and to ensure the freedom of trade and to protect the interest of the consumer in whole; The MRTP Commission has the advisory role only whereas the later has some effective role including that of initiating *suo moto* actions and impose punishments to the entities having some adverse effect in the market.

The following are the basic differences between MRTP and Competition Act:

S. No	MRTP ACT, 1969	COMPETITION ACT, 2002
1	It is based on the pre- liberalisation and globalisation era.	It is based on the post- reforms scenario.
2	The objective of the Act is to prevent concentration of economic power to common detriment to control of monopolies, prevention of monopolistic and restrictive trade practices.	The objective of the Act is prevent practices having adverse effect on competition and to promote as well as sustaining the competition to protect consumer interests at market place and ensuring freedom of trade.
3	It lists out 14 offences, which are against the principle of natural justice.	It recognises only 4 offences, which are deemed to be against the principle of natural justice.
4	MRTP Commission has the power to pass only "Cease" and "Desist" orders.	The Competition Act can pass an order to prevent and punish such of those activities, which abuses competition.
5	The MRTP Act did not provide for the formation of fund for its activities.	The Competition Act provides competition fund for promotion of competition advocacy and creation of awareness about competitive issues and training as may be prescribed in its rules.
6	Entity having status of dominant position is itself considered as bad.	Entity having status of dominant position is not considered as bad. Whereas abuse of dominant position affecting consumer interest is considered as immoral.
7	In general registration of agreement was mandatory.	It does not lay down any such requirement for registration of agreements.
8	The definition of 'group' was wider.	The 'group' definition has been simplified.
9	The size of the firm, is the factor for determining dominance etc.	It focusses on the firm's structure not on the size factor.

10	MRTP Commission role was only advisory.	Competition Commission can initiate the suo motu proceedings and levy penalties.
11	MRTP Commission dealt with the unfair trade practices.	The cases relating to unfair trade practices will be transferred to consumer courts.
12	Focused on consumer interest at large.	Focused on public at large.
13	The chairman of MRTP Commission was appointed by Central Government.	The chairman of the commission will be appointed by a committee consisting of retired.

4.12 COMPETITION ACT, 2002 AND CORPORATE GOVERNANCE

In a competitive environment, firms generally cannot expect to earn excess profits. An industry that generates above-average profits tends to attract new competitors, which bring forth additional supply and drive down profitability. Where natural barriers to entry are high, excess profits may persist and interim regulation may be needed to protect consumers. Over time, however, technological advances and entrepreneurial innovations tend to chip away the natural barriers, unless they are prevented by regulations.

To withstand competition, firms need to rely on operation efficiency. Unless their production and administrative costs are kept below prevailing market prices, which may be determined by efficient competitors at home or abroad, they cannot service their debt and meet shareholders' expectations. Investors need to evaluate the viability and cash flows of projects, rather than relying on preferential treatments or on market power. Under effective competition, preferential treatment can be quickly detected and brought to light by those who suffer the adverse consequences.

Where competition is intense and global in scope, more firms realise that corporate governance makes good business sense. Investors seek out firms that run the business efficiently, treat shareholders equitably and comply with high standards of disclosure, even when they are not mandatory. By applying good governance, a firm can earn a good reputation and efficient access to finance, which in turn enhances their ability to compete. In effect, good governance becomes an instrument of competitive strategies.

Study Note - 5

LAWS RELATED TO BANKING SECTOR



This Study Note includes

- 5.1 The Banking Regulation Act, 1949**
- 5.2 The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002**
- 5.3 The Prevention of Money Laundering Act, 2002**
- 5.4 The Foreign Exchange Management Act, 1999**

5.1 THE BANKING REGULATION ACT, 1949

Short title, extent and commencement [Section 1]

- (1) This Act may be called the Banking Regulation Act, 1949.
- (2) It extends to the whole of India.
- (3) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint in this behalf.

Application of other laws not barred [Section 2]

The provisions of this Act shall be in addition to, and not, save as hereunder expressly provided, in derogation of the Companies Act, 1956 (1 of 1956), and any other law for the time being in force.

Act to apply to co-operative societies in certain cases [Section 3]

Nothing in this Act shall apply to. —

- (a) a primary agricultural credit society;
- (b) a co-operative land mortgage bank; and
- (c) any other co-operative society, except in the manner and to the extent specified in Part V.

Power to suspend operation of Act [Section 4]

- (1) The Central Government, if on a representation made by the Reserve Bank in this behalf it is satisfied that it is expedient so to do, may by notification in the Official Gazette suspend for such period, not exceeding sixty days, as may be specified in the notification, the operation of all or any of the provisions of this Act, either generally or in relation to any specified banking company.
- (2) In a case of special emergency, the Governor of the Reserve Bank, or in his absence a Deputy Governor of the Reserve Bank nominated by him in this behalf may, by order in writing, exercise the powers of the Central Government under sub-section (1) so however that the period of suspension shall not exceed thirty days, and where the Governor or the Deputy Governor, as the case may be, does so, he shall report the matter to the Central Government forthwith, and the order shall, as soon as may be, be published in the Gazette of India.
- (3) The Central Government may, by notification in the Official Gazette, extend from time to time

the period of any suspension ordered under sub-section (1) or subsection (2) for such period, not exceeding sixty days at any one time, as it thinks fit so however that the total period does not exceed one year.

- (4) A copy of any notification issued under sub-section (3) shall be laid on the table of Parliament as soon as may be after it is issued.

Interpretation [Section 5]

In this Act, unless there is anything repugnant in the subject or context, —

- (a) “approved securities” means the securities issued by the Central Government or any State Government or such other securities as may be specified by the Reserve Bank from time to time;.
- (b) “banking” means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise;
- (c) “banking company” means any company which transacts the business of banking in India;

Explanation. —Any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking within the meaning of this clause;

- (ca) “banking policy” means any policy which is specified from time to time by the Reserve Bank in the interest of the banking system or in the interest of monetary stability or sound economic growth, having due regard to the interests of the depositors, the volume of deposits and other resources of the bank and the need for equitable allocation and the efficient use of these deposits and resources;
- (cc) “branch” or “branch office”, in relation to a banking company, means any branch or branch office, whether called a pay office or sub-pay office or by any other name, at which deposits are received, cheques cashed or moneys lent, and for the purposes of section 35 includes any place of business where any other form of business referred to in sub-section (1) of section 6 is transacted;
- (d) “company” means any company as defined in section 3 of the Companies Act, 1956 (1 of 1956); and includes a foreign company within the meaning of section 591 of that Act;
- (da) “corresponding new bank” means a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970); or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980);
- (e) Omitted by Act 52 of 1953, Section 2.
- (f) “demand liabilities” means liabilities which must be met on demand, and “time liabilities” means liabilities which are not demand liabilities;
- (ff) “Deposit Insurance Corporation” means the Deposit Insurance Corporation established under section 3 of the Deposit Insurance Corporation Act, 1961 (47 of 1961);
- (ffa) “Development Bank” means the Industrial Development Bank of India established under section 3 of the Industrial Development Bank of India Act, 1964 (18 of 1964);
- (ffb) “Exim Bank” means the Export-Import Bank of India established under section 3 of the Export-Import India Act, 1981 (28 of 1981);



- (ffc) "Reconstruction Bank" means the Industrial Reconstruction Bank of India established under section 3 of the Industrial Reconstruction Bank of India Act, 1984 (62 of 1984);
- (ffd) "National Housing Bank" means the National Housing Bank established under section 3 of the National Housing Bank Act, 1987;
- (g) "gold" includes gold in the form of coin, whether legal tender or not, or in the form of bullion or ingot, whether refined or not;
- (gg) "managing agent" includes. —
 - (i) Secretaries and Treasurers;
 - (ii) Where the managing agent is a company, and director of such company, and any member thereof who holds substantial interest in such company;
 - (iii) Where the managing agent is a firm, any partner of such firm;]
- (h) "managing director", in relation to a banking company, means a director who, by virtue of an agreement with the banking company or of a resolution passed by the banking company in general meeting or by its Board of directors or, by virtue of its memorandum or articles of association, is entrusted with the management of the whole, or substantially the whole of the affairs of the company, and includes a director occupying the position of a managing director, by whatever name called:

Provided that the managing director shall exercise his powers subject to the superintendence, control and direction of the Board of Directors;
- (ha) "National Bank" means the National Bank for Agriculture and Rural Development established under section 3 of the National Bank for Agriculture and Rural Development Act, 1981;
- (i) Omitted by Act 33 of 1959, Section 2 w.e.f. 1-5-1982.
- (j) "prescribed" means prescribed by rules made under this Act;
- (ja) "regional rural bank" means a regional rural bank established under section 3 of the Regional Rural Banks Act, 1976 (21 of 1976);
- (k) Omitted by Act 33 of 1959, Section 2 w.e.f. 1-5-1982.
- (l) "Reserve Bank" means the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934 (2 of 1934);
- (m) Omitted by Act 33 of 1959, Section 2 w.e.f. 1-5-1982.
- (n) "secured loan or advance" means a loan or advance made on the security of assets the market value of which is not at any time less than the amount of such loan or advance; and "unsecured loan or advance" means a loan or advance not so secured;
- (ni) "Small Industries Bank" means the Small Industries Development Bank of India established under section 3 of the Small Industries Development Bank of India, 1989;
- (na) "small-scale industrial concern" means an industrial concern in which the investment in plant and machinery is not in excess of seven and a half lakhs of rupees or such higher amount, not exceeding twenty lakhs of rupees, as the Central Government may, by notification in the Official Gazette, specify in this behalf, having regard to the trends in industrial development and other relevant factors;
- (nb) "Sponsor Bank" has the meaning assigned to it in the Regional Rural Banks Act, 1976 (21 of 1976);
- (nc) "State Bank of India" means the State Bank of India constituted under section 3 of the State Bank of India Act, 1955 (23 of 1955);

- (nd) "subsidiary bank" has the meaning assigned to it in the State Bank of India (Subsidiary Banks) Act, 1959;
- (ne) "substantial interest". —
 - (i) in relation to a company, means the holding of a beneficial interest by an individual or his spouse or minor child, whether singly or taken together, in the shares thereof, the amount paid up on which exceeds five lakhs of rupees or ten percent of the paid-up capital of the company, whichever is less;
 - (ii) in relation to a firm, means the beneficial interest held therein by an individual or his spouse or minor child, whether singly or taken together, which represents more than ten per cent of the total capital subscribed by all the partners of the said firm;
- (o) all other words and expressions used herein but not defined and defined in the Companies Act, 1956 (1 of 1956), shall have the meanings respectively assigned to them in that Act.
- (2) Omitted by the A.O. 1950

Act to override memorandum, articles, etc [Section 5A]

Save as otherwise expressly provided in this Act. —

- (a) the provisions of this Act shall have effect notwithstanding anything to the contrary contained in the memorandum or articles of a banking company, or in any agreement executed by it, or in any resolution passed by the banking company in general meeting or by its Board of Directors, whether the same be registered, executed or passed, as the case may be, before or after the commencement of the Banking Companies (Amendment) Act, 1959 (33 of 1959); and
- (b) any provision contained in the memorandum, articles, agreement or resolution aforesaid shall, to the extent to which it is repugnant to the provisions of this Act, become or be void, as the case may be.

Forms of business in which banking companies may engage [Section 6]

- (1) In addition to the business of banking, a banking company may engage in any one or more of the following forms of business, namely: —
 - (a) the borrowing, raising, or taking up of money; the lending or advancing of money either upon or without security; the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hoondees, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scrips and other instruments and securities whether transferable or negotiable or not; the granting and issuing of letters of credit, traveller's cheques and circular notes; the buying, selling and dealing in bullion and specie; the buying and selling of foreign exchange including foreign bank notes; the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities and investments of all kinds; the purchasing and selling of bonds, scrips or other forms of securities on behalf of constituents or others, the negotiating of loans and advances; the receiving of all kinds of bonds, scrips or valuables on deposit or for safe custody or otherwise; the providing of safe deposit vaults; the collecting and transmitting of money and securities;
 - (b) acting as agents for any Government or local authority or any other person or persons; the carrying on of agency business of any description including the clearing and forwarding of goods, giving of receipts and discharges and otherwise acting as an attorney on behalf of customers, but excluding the business of a managing agent or secretary and treasurer of a company;
 - (c) contracting for public and private loans and negotiating and issuing the same;



- (d) the effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue, public or private, of State, municipal or other loans or of shares, stock, debentures, or debenture stock of any company, corporation or association and the lending of money for the purpose of any such issue;
 - (e) carrying on and transacting every kind of guarantee and indemnity business;
 - (f) managing, selling and realising any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims;
 - (g) acquiring and holding and generally dealing with any property or any right, title or interest in any such property which may form the security or part of the security for any loans or advances or which may be connected with any such security;
 - (h) undertaking and executing trusts;
 - (i) undertaking the administration of estates as executor, trustee or otherwise;
 - (j) establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons; granting pensions and allowances and making payments towards insurance; subscribing to or guaranteeing moneys for charitable or benevolent objects or for any exhibition or for any public, general or useful object;
 - (k) the acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purposes of the company;
 - (l) selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company;
 - (m) acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in this sub-section;
 - (n) doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company;
 - (o) any other form of business which the Central Government may, by notification in the Official Gazette, specify as a form of business in which it is lawful for a banking company to engage.
- (2) No banking company shall engage in any form of business other than those referred to in sub-section (1).

Use of words “bank”, “banker”, “banking” or “banking company” [Section 7]

- (1) No company other than a banking company shall use as part of its name or in connection with its business any of the words “bank”, “banker” or “banking” and no company shall carry on the business of banking in India unless it uses as part of its name at least one of such words.
- (2) No firm, individual or group of individuals shall, for the purpose of carrying on any business, use as part of its or his name any of the words “bank”, “banking” or “banking company”.
- (3) Nothing in this section shall apply to. —
 - (a) a subsidiary of a banking company formed for one or more of the purposes mentioned in sub-section (1) of section 19, whose name indicates that it is a subsidiary of that banking company;
 - (b) any association of banks formed for the protection of their mutual interests and registered under section 25 of the Companies Act, 1956 (1 of 1956).]

Prohibition of trading [Section 8]

Notwithstanding anything contained in section 6 or in any contract, no banking company shall directly or indirectly deal in the buying or selling or bartering of goods, except in connection with the realisation of security given to or held by it, or engage in any trade, or buy, sell or barter goods for others otherwise than in connection with bills of exchange received for collection or negotiation or with such of its business as is referred to in clause (i) of sub-section (1) of section 6:

Provided that this section shall not apply to any such business as is specified in pursuance of clause (o) of sub-section (1) of section 6.

Explanation. — For the purposes of this section, “goods” means every kind of movable property, other than actionable claims, stocks, shares, money, bullion and specie, and all instruments referred to in clause (a) of sub-section (1) of section 6.

Disposal of non-banking assets [Section 9]

Notwithstanding anything contained in section 6, no banking company shall hold any immovable property howsoever acquired, except such as is required for its own use, for any period exceeding seven years from the acquisition thereof or from the commencement of this Act, whichever is later or any extension of such period as in this section provided, and such property shall be disposed of within such period or extended period, as the case may be:

Provided that the banking company may, within the period of seven years as aforesaid deal or trade in any such property for the purpose of facilitating the disposal thereof:

Provided further that the Reserve Bank may in any particular case extend the aforesaid period of seven years by such period not exceeding five years where it is satisfied that such extension would be in the interests of the depositors of the banking company.

Prohibition of employment of managing agents and restrictions on certain forms of employment [Section 10]

(1) No banking company —

- (a) shall employ or be managed by a managing agent; or
- (b) shall employ or continue the employment of any person—
 - (i) who is, or at any time has been, adjudicated insolvent, or has suspended payment or has compounded with his creditors, or who is, or has been, convicted by a criminal court of an offence involving moral turpitude; or
 - (ii) whose remuneration or part of whose remuneration takes the form of commission or of a share in the profits of the company:

Provided that nothing contained in this sub-clause shall apply to the payment by a banking company of—

- (a) any bonus in pursuance of a settlement or award arrived at or made under any law relating to industrial disputes or in accordance with any scheme framed by such banking company or in accordance with the usual practice prevailing in banking business;
 - (b) any commission to any broker (including guarantee broker), cashier-contractor, clearing and forwarding agent, auctioneer or any other person, employed by the banking company under a contract otherwise than as a regular member of the staff of the company; or
 - (iii) whose remuneration is, in the opinion of the Reserve Bank, excessive; or
- (c) shall be managed by any person—



- (i) who is a director of any other company not being—
 - (a) a subsidiary of the banking company, or
 - (b) a company registered under section 25 of the Companies Act, 1956 (1 of 1956):

Provided that the prohibition in this sub-clause shall not apply in respect of any such director for a temporary period not exceeding three months or such further period not exceeding nine months as the Reserve Bank may allow; or

- (ii) who is engaged in any other business or vocation; or
- (iii) whose term of office as a person managing the company is for period exceeding five years at any one time:

Provided that the term of office of any such person may be renewed or extended by further periods not exceeding five years on each occasion subject to the condition that such renewal/extension shall not be sanctioned earlier than two years from the date on which it is to come into force:

Provided also that where the term of office of such person is for an indefinite period, such term, unless it otherwise comes to an end earlier, shall come to an end immediately on the expiry of five years from the date of his appointment or on the expiry of three months from the date of commencement of section 8 of the Banking Laws (Miscellaneous Provisions) Act, 1963 (55 of 1963), whichever is later:

Provided further that nothing in this clause shall apply to a director, other than the managing director, of a banking company by reason only of his being such director.

Explanation. —For the purpose of sub-clause (iii) of clause (b), the expression “remuneration”, in relation to person employed or continued in employment, shall include salary, fees and perquisites but shall not include any allowances or other amounts paid to him for the purpose of reimbursing him in respect of the expense actually incurred by him in the performance of his duties.

- (2) In forming its opinion under sub-clause (iii) of clause (b) of sub-section (1), the Reserve Bank may have regard among other matters to the following: —
 - (i) the financial condition and history of the banking company, its size and area of operation, its resources, the volume of its business, and the trend of its earning capacity;
 - (ii) the number of its branches or offices;
 - (iii) the qualifications, age and experience of the person concerned;
 - (iv) the remuneration paid to other persons employed by the banking company or to any person occupying a similar position in any other banking company similarly situated; and
 - (v) the interests of its depositors.
- (3) Omitted by Act 55 of 1963, Section 8 w.e.f. 1-2-1964.
- (4) Omitted by Act 55 of 1963, Section 8 w.e.f. 1-2-1964.
- (5) Omitted by Act 55 of 1963, Section 8 w.e.f. 1-2-1964.
- (6) Any decision or order of the Reserve Bank made under this section shall be final for all purposes.

Board of directors to include persons with professional or other experience [Section 10A]

- (1) Notwithstanding anything contained in any other law for the time being in force, every banking company,

- (a) in existence on the commencement of section 3 of the Banking Laws (Amendment) Act, 1968 (58 of 1968), or
 - (b) which comes into existence thereafter, shall comply with the requirements of this section:
Provided that nothing contained in this sub-section shall apply to a banking company referred to in clause (a) for a period of three months from such commencement.
- (2) Not less than fifty-one per cent, of the total number of members of the Board of directors of a banking company shall consist of persons, who—
- (a) shall have special knowledge or practical experience in respect of one or more of the following matters, namely:—
 - (i) accountancy,
 - (ii) agriculture and rural economy,
 - (iii) banking,
 - (iv) co-operation,
 - (v) economics,
 - (vi) finance,
 - (vii) law,
 - (viii) small-scale industry,
 - (ix) any other matter the special knowledge of, and practical experience in, which would, in the opinion of the Reserve Bank, be useful to the banking company:

Provided that out of the aforesaid number of directors, not less than two shall be persons having special knowledge or practical experience in respect of agriculture and rural economy, co-operation or small-scale industry; and
 - (b) shall not—
 - (1) have substantial interest in, or be connected with, whether as employee, manager or managing agent,—
 - (i) any company, not being a company registered under section 25 of the Companies Act, 1956 (1 of 1956), or
 - (ii) any firm,
which carries on any trade, commerce or industry and which, in either case, is not a small-scale industrial concern, or
- (2) be proprietors of any trading, commercial or industrial concern, not being a small-scale industrial concern.
- (2A) Notwithstanding anything to the contrary contained in the Companies Act, 1956 (1 of 1956), or in any other law for the time being in force, —
- (i) no director of a banking company, other than its chairman or whole-time director, by whatever name called, shall hold office continuously for a period exceeding eight years;
 - (ii) a chairman or other whole-time director of a banking company who has been removed from office as such chairman, or whole-time director, as the case may be, under the provisions of this Act shall also cease to be a director of the banking company and shall also not be eligible to be appointed as a director of such banking company, whether by election or co-option or otherwise, for a period of four years from the date of his ceasing to be the -chairman or whole-time director as the case may be.



- (3) If, in respect of any banking company the requirements, as laid down in subsection (2), are not fulfilled at any time, the Board of directors of such banking company shall re-constitute such Board so as to ensure that the said requirements are fulfilled.
- (4) If, for the purpose of re-constituting the Board under sub-section (3), it is necessary to retire any director or directors, the Board may, by lots drawn in such manner as may be prescribed, decide which director or directors shall cease to hold office and such decision shall be binding on every director of the Board.
- (5) Where the Reserve Bank is of opinion that the composition of the Board of directors of a banking company is such that it does not fulfil the requirements of subsection (2), it may, after giving to such banking company a reasonable opportunity of being heard, by an order in writing, direct the banking company to so re-constitute its Board of directors as to ensure that the said requirements are fulfilled and, if within two months from the date of receipt of that order, the banking company does not comply with the directions made by the Reserve Bank, that Bank may, after determining, by lots drawn in such manner as may be prescribed, the person who ought to be removed from the membership of the Board of directors, remove such person from the office of the director of banking company and with a view to complying with the provision of sub-section (2) appoint a suitable person as a member of the Board of directors in the place of the person so removed whereupon the person so appointed shall be deemed to have been duly elected by the banking company as its director.
- (6) Every appointment, removal or reconstitution duly made, and every election duly held, under this section shall be final and shall not be called into question in any court.
- (7) Every director elected or, as the case may be, appointed under this section shall hold office until the date up to which his predecessor would have held office, if the election had not been held, or, as the case may be, the appointment had not been made.
- (8) No act or proceeding of the Board of directors of a banking company shall be invalid by reason only of any defect in the composition thereof or on the ground that it is subsequently discovered that any of its members did not fulfil the requirements of this section.

Banking company to be managed by whole time chairman [Section 10B]

- (1) Notwithstanding anything contained in any law for the time being in force or in any contract to the contrary, every banking company in existence on the commencement of the Banking Regulation (Amendment) Act, 1994 (20 of 1944), or which comes into existence thereafter shall have one of its directors, who may be appointed on a whole-time or a part-time basis, as chairman of its board of directors, and where he is appointed on a whole-time basis, as chairman of its board of directors, he shall be entrusted with the management of the whole of the affairs of the banking company :

Provided that the chairman shall exercise his powers subject to the superintendence, control and direction of the board of directors.

- (1A) Where a chairman is appointed on a part-time basis, —
 - (i) such appointment shall be with the previous approval of the Reserve Bank and be subject to such conditions as the Reserve Bank may specify while giving such approval;
 - (ii) the management of the whole of the affairs of such banking company shall be entrusted to a managing director who shall exercise his powers subject to the superintendence, control and direction of the board of directors.
- (2) Every chairman of the board of directors who is appointed on a whole-time basis and every managing director of a banking company shall be in the whole-time employment of such company and shall hold office for such period, not exceeding five years, as the board of directors may fix,

but shall, subject to the provisions of this section, be eligible for re-election or reappointment:

Provided that nothing in this sub-section shall be construed as prohibiting a chairman from being a director of a subsidiary of the banking company or a director of a company registered under section 25 of the Companies Act, 1956 (1 of 1956).

- (3) Every person holding office on the commencement of section 3 of the Banking Laws (Amendment) Act, 1968 (58 of 1968), as managing director of a banking company shall—
 - (a) if there is a chairman of its board of directors, vacate office on such commencement, or
 - (b) if there is no chairman of its board of directors, vacate office on the date on which the chairman of its board of directors is elected or appointed in accordance with the provisions of this section.
- (4) Every chairman who is appointed on a whole-time basis and every managing director of a banking company appointed under sub-section (1A) shall be person who has special knowledge and practical experience of—
 - (a) the working of a banking company, or of the State Bank of India or any subsidiary bank or a financial institution, or
 - (b) financial, economic or business administration :

Provided that a person shall be disqualified for being a chairman who is appointed on a whole time basis or a managing director, if he—

- (a) is a director of any company other than a company referred to in the proviso to sub-section (2), or
 - (b) is a partner of any firm which carries on any trade, business or industry, or
 - (c) has substantial interest in any other company or firm, or
 - (d) is a director, manager, managing agent, partner or proprietor of any trading, commercial or industrial concern, or
 - (e) is engaged in any other business or vocation.
- (5) A chairman of the board of directors appointed on a whole-time basis or a managing director of a banking company may, by writing, under his hand addressed to the company, resign his office.
- (5A) A chairman of the board of directors appointed on a whole-time basis or a managing director whose term of office has come to an end, either by reason of his resignation or by reason of expiry of the period of his office, shall, subject to the approval of the Reserve Bank, continue in office until his successor assumes office.
- (6) Without prejudice to the provisions of section 36AA where the Reserve Bank is of opinion that any person who, is, or has been elected to be, the chairman of the board of directors who is appointed on a whole-time basis or the managing director of a banking company is not a fit and proper person to hold such office, it may, after giving to such person and to the banking company a reasonable opportunity of being heard by order in writing, require the banking company to elect or appoint any other person as the chairman of the board of directors who is appointed on a whole-time basis or the managing director and if, within a period of two months from the date of receipt of such order, the banking company fails to elect or appoint a suitable person as the chairman of the board of directors who is appointed on a whole-time basis or the managing director, the Reserve Bank may, by order, remove the first-mentioned person from the office of the chairman of the board of directors who is appointed on a whole-time basis



or the managing director of the banking company and appoint a suitable person in his place whereupon the person so appointed shall be deemed to have been duly elected or appointed, as the case may be, as the chairman of the board of directors who is appointed on a whole-time basis or the managing director of such banking company and any person elected or appointed as chairman on a whole-time basis or managing director under this sub-section shall hold office for the residue of the period of office of the person in whose place he has been so elected or appointed.

- (7) The banking company and any person against whom an order of removal is made under sub-section (6) may, within thirty days from the date of communication to it or to him of the order, prefer an appeal to the Central Government and the decision of the Central Government thereon, and subject thereto, the order made by the Reserve Bank under sub-section (6), shall be final and shall not be called into question in any court.
- (8) Notwithstanding anything contained in this section, the Reserve Bank may, if in its opinion it is necessary in the public interest so to do, permit the chairman of the board of directors who is appointed on a whole-time basis or the managing director to undertake such part-time honorary work as is not likely to interfere with his duties as such chairman or managing director.
- (9) Notwithstanding anything contained in this section, where a person appointed on a whole-time basis, as chairman of the board of directors or the managing director dies or resigns or is by infirmity or otherwise rendered incapable of carrying out his duties or is absent on leave or otherwise in circumstances not involving the vacation of his office, the banking company may, with the approval of the Reserve Bank, make suitable arrangements for carrying out the duties of chairman or managing director for a total period not exceeding four months.

Power of Reserve Bank to appoint Chairman of the Board of directors appointed on a whole-time basis or a managing director of a banking company [Section 10BB]

- (1) Where the office, of the chairman of the board of directors appointed on a whole-time basis or a managing director of a banking company is vacant, the Reserve Bank may, if it is of opinion that the continuation of such vacancy is likely to adversely affect the interests of the banking company, appoint a person eligible under sub-section (4) of section 10B to be so appointed, to be the chairman of the board of directors appointed on a whole-time basis or a managing director of the banking company and where the person so appointed is not a director of such banking company, he shall, so long as he holds the office of the chairman of the board of directors appointed on a whole-time basis or a managing director, be deemed to be director of the banking company.
- (2) The chairman of the board of directors appointed on a whole-time basis or a managing director so appointed by the Reserve Bank shall be in the whole-time employment of the banking company and shall hold office for such period not exceeding three years, as the Reserve Bank may specify, but shall, subject to other provisions of this Act, be eligible for reappointment.
- (3) The chairman of the board of directors appointed on a whole-time basis or a managing director so appointed by the Reserve Bank shall draw from the banking company such pay and allowances as the Reserve Bank may determine and may be removed from office only by the Reserve Bank.
- (4) Save as otherwise provided in this section, the provisions of section 10B shall, as far as may be, apply to the chairman of the board of directors appointed on a whole-time basis or a managing director appointed by the Reserve Bank under subsection (1) as they apply to a chairman of the board of directors appointed on a whole-time basis or a managing director appointed by the banking company.

Chairman and certain directors not to be required to hold qualification shares [Section 10C]

Chairman of the board of directors who is appointed on a whole-time basis or a managing director of a banking company (by whomsoever appointed) and a director of a banking company (appointed by the Reserve Bank under section 10A) shall not be required to hold qualification shares in the banking company.

Provisions of sections 10A and 10B to override all other laws, contracts, etc [Section 10D]

Any appointment or removal of a director, chairman of the board of directors who is appointed on a whole-time basis or a managing director in pursuance of section 10A or section 10B or section 10BB shall have effect and any such person shall not be entitled to claim any compensation for the loss or termination of office, notwithstanding anything contained in any law or in any contract, memorandum or articles of association.

Requirement as to minimum paid-up capital and reserves [Section 11]

- (1) Notwithstanding anything contained in section 149 of the Companies Act, 1956 (1 of 1956), no banking company in existence on the commencement of this Act, shall, after the expiry of three years from such commencement or of such further period not exceeding one year as the Reserve Bank, having regard to the interests of the depositors of the company, may think fit in any particular case to allow, carry on business in India, and no other banking company shall after the commencement of this Act, commence or carry on business in India unless it complies with such of the requirements of this section as are applicable to it.
- (2) In the case of a banking company incorporated outside India—
 - (a) the aggregate value of its paid-up capital and reserves shall not be less than fifteen lakhs of rupees and if it has a place or places of business in the city of Bombay or Calcutta or both, twenty lakhs of rupees; and
 - (b) the banking company shall deposit and keep deposited with the Reserve Bank either in cash or in the form of unencumbered approved securities, or partly in cash and partly in the form of such securities —
 - (i) an amount which shall not be less than the minimum required by clause (a); and
 - (ii) as soon as may be after the expiration of each year, an amount calculated at twenty per cent of its profit for that year in respect of all business transacted through its branches in India, as disclosed in the profit and loss account prepared with reference to that year under section 29:

Provided that any such banking company may at any time replace —

- (i) any securities so deposited by cash or by any other unencumbered approved securities or partly by cash and partly by other such securities, so however, that the total amount deposited is not affected;
 - (ii) any cash so deposited by unencumbered approved securities of an equal value.
- (2A) Notwithstanding anything contained in sub-section (2), the Central Government may, on the recommendation of the Reserve Bank, and having regard to the adequacy of the amounts already deposited and kept deposited by a banking company under sub-section (2), in relation to its deposit liabilities in India, declare by order in writing that the provisions of sub-clause (ii) of clause (b) of sub-section (2) shall not apply to such banking company for such period as may be specified in the order.
- (3) In the case of any banking company to which the provisions of sub-section (2) do not apply, the aggregate value of its paid-up capital and reserves shall not be less than—



- (i) if it has places of business in more than one State, five lakhs of rupees, and if any such place or places of business is or are situated in the city of Bombay or Calcutta or both, ten lakhs of rupees;
- (ii) if it has all its places of business in one State none of which is situated in the city of Bombay or Calcutta, one lakh of rupees in respect of its principal place of business, plus ten thousand rupees in respect of each of its other places of business situated in the same district in which it has its principal place of business, plus twenty-five thousand rupees in respect of each place of business situated elsewhere in the State otherwise than in the same district:

Provided that no banking company to which this clause applies shall be required to have paid-up capital and reserves exceeding an aggregate value of five lakhs of rupees:

Provided further that no banking company to which this clause applies and which has only one place of business, shall be required to have paid-up capital and reserves exceeding an aggregate value of fifty thousand rupees:

Provided further that in the case of every banking company to which this clause applies and which commences banking business for the first time after the commencement of the Banking Companies (Amendment) Act, 1962 (36 of 1962), the value of its paid-up capital shall not be less than five lakhs of rupees;

- (iii) if it has all its places of business in one State, one or more of which is or are situated in the city of Bombay or Calcutta, five lakhs of rupees, plus twenty-five thousand rupees in respect of each place of business situated outside the city of Bombay or Calcutta, as the case may be:

Provided that no banking company to which this clause applies shall be required to have paid-up capital and reserves exceeding an aggregate value of ten lakhs of rupees.

Explanation. — For the purposes of this sub-section, a place of business situated in a State other than that in which the principal place of business of the banking company is situated shall, if it is not more than twenty-five miles distant from such principal place of business, be deemed to be situated within the same State as such principal place of business.

- (4) Any amount deposited and kept deposited with the Reserve Bank under sub-section (2) by any banking company incorporated outside India shall, in the event of the company ceasing for any reason to carry on banking business in India, be an asset of the company on which the claims of all the creditors of the company in India shall be a first charge.
- (5) For the purposes of this section, —
 - (a) "place of business" means any office, sub-office, sub-pay office and any place of business at which deposits are received, cheques cashed, or moneys lent;
 - (b) "value" means the real or exchangeable value, and not the nominal value which may be shown in the books of the banking company concerned.
- (6) If any dispute arises in computing the aggregate value of the paid-up capital and reserves of any banking company, a determination thereof by the Reserve Bank shall be final for the purposes of this section.

Regulation of paid-up capital, subscribed capital and authorised capital and voting rights of shareholders [Section 12]

- (1) No banking company shall carry on business in India, unless it satisfies the following conditions, namely:—
 - (i) that the subscribed capital of the company is not less than one-half of the authorised capital, and the paid-up capital is not less than one-half of the subscribed capital and that,

if the capital is increased, it complies with the conditions prescribed in this clause within such period not exceeding two years as the Reserve Bank may allow;

- (ii) "that", notwithstanding anything contained in the Companies Act, 1956 (1 of 1956), the capital of such banking company consists of
 - (a) equity shares only, or
 - (b) equity shares and preference shares:

Provided that the issue of preference share shall be in accordance with the guidelines framed by the Reserve Banks specifying the class of preference shares, the extent of issue of each class of such preference shares (whether perpetual or irredeemable or redeemable), and the terms and conditions subject to which each class of preference shares may be issued.

Provided further that no holder of the preference share, issued by the company, shall be entitled to exercise the voting right specified in clause (h) of sub-section (2) of section 87 of the Companies Act, 1956 (1 of 1956);";

- (2) No person holding shares in a banking company shall, in respect of any shares held by him, exercise voting rights on poll in excess of (ten per cent) of the total voting rights of all the shareholders of the banking company.

"Provided that the Reserve Bank may increase, in a phased manner, such ceiling on voting rights from ten per cent to twenty-six per cent."

- (3) Notwithstanding anything contained in any law for the time being in force or in any contract or instrument no suit or other proceeding shall be maintained against any person registered as the holder of a share in a banking company on the ground that the title to the said share vests in a person other than the registered holder.

Provided that nothing contained in this sub-section shall bar a suit or other proceeding—

- (a) by a transferee of the share on the ground that he has obtained from the registered holder a transfer of the share in accordance with any law relating to such transfer; or
 - (b) on behalf of a minor or a lunatic on the ground that the registered holder holds the share on behalf of the minor or lunatic.
- (4) Every chairman, managing director or chief executive officer by whatever name called of a banking company shall furnish to the Reserve Bank through that banking company returns containing full particulars of the extent and value of his holding of shares, whether directly or indirectly, in the banking company and of any change in the extent of such holding or any variation in the rights attaching thereto and such other information relating to those shares as the Reserve Bank may, by order, require and in such form and at such time as may be specified in the order.

Election of new directors [Section 12A]

- (1) The Reserve Bank may, by order, require any banking company to call a general meeting of the shareholders of the company within such time, not less than two months from the date of the order, as may be specified in the order or within such further time as the Reserve Bank may allow in this behalf, to elect in accordance with the voting rights permissible under this Act fresh directors, and the banking company shall be bound to comply with the order.
- (2) Every director elected under sub-section (1) shall hold office until the date up to which his predecessor would have held office, if the election had not been held.
- (3) Any election duly held under this section shall not be called in question in any court.



Regulation of acquisition of shares or voting rights [Section 12B]

- (1) No person (hereinafter referred to as “the applicant”) shall, except with the previous approval of the Reserve Bank, on an application being made, acquire or agree to acquire, directly or indirectly, by himself or acting in concert with any other person, shares of a banking company or voting rights therein, which acquisition taken together with shares and voting rights, if any, held by him or his relative or associate enterprise or person acting in concert with him, makes the applicant to hold five per cent, or more of the paid-up share capital of such banking company or entitles him to exercise five per cent, or more of the voting rights in such banking company.

Explanation 1. -For the purposes of this sub-section,

- (a) “relative” shall have the meaning assigned to it in section 6 of the Companies Act, 1956 (1 of 1956);
- (b) “associate enterprise” means a company, whether incorporated or not, which,
 - (i) is a holding company or a subsidiary company of the applicant; or
 - (ii) is a joint venture of the applicant; or
 - (iii) controls the composition of the Board of Directors or other body governing the applicant; or
 - (iv) exercises, in the opinion of the Reserve Bank, significant influence on the applicant in taking financial or policy decisions; or
 - (v) is able to obtain economic benefits from the activities of the applicant;
- (c) persons shall be deemed to be “acting in concert” who, for a common objective or purpose of acquisition of shares or voting rights in excess of the percentage mentioned in this sub-section, pursuant to an agreement or understanding (formal or informal), directly or indirectly cooperate by acquiring or agreeing to acquire shares or voting rights in the banking company.

Explanation 2. -For the purposes of this Act, joint venture means a legal entity in the nature of a partnership engaged in the joint undertaking of a particular transaction for mutual profit or an association of persons or companies jointly undertaking some commercial enterprise wherein all contribute assets and share risks.

- (2) An approval under sub-section (1) may be granted by the Reserve Bank if it is satisfied that
- (a) in the public interest; or
 - (b) in the interest of banking policy; or
 - (c) to prevent the affairs of any banking company being conducted in a manner detrimental or prejudicial to the interests of the banking company; or
 - (d) in view of the emerging trends in banking and international best practices; or
 - (e) in the interest of the banking and financial system in India,
- the applicant is a fit and proper person to acquire shares or voting rights:
- Provided that the Reserve Bank may call for such information from the applicant as it may deem necessary for considering the application referred to in sub-section (1): Provided further that the Reserve Bank may specify different criteria for acquisition of shares or voting rights in different percentages.
- (3) Where the acquisition is by way of transfer of shares of a banking company and the Reserve Bank is satisfied that such transfer should not be permitted, it may, by order, direct that no such share

shall be transferred to the proposed transferee and may further direct the banking company not to give effect to the transfer of shares and in case the transfer has been registered, the transferee shall not be entitled to exercise voting rights on poll in any of the meetings of the banking company.

- (4) The approval for acquisition of shares may be subject to such conditions as the Reserve Bank may deem fit to impose, including a condition that any further acquisition of shares shall require prior approval of the Reserve Bank and that the applicant continues to be a fit and proper person to hold the shares or voting rights.
- (5) Before issuing or allotting any share to any person or registering the transfer of shares in the name of any person, the banking company shall ensure that the requirements of sub-section (1) are complied with by that person and where the acquisition is with the approval of the Reserve Bank, the banking company shall further ensure that the conditions imposed under sub-section (4), if any, of such approval are fulfilled.
- (6) The decision of the Reserve Bank on the application made under sub-section (1) shall be taken within a period of ninety days from the date of receipt of the application by the Reserve Bank.
Provided that in computing the period of ninety days, the period taken by the applicant for furnishing the information called for by the Reserve Bank shall be excluded.
- (7) The Reserve Bank may specify the minimum percentage of shares to be acquired in a banking company if it considers that the purpose for which the shares are proposed to be acquired by the applicant warrants such minimum shareholding.
- (8) The Reserve Bank may, if it is satisfied that any person or persons acting in concert with him holding shares or voting rights in excess of five per cent, of the total voting rights of all the shareholders of the banking company, are not fit and proper to hold such shares or voting rights, pass an order directing that such person or persons acting in concert with him shall not, in the aggregate, exercise voting rights on poll in excess of five per cent, of the total voting rights of all the shareholders of the banking company.

Provided that the Reserve Bank shall not pass any such order without giving an opportunity of being heard to such person or persons acting in concert with him.

Restriction on commission, brokerage, discount, etc. on sale of shares [Section 13]

Notwithstanding anything to the contrary contained in sections 76 and 79 of the Companies Act, 1956 (1 of 1956)], no banking company shall pay out directly or indirectly by way of commission, brokerage, discount or remuneration in any form in respect of any shares issued by it, any amount exceeding in the aggregate two and one-half per cent of the price at which the said shares are issued.

Explanation.- For the removal of doubts, it is hereby declared that the expression “price at which the said shares are issued” shall include amount or value of premium on such shares..

Prohibition of charge on unpaid capital [Section 14]

No banking company shall create any charge upon any unpaid capital of the company, and any such charge shall be invalid.

Prohibition of floating charge on assets [Section 14A]

- (1) Notwithstanding anything contained in section 6, no banking company shall create a floating charge on the undertaking or any property of the company or any part thereof, unless the creation of such floating charge is certified in writing by the Reserve Bank as not being detrimental to the interests of the depositors of such company.
- (2) Any such charge created without obtaining the certificate of the Reserve Bank shall be invalid.



- (3) Any banking company aggrieved by the refusal of a certificate under subsection (1) may, within ninety days from the date on which such refusal is communicated to it, appeal to the Central Government.
- (4) The decision of the Central Government where an appeal has been preferred to it under subsection (3) or of the Reserve Bank where no such appeal has been preferred shall be final.

Restrictions as to payment of dividend [Section 15]

- (1) No banking company shall pay any dividend on its shares until all its capitalised expenses (including preliminary expenses, organisation expenses, share-selling commission, brokerage, amounts of losses incurred and any other item of expenditure not represented by tangible assets) have been completely written off.
- (2) Notwithstanding anything to the contrary contained in sub-section (1) or in the Companies Act, 1956 (1 of 1956), a banking company may pay dividends on its shares without writing off—
 - (i) the depreciation, if any, in the value of its investments in approved securities in any case where such depreciation has not actually been capitalised or otherwise accounted for as a loss;
 - (ii) the depreciation, if any, in the value of its investments in shares, debentures or bonds (other than approved securities) in any case where adequate provision for such depreciation has been made to the satisfaction of the auditor of the banking company;
 - (iii) the bad debts, if any, in any case where adequate provision for such debts has been made to the satisfaction of the auditor of the banking company.

Prohibition of common directors [Section 16]

- (1) No banking company incorporated in India shall have as a director in its Board of directors any person who is a director of any other banking company.
- (1A) No banking company referred to in sub-section (1) shall have in its Board of directors, more than three directors who are directors of companies which among themselves are entitled to exercise voting rights in excess of twenty per cent of the total voting rights of all the shareholders to that banking company.
- (2) If immediately before the commencement of the Banking Companies (Amendment) Act, 1956 (95 of 1956), any person holding office as a director of a banking company is also a director of companies which among themselves are entitled to exercise voting rights in excess of twenty percent of the total voting rights of all the shareholders of the banking company, he shall, within such period from such commencement as the Reserve Bank may specify in this behalf—
 - (a) either resign his office as a director of the banking company; or
 - (b) choose such number of companies as among themselves are not entitled to exercise voting rights in excess of twenty per cent, of the total voting rights of all the shareholders of the banking company as companies in which he wishes to continue to hold the office of a director and resign his office as a director in the other companies.
- (3) Nothing in sub-section (1) shall apply to, or in relation to, any director appointed by the Reserve Bank.

Reserve Fund [Section 17]

- (1) Every banking company incorporated in India shall create a reserve fund and shall, out of the balance of profit of each year as disclosed in the profit and loss account prepared under section 29 and before any dividend is declared, transfer to the reserve fund a sum equivalent to not less than twenty per cent of such profit.
- (1A) Notwithstanding anything contained in sub-section (1), the Central Government may, on the

recommendation of the Reserve Bank and having regard to the adequacy of the paid-up capital and reserves of a banking company in relation to its deposit liabilities, declare by order in writing that the provisions of sub-section (1) shall not apply to the banking company for such period as may be specified in the order:

Provided that no such order shall be made unless, at the time it is made, the amount in the reserve fund under sub-section (1), together with the amount in the share premium account is not less than the paid-up capital of the banking company.

- (2) Where a banking company appropriates any sum or sums from the reserve fund or the share premium account, it shall, within twenty-one days from the date of such appropriation, report the fact to the Reserve Bank, explaining the circumstances relating to such appropriation:

Provided that the Reserve Bank may, in any particular case, extend the said period of twenty-one days by such period as it thinks fit or condone any delay in the making of such report.

Cash reserve [Section 18]

- (1) Every banking company, not being a scheduled bank, shall maintain in India on a daily basis by way of cash reserve with itself or by way of balance in a current account with the Reserve Bank, or by way of net balance in current accounts or in one or more of the aforesaid ways, a sum equivalent to such per cent of the total of its demand and time liabilities in India as on the last Friday of the second preceding fortnight as the Reserve Bank may specify, by notification in the Official Gazette, from time to time, having regard to the needs of securing the monetary stability in the country and shall submit to the Reserve Bank before the twentieth day of every month a return showing the amount so held on alternate Fridays during a month with particulars of its demand and time liabilities in India on such Fridays or if any such Friday is a public holiday under the Negotiable Instruments Act, 1881 (26 of 1881), at the close of business on the preceding working day.

Explanation. —In this section, and in section 24, —

- (a) "liabilities in India" shall not include—
- (i) the paid-up capital or the reserves or any credit balance in the profit and loss account of the banking company;
 - (ii) any advance taken from the Reserve Bank or from the Exim Bank or from the Reconstruction Bank or from the National Housing Bank or from the National Bank or from the Small Industries Bank by the banking company;
 - (iii) in the case of a Regional Rural Bank, also any loan taken by such bank from its Sponsor Bank;
- (b) "fortnight" shall mean the period from Saturday to the second following Friday, both days inclusive;
- (c) "net balance in current accounts" shall, in relation to a banking company, mean the excess, if any, of the aggregate of the credit balances in current account maintained by that banking company with State Bank of India or a subsidiary bank or a corresponding new bank over the aggregate of the credit balances in current account held by the said banks with such banking company;
- (d) for the purposes of computation of liabilities, the aggregate of the liabilities of a banking company to the State Bank of India, a subsidiary bank, a corresponding new bank, a regional rural bank, another banking company, a co-operative bank or any other financial institution notified by the Central Government in this behalf, shall be reduced by the aggregate of the liabilities of all such banks and institutions to the banking company;



- (e) the expression "co-operative bank" shall have the meaning assigned to it in clause (cci) of section 56.
- (IA) If the balance held by such banking company at the close of business on any day is below the minimum specified under sub-section (I), such banking company shall, without prejudice to the provisions of any other law for the time being in force, be liable to pay to the Reserve Bank, in respect of that day, penal interest at a rate of three per cent, above the bank rate on the amount by which such balance falls short of the specified minimum, and if the shortfall continues further, the penal interest so charged shall be increased to a rate of five per cent, above the bank rate in respect of each subsequent day during which the default continues.
- (IB) Notwithstanding anything contained in this section, if the Reserve Bank is satisfied, on an application in writing by the defaulting banking company, that such defaulting banking company had sufficient cause for its failure to comply with the provisions of sub-section (1), it may not demand the payment of the penal interest.
- (IC) The Reserve Bank may, for such period and subject to such conditions as may be specified, grant to any banking company such exemptions from the provisions of this section as it thinks fit with reference to all or any of its offices or with reference to the whole or any part of its assets and liabilities."
- (2) The Reserve Bank may, for the purposes of this section and section 24, specify from time to time, with reference to any transaction or class of transactions, that such transaction or transactions shall be regarded as liability in India of a banking company and, if any question arises as to whether any transaction or class of transactions shall be regarded for the purposes of this section and section 24 as liability in India of a banking company, the decision of the Reserve Bank thereon shall be final.

Restriction on nature of subsidiary companies [Section 19]

- (1) A banking company shall not form any subsidiary company except a subsidiary company formed for one or more of the following purposes, namely: —
- (a) the undertaking of any business which, under clauses (a) to (o) of subsection (3) of section 6, is permissible for a banking company to undertake, or
- (b) with the previous permission in writing of the Reserve Bank, the carrying on of the business of banking exclusively outside India, or
- (c) the undertaking of such other business, which the Reserve Bank may, with the prior approval of the Central Government, consider to be conducive to the spread of banking in India or to be otherwise useful or necessary in the public interest.

Explanation. —For the purposes of section 8, a banking company shall not be deemed, by reason of its forming or having a subsidiary company, to be engaged indirectly in the business carried on by such subsidiary company.

- (2) Save as provided in sub-section (1), no banking company shall hold shares in any company, whether as pledgee, mortgagee or absolute owner, of an amount exceeding thirty per cent of the paid-up share capital of that company or thirty per cent of its own paid-up share capital and reserves, whichever is less:

Provided that any banking company which is on the date of the commencement of this Act holding any shares in contravention of the provisions of this sub-section shall not be liable to any penalty therefore if it reports the matter without delay to the Reserve Bank and if it brings its holding of shares into conformity with the said provisions within such period, not exceeding two years, as the Reserve Bank may think fit to allow.

- (3) Save as provided in sub-section (1) and notwithstanding anything contained in sub-section (2),

a banking company shall not, after the expiry of one year from the date of the commencement of this Act, hold shares, whether as pledge, mortgage or absolute owner, in any company in the management of which any managing director or manager of the banking company is in any manner concerned or interested.

Restrictions on loans and advances [Section 20]

- (1) Notwithstanding anything to the contrary contained in section 77 of the Companies Act, 1956 (1 of 1956), no banking company shall,—
 - (a) grant any loans or advances on the security of its own shares, or—
 - (b) enter into any commitment for granting any loan or advance to or on behalf of—
 - (i) any of its directors,
 - (ii) any firm in which any of its directors is interested as partner, manager, employee or guarantor, or
 - (iii) any company not being a subsidiary of the banking company or a company registered under section 25 of the Companies Act, 1956 (1 of 1956), or a Government company of which or the subsidiary or the holding company of which any of the directors of the banking company is a director, managing agent, manager, employee or guarantor or in which he holds substantial interest, or
 - (iv) any individual in respect of whom any of its directors is a partner or guarantor.
- (2) Where any loan or advance granted by a banking company is such that a commitment for granting it could not have been made if clause (b) of sub-section (1) had been in force on the date on which the loan or advance was made, or is granted by a banking company after the commencement of section 5 of the Banking Laws (Amendment) Act, 1968 (58 of 1968), but in pursuance of a commitment entered into before such commencement, steps shall be taken to recover the amounts due to the banking company on account of the loan, or advance together with interest, if any, due thereon within the period stipulated at the time of the grant of the loan or advance, or where no such period has been stipulated, before the expiry of one year from the commencement of the said section 5:

Provided that the Reserve Bank may, in any case, on an application in writing made to it by the banking company in this behalf, extend the period for the recovery of the loan or advance until such date, not being a date beyond the period of three years from the commencement of the said section 5, and subject to such terms and conditions, as the Reserve Bank may deem fit:

Provided further that this sub-section shall not apply if and when the director concerned vacates the office of the director of the banking company, whether by death, retirement, resignation or otherwise.
- (3) No loan or advance, referred to in sub-section (2), or any part thereof shall be remitted without the previous approval of the Reserve Bank, and any remission without such approval shall be void and of no effect.
- (4) Where any loan or advance referred to in sub-section (2), payable by any person, has not been repaid to the banking company within the period specified in that subsection, then, such person shall, if he is a director of such banking company on the date of the expiry of the said period, be deemed to have vacated his office as such on the said date.

Explanation. — In this section—

- (a) “loans or advance” shall not include any transaction which the Reserve Bank may, having regard to the nature of the transaction, the period within which, and the manner and circumstances in which, any amount due on account of the transaction is likely to be



realised, the interest of the depositors and other relevant considerations, specify by general or special order as not being a loan or advance for the purpose of this section;

- (b) "director" include a member of any board or committee in India constituted by a banking company for the purpose of managing, or for the purpose of advising it in regard to the management of, all or any of its affairs.
- (5) If any question arises whether any transaction is a loan or advance for the purposes of this section, it shall be referred to the Reserve Bank, whose decision thereon shall be final.

Restrictions on power to remit debts [Section 20A]

- (1) Notwithstanding anything to the contrary contained in section 293 of the Companies Act, 1956 (1 of 1956), a banking company shall not, except with the prior approval of the Reserve Bank, remit in whole or in part any debt due to it by—
- (a) any of its directors, or
 - (b) any firm or company in which any of its directors is interested as director, partner, managing agent or guarantor, or
 - (c) any individual if any of its directors is his partner or guarantor.
- (2) Any remission made in contravention of the provisions of sub-section (1) shall be void and of no effect.

Power of Reserve Bank to control advances by banking companies [Section 21]

- (1) Where the Reserve Bank is satisfied that it is necessary or expedient in the public interest or in the interests of depositors or banking policy so to do, it may determine the policy in relation to advances to be followed by banking companies generally or by any banking company in particular, and when the policy has been so determined, all banking companies or the banking company concerned, as the case may be, shall be bound to follow the policy as so determined.
- (2) Without prejudice to the generality of the power vested in the Reserve Bank under sub-section (1) the Reserve Bank may give directions to banking companies, either generally or to any banking company or group of banking companies in particular, as to—
- (a) the purposes for which advances may or may not be made,
 - (b) the margins to be maintained in respect of secured advances,
 - (c) the maximum amount of advances or other financial accommodation which, having regard to the paid-up capital, reserves and deposits of a banking company and other relevant considerations, may be made by that banking company to any one company, firm, association of persons or individual,
 - (d) the maximum amount up to which, having regard to the considerations referred to in clause (c), guarantees may be given by a banking company on behalf of any one company, firm, association of persons or individual, and
 - (e) the rate of interest and other terms and conditions on which advances or other financial accommodation may be made or guarantees may be given.
- (3) Every banking company shall be bound to comply with any directions given to it under this section.

Rates of interest charged by banking companies not to be subject to scrutiny by courts [Section 21A]

Notwithstanding anything contained in the Usurious Loans Act, 1918 (10 of 1918), or any other law relating to indebtedness in force in any State, a transaction between a banking company and its

debtor shall not be re-opened by any court on the ground that the rate of interest charged by the banking company in respect of such transaction is excessive.

Licensing of banking companies [Section 22]

- (1) Save as hereinafter provided, no company shall carry on banking business in India unless it holds a licence issued in that behalf by the Reserve Bank and any such licence may be issued subject of such conditions as the Reserve Bank may think fit to impose.
- (2) Every banking company in existence on the commencement of this Act, before the expiry of six months from such commencement, and every other company before commencing banking business in India, shall apply in writing to the Reserve Bank for a licence under this section:

Provided that in the case of a banking company in existence on the commencement of this Act, nothing in sub-section (1) shall be deemed to prohibit the company from carrying on banking business until it is granted a licence in pursuance of this section or is by notice in writing informed by the Reserve Bank that a licence cannot be granted to it:

Provided further that the Reserve Bank shall not give a notice as aforesaid to a banking company in existence on the commencement of this Act before the expiry of the three years referred to in sub-section (1) of section 11 or of such further period as the Reserve Bank may under that sub-section think fit to allow.

- (3) Before granting any licence under this section, the Reserve Banking may require to be satisfied by an inspection of the books of the company or otherwise that the following conditions are fulfilled, namely : —
 - (a) that the company is or will be in a position to pay its present or future depositors in full as their claims accrue;
 - (b) that the affairs of the company are not being, or are not likely to be, conducted in a manner detrimental to the interests of its present or future depositors;
 - (c) that the general character of the proposed management of the company will not be prejudicial to the public interest or the interest of its depositors;
 - (d) that the company has adequate capital structure and earning prospects;
 - (e) that the public interest will be served by the grant of a licence to the company to carry on banking business in India;
 - (f) that having regard to the banking facilities available in the proposed principal area of operations of the company, the potential scope for expansion of banks already in existence in the area and other relevant factors the grant of the licence would not be prejudicial to the operation and consolidation of the banking system consistent with monetary stability and economic growth;
 - (g) any other condition, the fulfilment of which would, in the opinion of the Reserve Bank, be necessary to ensure that the carrying on of banking business in India by the company will not be prejudicial to the public interest or the interests of the depositors.
- (3A) Before granting any licence under this section to a company incorporated outside India, the Reserve Bank may require to be satisfied by an inspection of the books of the company or otherwise that the conditions specified in sub-section (3) are fulfilled and that the carrying on of banking business by such company in India will be in the public interest and that the Government or law of the country in which it is incorporated does not discriminate in any way against banking companies registered in India and that the company complies with all the provisions of this Act applicable to banking companies incorporated outside India.



- (4) The Reserve Bank may cancel a licence granted to a banking company under this section —
- (i) if the company ceases to carry on banking business in India; or
 - (ii) if the company at any time fails to comply with any of the conditions imposed upon it under sub-section (1); or
 - (iii) if at any time, any of the conditions referred to in sub-section (3) and sub-section (3A) is not fulfilled:

Provided that before cancelling a licence under clause (ii) or clause (iii) of this sub-section on the ground that the banking company has failed to comply with or has failed to fulfil any of the conditions referred to therein, the Reserve Bank, unless it is of opinion that the delay will be prejudicial to the interests of the company's depositors or the public, shall grant to the company on such terms as it may specify, an opportunity of taking the necessary steps for complying with or fulfilling such condition.

- (5) Any banking company aggrieved by the decision of the Reserve Bank cancelling a licence under this section may, within thirty days from the date on which such decision is communicated to it, appeal to the Central Government.
- (6) The decision of the Central Government where an appeal has been preferred to it under sub-section (5) or of the Reserve Bank where no such appeal has been preferred shall be final.]

Restrictions on opening of new, and transfer of existing, places of business [Section 23]

- (1) Without obtaining the prior permission of the Reserve Bank—
- (a) no banking company shall open a new place of business in India or change otherwise than within the same city, town or village, the location of an existing place of business situated in India; and
 - (b) no banking company incorporated in India shall open a new place of business outside India or change, otherwise than within the same city, town or village in any country or area outside India, the location of an existing place of business situated in that country or area:
- Provided that nothing in this sub-section shall apply to the opening for a period not exceeding one month of a temporary place of business within a city, town or village or the environs thereof within which the banking company already has a place of business, for the purpose of affording banking facilities to the public on the occasion of an exhibition, a conference or a mela or any other like occasion.
- (2) Before granting any permission under this section, the Reserve Bank may require to be satisfied by an inspection under section 35 or otherwise as to the financial condition and history of the company, the general character of its management, the adequacy of its capital structure and earning prospects and that public interest will be served by the opening or, as the case may be, change of location, of the place of business.
- (3) The Reserve Bank may grant permission under sub-section (1) subject to such conditions as it may think fit to impose either generally or with reference to any particular case.
- (4) Where, in the opinion of the Reserve Bank, a banking company has, at any time, failed to comply with any of the conditions imposed on it under this section, the Reserve Bank may, by order in writing and after affording reasonable opportunity to the banking company for showing cause against the action proposed to be taken against it, revoke any permission granted under this section.
- (4A) Any regional rural bank requiring the permission of the Reserve Bank under this section shall forward its application to the Reserve Bank through the National Bank which shall give its comments on the merits of the application and send it to the Reserve Bank:

Provided that the regional rural bank shall also send an advance copy of the application directly to the Reserve Bank.

- (5) For the purpose of this section "place of business" includes any sub-office, pay office, subpay office and any place of business at which deposits are received, cheques cashed or moneys lent.

Maintenance of a percentage of assets [Section 24]

- (1) Omitted by Banking Regulation Amendment Act, 2007.
- (2) Omitted by Banking Regulation Amendment Act, 2007.
- (2A) A scheduled bank, in addition to the average daily balance which it is, or may be, required to maintain under section 42 of the Reserve Bank of India Act, 1934 and every other banking company, in addition to the cash reserve which it is required to maintain under section 18, shall maintain in India, assets, the value of which shall not be less than such percentage not exceeding forty per cent. of the total of its demand and time liabilities in India as on the last Friday of the second preceding fortnight as the Reserve Bank may, by notification in the Official Gazette, specify from time to time and such assets shall be maintained, in such form and manner, as may be specified in such notification.
- (2B) Omitted by Banking Regulation Amendment Act, 2007
- (3) For the purpose of ensuring compliance with the provisions of this section, every banking company shall, not later than twenty days after the end of the month to which it relates, furnish to the Reserve Bank in the prescribed form and manner a monthly return showing particulars of its assets maintained in accordance with this section, and its demand and time liabilities in India at the close of business on each alternate Friday during the month, or if any such Friday is a public holiday, at the close of business on the preceding working day:

Provided that every Regional Rural Bank shall also furnish a copy of the said return to the National Bank.

- (4) (a) If on any alternate Friday or, if such Friday is a public holiday, on the preceding working day, the amount maintained by a banking company at the close of business on that day falls below the minimum prescribed by or under sub-section (2A) such banking company shall be liable to pay to the Reserve Bank in respect of that day's default, penal interest for that day at the rate of three per cent per annum above the bank rate on the amount by which the amount actually maintained falls short of the prescribed minimum on that day; and

(b) If the default occurs again on the next succeeding alternate Friday, or, if such Friday is a public holiday, on the preceding working day, and continues on succeeding alternate Fridays or preceding working days, as the case may be, the rate of penal interest shall be increased to a rate of five per cent per annum above the bank rate on each such shortfall in respect of that alternate Friday and each succeeding alternate Friday or preceding working day, if such Friday is a public holiday, in which the default continues.
- (5) (a) Without prejudice to the provisions of sub-section (3), the Reserve Bank may require a banking company to furnish to it a return in the form and manner specified by it showing particulars of its assets maintained in accordance with this section and its demand and time liabilities in India, as at the close of business on each day of a month; and

(b) Without prejudice to the provisions of sub-section (4), on the failure of a banking company to maintain as on any day, the amount so required to be maintained by or under clause (a) of sub-section (2A) the Reserve Bank may, in respect of such default, require the banking company to pay penal interest for that day as provided of sub-section (4) and if the default continues on the next succeeding working day, the penal interest may be increased as provided in clause (b) of sub-section (4) for the concerned days.



- (6) (a) The penalty payable under sub-section (4) and sub-section (5) shall be paid within a period of fourteen days from the date on which a notice issued by the Reserve Bank demanding payment of the same is served on the banking company and in the event of failure of the banking company to pay the same within such period, the penalty may be levied by a direction of the principal civil court having jurisdiction in the area where an office of the defaulting banking company is situated, such direction to be made only upon an application made by the Reserve Bank in this behalf to the court; and (b) When the court makes a direction under clause (a), it shall issue a certificate specifying the sum payable by the banking company and every such certificate shall be enforceable in the same manner as if it were a decree made by the court in a suit.
- (7) When under the provisions of clause (b) of sub-section (4), penal interest at the increased rate of five per cent, above the bank rate has become payable by a banking company, if thereafter the amount required to be maintained on the next succeeding alternate Friday, or if such Friday is a public holiday, the next preceding working day, is still below the prescribed minimum, every director, manager or secretary of the banking company, who is knowingly and wilfully a party to the default, shall be punishable with fine which may extend to five hundred rupees and with a further fine which may extend to five hundred rupees for each subsequent alternate Friday or the preceding working day, as the case may be, on which the default continues.
- (8) Notwithstanding anything contained in this section, if the Reserve Bank is satisfied, on an application in writing by the defaulting banking company, that the banking company had sufficient cause for its failure to comply with the provisions of sub-section (2A), the Reserve Bank may not demand the payment of the penal interest.

Explanation. — In this section, the expression “public holiday” means a day which is a public holiday under the Negotiable Instruments Act, 1881 (26 of 1881)].

Assets in India [Section 25]

- (1) The assets in India of every banking company at the close of business on the last Friday of every quarter or, if that Friday is a public holiday under the Negotiable Instruments Act, 1881 (26 of 1881), at the close of the business on the preceding working day, shall not be less than seventy-five percent of its demand and time liabilities in India.'
- (2) Every banking company shall, within one month from the end of every quarter, submit to the Reserve Bank a return in the prescribed form and manner of the assets and liabilities referred to in sub-section (1) as at the close of business on the last Friday of the previous quarter, or, if that Friday is a public holiday under the Negotiable Instruments Act, 1881 (26 of 1881) at the close of business on the preceding working day:

Provided that every regional rural bank shall also furnish a copy of the said return to the National Bank.

- (3) For the purposes of this section, —

- (a) “assets in India” shall be deemed to include export bills drawn in, and import bills drawn on and payable in India and expressed in such currencies as the Reserve Bank may from time to time approve in this behalf and also such securities as the Reserve Bank may approve in this behalf notwithstanding that all or any of the said bills or securities are held outside India;
- (b) “liabilities in India” shall not include the paid-up capital or the reserves or any credit balance in the profit and loss account of the banking company;
- (c) “quarter” means the period of three months ending on the last day of March, June, September or December.

Return of unclaimed deposits [Section 26]

Every banking company shall, within thirty days after the close of each calendar year, submit a return in the prescribed form and manner to the Reserve Bank as at the end of such calendar year of all accounts in India which have not been operated upon for ten years:

Provided that in the case of money deposited for a fixed period the said term of ten years shall be reckoned from the date of the expiry of such fixed period:

Provided further that every regional rural bank shall also furnish a copy of the said return to the National Bank.

Establishment of Depositor Education and Awareness Fund [Section 26A]

(1) The Reserve Bank shall establish a Fund to be called the "Depositor Education and Awareness Fund" (hereafter in this section referred to as the "Fund").

(2) There shall be credited to the Fund the amount to the credit of any account in India with a banking company which has not been operated upon for a period of ten years or any deposit or any amount remaining unclaimed for more than ten years, within a period of three months from the expiry of the said period of ten years:

Provided that nothing contained in this sub-section shall prevent a depositor or any other claimant to claim his deposit or unclaimed amount or operate his account or deposit account from or with the banking company after the expiry of said period of ten years and such banking company shall be liable to repay such deposit or amount at such rate of interest as may be specified by the Reserve Bank in this behalf.

(3) Where the banking company has paid outstanding amount referred to in sub-section (2) or allowed operation of such account or deposit, such banking company may apply for refund of such amount in such manner as may be specified by the authority¹ or committee referred to in sub-section (5).

(4) The Fund shall be utilised for promotion of depositors' interests and for such other purposes which may be necessary for the promotion of depositors' interests as may be specified by the Reserve Bank from time to time.

(5) The Reserve Bank shall, by notification in the Official Gazette, specify an authority or committee, with such members as the Reserve Bank may appoint, to administer the Fund, and to maintain separate accounts and other relevant records in relation to the Fund in such forms as may be specified by the Reserve Bank.

(6) It shall be competent for the authority or committee appointed under subsection (5) to spend moneys out of the Fund for carrying out the objects for which the Fund has been established.¹

Monthly returns and power to call for other returns and information [Section 27]

(1) Every banking company shall, before the close of the month succeeding that to which it relates, submit to the Reserve Bank a return in the prescribed form and manner showing its assets and liabilities [in India] as at the close of business on the last Friday of every month or if that Friday is a public holiday under the Negotiable Instruments Act, 1881 (26 of 1881), at the close of business on the preceding working day.

(2) The Reserve Bank may at any time direct a banking company to furnish it within such time as may be specified by the Reserve Bank, with such statements and information relating to the business or affairs of the banking company (including any business or affairs with which such banking company is concerned) as the Reserve Bank may consider necessary or expedient to obtain for the purposes of this Act, and without prejudice to the generality of the foregoing power may call for information every half-year regarding 99[the investments of a banking company and the classification of its advances in respect of industry, commerce and agriculture.



- (3) Every regional rural bank shall submit a copy of the return which it submits to the Reserve Bank under sub-section (1) also to the National Bank and the powers exercisable by the Reserve Bank under sub-section (2) may also be exercised by the National Bank in relation to regional rural banks.

Power to publish information [Section 28]

The Reserve Bank or the National Bank, or both, if they consider it in the public interest so to do, may publish any information obtained by them under this Act in such consolidated form as they think fit.

Accounts and balance-sheet [Section 29]

- (1) At the expiration of each calendar year or at the expiration of a period of twelve months ending with such date as the Central Government may, by notification in the Official Gazette, specify in this behalf, every banking company incorporated in India, in respect of all business transacted by it, and every banking company incorporated outside India, in respect of all business transacted through its branches in India, shall prepare with reference to that year or period, as the case may be, a balance-sheet and profit and loss account as on the last working day of that year or the period, as the case may be in the Forms set out in the Third Schedule or as near thereto as circumstances admit:

Provided that with a view to facilitating the transition from one period, of accounting to another period of-accounting under this sub-section, the Central Government may, by order published in the Official Gazette, make such provisions as it considers necessary or expedient for the preparation of, or for other matters relating to, the balance sheet or profit and loss account in respect of the concerned year or period, as the case may be.

- (2) The balance-sheet and profit and loss account shall be signed—
- (a) in the case of a banking company incorporated in India, by the manager or the principal officer of the company and where there are more than three directors of the company, by at least three of those directors, or where there are not more than three directors, by all the directors, and
 - (b) in the case of a banking company incorporated outside India by the manager or agent of the principal office of the company in India.
- (3) Notwithstanding that the balance-sheet of a banking company is under subsection (1) required to be prepared in a form other than the form set out in Part I -of Schedule VI to the Companies Act, 1956 (1 of 1956), the requirements of that relating to the balance-sheet and profit and loss account of a company shall, in so far as they are not inconsistent with this Act, apply to the balance-sheet or profit and loss account, as the case may be, of a banking company.
- (3A) Notwithstanding anything to the contrary contained in sub-section (3) of section 210 of the Companies Act, 1956 (1 of 1956), the period to which the profit and loss account relates shall, in the case of a banking company, be the period ending with the last working day of the year immediately preceding the year in which the annual general meeting is held.

Explanation. —In sub-section (3A), “year” means the year or, as the case may be, the period referred to in sub-section (1).

- (4) The Central Government, after giving not less than three months’ notice of its intention so to do by a notification in the Official Gazette, may from time to time by a like notification amend the Form set out in the Third Schedule.

Power in respect of associate enterprises [Section 29A]

- (1) The Reserve Bank may, at any time, direct a banking company to annex to its financial statements or furnish to it separately, within such time and at such intervals as may be specified by the

Reserve Bank, such statements and information relating to the business or affairs of any associate enterprise of the banking company as the Reserve Bank may consider necessary or expedient to obtain for the purpose of this Act.

- (2) Notwithstanding anything to the contrary contained in the Companies Act, 1956, the Reserve Bank may, at any time, cause an inspection to be made of any associate enterprise of a banking company and its books of account jointly by one or more of its officers or employees or other persons along with the Board or authority regulating such associate enterprise.
- (3) The provisions of sub-sections (2) and (3) of section 35 shall apply *mutatis mutandis* to the inspection under this section.

Explanation.- “associate enterprise” in relation to a banking company includes an enterprise which

- (i) is a holding company or a subsidiary company of the banking company; or
- (ii) is a joint venture of the banking company; or
- (iii) is a subsidiary company or a joint venture of the holding company of the banking company; or
- (iv) controls the composition of the Board of directors or other body governing the banking company; or
- (v) exercises, in the opinion of the Reserve Bank, significant influence on the banking company in taking financial or policy decisions; or
- (vi) is able to obtain economic benefits from the activities of the banking ; company.’.

Audit [Section 30]

- (1) The balance-sheet and profit and loss account prepared in accordance with section 29 shall be audited by a person duly qualified under any law for the time being in force to be an auditor of companies.
- (1A) Notwithstanding anything contained in any law for the time being in force or in any contract to the contrary, every banking shall, before appointing re-appointing or removing any auditor or auditors, obtain the previous approval of the Reserve Bank.
- (1B) Without prejudice to anything contained in the Companies Act, 1956 (1 of 1956), or any other law for the time being in force, where the Reserve Bank is of opinion that it is necessary in the public interest or in the interest of the banking company or its depositors so to do, it may at any time by order direct that a special audit of the banking company's accounts, for any such transaction or class of transactions or for such period or periods as may be specified in the order, shall be conducted and may by the same or a different order either appoint a person duly qualified under any law for the time being in force to be an auditor of companies or direct the auditor of the banking company himself to conduct such special audit] and the auditor shall comply with such directions and make a report of such audit to the Reserve Bank and forward a copy thereof to the company.
- (1C) The expenses of, or incidental to the special audit specified in the order made by the Reserve Bank shall be borne by the banking company.
- (2) The auditor shall have the powers of, exercise the functions vested in, and discharge the duties and be subject to the liabilities and penalties imposed on, auditors of companies by section 227 of the Companies Act, 1956 (1 of 1956), and auditors, if any, appointed by the law establishing, constituting or forming the banking company concerned.



- (3) In addition to the matters which under the aforesaid Act the auditor is required to state in his report, he shall, in the case of a banking company incorporated in India, state in his report,—
- (a) whether or not the information and explanation required by him have been found to be satisfactory;
 - (b) whether or not the transactions of the company which have come to his notice have been within the powers of the company;
 - (c) whether or not the returns received from branch offices of the company have been found adequate for the purposes of his audit;
 - (d) whether the profit and loss account shows a true balance of profit or loss for the period covered by such account;
 - (e) any other matter which he considers should be brought to the notice of the shareholders of the company.

Submission of returns [Section 31]

The accounts and balance-sheet referred to in section 29 together with the auditor's report shall be published in the prescribed manner and three copies thereof shall be furnished as returns to the Reserve Bank within three months from the end of the period to which they refer:

Provided that the Reserve Bank may in any case extend the said period of three months for the furnishing of such returns by a further period not exceeding three months:

Provided further that a regional rural bank shall furnish such returns also to the National Bank.

Copies of balance-sheets and accounts to be sent to registrar [Section 32]

- (1) Where a banking company in any year furnishes its accounts and balance-sheet in accordance with the provisions of section 31, it shall at the same time send to the registrar three copies of such accounts and balance-sheet and of the auditor's report, and where such copies are so sent, it shall not be necessary to file with the registrar, in the case of a public company, copies of the accounts and balance-sheet and of the auditor's report, and, in the case of a private company, copies of the balance-sheet and of the auditor's report as required by sub-section (1) of section 220 of the Companies Act, 1956 (1 of 1956); and the copies so sent shall be chargeable with the same fee and shall be dealt with in all respects as if they were filed in accordance with that section.
- (2) When in pursuance of sub-section (2) of section 27 the Reserve Bank requires any additional statement or information in connection with the balance-sheet and accounts furnished under section 31, the banking company shall, when supplying such statement or information, send a copy thereof to the registrar.

Display of audited balance-sheet by companies incorporated outside India [Section 33]

Every banking company incorporated outside India shall, not later than the first Monday in August of any year in which it carries on business, display in a conspicuous place in its principal office and in every branch office in India a copy of its last audited balance-sheet and profit and loss account prepared under section 29, and shall keep the copy so displayed until replaced by a copy of the subsequent balance-sheet and profit and loss account so prepared, and every such banking company shall display in like manner copies of its complete audited balance-sheet and profit and loss account relating to its banking business as soon as they are available, and shall keep the copies so displayed until copies of such subsequent accounts are available.

Accounting provisions of this Act not retrospective [Section 34]

Nothing in this Act shall apply to the preparation of accounts by a banking company and the audit and

submission thereof in respect of any accounting year which has expired prior to the commencement of this Act, and notwithstanding the other provisions of this Act, such accounts shall be prepared, audited and submitted in accordance with the law in force immediately before the commencement of this Act.

Production of documents of confidential nature [Section 34A]

- (1) Notwithstanding anything contained in section 11 of the Industrial Disputes Act, 1947 (14 of 1947), or any other law for the time being in force, no banking company shall, in any proceeding under the said Act or in any appeal or other proceeding arising therefrom or connected therewith, be compelled by any authority before which such proceeding is pending to produce, or give inspection of, any of its books of account or other document or furnish or disclose any statement or information, when the banking company claims that such document, statement or information is of a confidential nature and that the production or inspection of such document or the furnishing or disclosure of such statement or information would involve disclosure of information relating to—
 - (a) any reserves not shown as such in its published balance-sheet; or
 - (b) any particulars not shown therein in respect of provisions made for bad and doubtful debts and other usual or necessary provisions.
- (2) If, in any such proceeding in relation to any banking company other than the Reserve Bank of India, any question arises as to whether any amount out of the reserves or provisions referred to in sub-section (1) should be taken into account by the authority before which such proceeding is pending, the authority may, if it so thinks fit, refer the question to the Reserve Bank and the Reserve Bank shall, after taking into account principles of sound banking and all relevant circumstances concerning the banking company, furnish to the authority a certificate stating that the authority shall not take into account any amount as such reserves and provisions of the banking company or may take them into account only to the extent of the amount specified by it in the certificate, and the certificate of the Reserve Bank on such question shall be final and shall not be called in question in any such proceeding.
- (3) For the purposes of this section "banking company" includes the Reserve Bank, the Development Bank, the Exim Bank, the Reconstruction Bank, the National Housing Bank, the National Bank, the Small Industries Bank the State Bank of India, a corresponding new bank, a regional rural bank and a subsidiary bank.

Inspection [Section 35]

- (1) Notwithstanding anything to the contrary contained in section 235 of the Companies Act, 1956 (1 of 1956)], the Reserve Bank at any time may, and on being directed so to do by the Central Government shall, cause an inspection to be made by one or more of its officers of any banking company and its books and accounts; and the Reserve Bank shall supply to the banking company a copy of its report on such inspection.
- (1A) (a) Notwithstanding anything to the contrary contained in any law for the time being in force and without prejudice to the provisions of sub-section (1), the Reserve Bank, at any time, may also cause a scrutiny to be made by any one or more of its officers, of the affairs of any banking company and its books and accounts; and
 - (b) a copy of the report of the scrutiny shall be furnished to the banking company if the banking company makes a request for the same or if any adverse action is contemplated against the banking company on the basis of the scrutiny.
- (2) It shall be the duty of every director or other officer or employee of the banking company to produce to any officer making an inspection under sub-section (1) or a scrutiny under sub-section (1A) all such books, accounts and other documents in his custody or power and to furnish him



with any statements and information relating to the affairs of the banking company as the said officer may require of him within such time as the said officer may specify.

- (3) Any person making an inspection under sub-section (1) for a scrutiny under sub-section (1A) may examine on oath any director or other officer or employee of the banking company in relation to its business, and may administer an oath accordingly.
- (4) The Reserve Bank shall, if it has been directed by the Central Government to cause an inspection to be made, and may, in any other case, report to the Central Government on any inspection 130[or scrutiny made under this section, and the Central Government, if it is of opinion after considering the report that the affairs of the banking company are being conducted to the detriment of the interests of its depositors, may, after giving such opportunity to the banking company to make a representation in connection with the report as, in the opinion of the Central Government, seems reasonable, by order in writing—
 - (a) prohibit the banking company from receiving fresh deposits;
 - (b) direct the Reserve Bank to apply under section 38 for the winding up of the banking company:

Provided that the Central Government may defer, for such period as it may think fit, the passing of an order under this sub-section, or cancel or modify any such order, upon such terms and conditions as it may think fit to impose.

- (5) The Central Government may, after giving reasonable notice to the banking company, publish the report submitted by the Reserve Bank or such portion thereof as may appear necessary.

Explanation. —For the purpose of this section, the expression “banking company” shall include—

- (i) in the case of a banking company incorporated outside India, all its branches in India; and
- (ii) in the case of a banking company incorporated in India—
 - (a) all its subsidiaries formed for the purpose of carrying on the business of banking exclusively outside India; and
 - (b) all its branches whether situated in India or outside India.
- (6) The powers exercisable by the Reserve Bank under this section in relation to regional rural banks may (without prejudice to the exercise of such powers by the Reserve Bank in relation to any regional rural bank whenever it considers necessary so to do) be exercised by the National Bank in relation to the regional rural banks, and accordingly, sub-sections (1) to (5) shall apply in relation to regional rural banks as if every reference therein to the Reserve Bank included also a reference to the National Bank.

Power of the Reserve Bank to give directions [Section 35A]

- (1) Where the Reserve Bank is satisfied that—
 - (a) in the public interest; or
 - (aa) in the interest of banking policy; or
 - (b) to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of the banking company; or
 - (c) to secure the proper management of any banking company generally, it is necessary to issue directions to banking companies generally or to any banking company in particular, it may,

from time to time, issue such directions as it deems fit, and the banking companies or the banking company, as the case may be, shall be bound to comply with such directions.

- (2) The Reserve Bank may, on representation made to it or on its own motion, modify or cancel any direction issued under sub-section (1), and in so modifying or cancelling any direction may impose such conditions as it thinks fit, subject to which the modification or cancellation shall have effect.

Amendments of provisions relating to appointments of managing directors, etc., to be subject to previous approval of the Reserve Bank [Section 35B]

- (1) In the case of a banking company—
 - (a) no amendment of any provision relating to the maximum permissible number of directors or the appointment or re-appointment or termination of appointment or remuneration of a chairman, a managing director or any other director, whole-time or otherwise or of a manager or a chief executive officer by whatever name called, whether that provision be contained in the company's memorandum or articles of association, or in an agreement entered into by it, or in any resolution passed by the company in general meeting or by its Board of directors shall have effect unless approved by the Reserve Bank;
 - (b) no appointment or re-appointment or termination of appointment of a chairman, a managing or whole-time director, manager or chief executive officer by whatever name called, shall have effect unless such appointment, re-appointment or termination of appointment is made with the previous approval of the Reserve Bank.

Explanation. —For the purpose of this sub-section, any provision conferring any benefit or providing any amenity or perquisite, in whatever form, whether during or after the termination of the term of office of the chairman or the manager or the chief executive officer by whatever name called or the managing director, or any other director, whole-time or otherwise, shall be deemed to be a provision relating to his remuneration.

- (2) Nothing contained in sections 268 and 269, the proviso to sub-section (3) of section 309, sections 310 and 311, the proviso to section 387, and section 388 (in so far as section 388 makes the provisions of sections 269, 310 and 311 apply in relation to the manager of a company) of the Companies Act, 1956 (1 of 1956), shall apply to any matter in respect of which the approval of the Reserve Bank has to be obtained under sub-section (1).
- (2A) Nothing contained in section 198 of the Companies Act, 1956 (1 of 1956) shall apply to a banking company and the provisions of sub-section (1) of section 309 and of section 387 of that Act shall, in so far as they are applicable to a banking company, have effect as if no reference had been made in the said provisions to section 198 of that Act.
- (3) No act done by a person as chairman or a managing or whole-time director or a director not liable to retire by rotation or a manager or a chief executive officer by whatever name called, shall be deemed to be invalid on the ground that it is subsequently discovered that his appointment or reappointment had not taken effect by reason of any of the provisions of this Act; but nothing in this sub-section shall be construed as rendering valid any act done by such person after his appointment or reappointment has been shown to the banking company not to have had effect.

Further powers and functions of Reserve Banks [Section 36]

- (1) The Reserve Bank may—
 - (a) caution or prohibit banking companies or any banking company in particular against entering into any particular transaction or class of transactions, and generally give advice to any banking company;



- (b) on a request by the companies concerned and subject to the provision of section 44A, assist, as intermediary or otherwise, in proposals for the amalgamation of such banking companies;
- (c) give assistance to any banking company by means of the grant of a loan or advance to it under clause (3) of sub-section (1) of section 18 of the Reserve Bank of India Act, 1934 (2 of 1934);
- (d) at any time, if it is satisfied that in the public interest or in the interest of banking policy or for preventing the affairs of the banking company being conducted in a manner detrimental to the interests of the banking company or its depositors it is necessary so to do, by order in writing and on such terms and conditions as may be specified therein—
 - (i) require the banking company to call a meeting of its directors for the purpose of considering any matter relating to or arising out of the affairs of the banking company; or require an officer of the banking company to discuss any such matter with an officer of the Reserve Bank;
 - (ii) depute one or more of its officers to which the proceedings at any meeting of the Board of directors of the banking company or of any committee or of any other body constituted by it; require the banking company to give an opportunity to the officers so deputed to be heard at such meetings and also require such officers to send a report of such proceedings to the Reserve Bank;
 - (iii) require the Board of directors of the banking company or any committee or any other body constituted by it to give in writing to any officer specified by the Reserve Bank in this behalf at his usual address all notices of, and other communications relating to, any meeting of the Board, committee or other body constituted by it;
 - (iv) appoint one or more of its officers to observe the manner in which the affairs of the banking company or of its offices or branches are being conducted and make a report thereon;
 - (v) require the banking company to make, within such time as may be specified in the order, such changes in the management as the Reserve Bank may consider necessary.
- (2) The Reserve Bank shall make an annual report to the Central Government on the trend and progress of banking in the country, with particular reference to its activities under clause (2) of section 17 of the Reserve Bank of India Act, 1934 (2 of 1934), including in such report its suggestions, if any, for the strengthening of banking business throughout the country.
- (3) The Reserve Bank may appoint such staff at such places as it considers necessary for the scrutiny of the returns, statements and information furnished by banking companies under this Act, and generally to ensure the efficient performance of its functions under this Act.

Certain provisions of the Act not to apply to certain banking companies [Section 36A]

- (1) The provisions of section 11, sub-section (1) of section 12, and sections 17, 18, 24 and 25 shall not apply to a banking company—
 - (a) which, whether before or after the commencement of the Banking Companies (Amendment) Act, 1959 (33 of 1959), has been refused a licence under section 22, or prohibited from accepting fresh deposits by a compromise, arrangement or scheme sanctioned by a court or by any order made in any proceeding relating to such compromise, arrangement or scheme, or prohibited from accepting deposits by virtue of any alteration made in its memorandum; or

- (b) whose licence has been cancelled under section 22, whether before or after the commencement of the Banking Companies (Amendment) Act, 1959 (33 of 1959).
- (2) Where the Reserve Bank is satisfied that any such banking company as is referred to in sub-section (1) has repaid, or has made adequate provision for repaying all deposits accepted by the banking company, either in full or to the maximum extent possible, the Reserve Bank may, by notice published in the Official Gazette, notify that the banking company has ceased to be a banking company within the meaning of this Act, and thereupon all the provisions of this Act applicable to such banking company shall cease to apply to it, except as respects things done or omitted to be done before such notice.

Power of Reserve Bank to remove managerial and other persons from office [Section 36AA]

- (1) Where the Reserve Bank is satisfied that in the public interest or for preventing the affairs of a banking company being conducted in a manner detrimental to the interests of the depositors or for securing the proper management of any banking company it is necessary so to do, the Reserve Bank may, for reasons to be recorded in writing, by order, remove from office, with effect from such date as may be specified in the order, any chairman, director, chief executive officer (by whatever name called) or other officer or employee of the banking company.
- (2) No order under sub-section (1) shall be made unless the chairman, director or chief executive officer or other officer or employee concerned has been given a reasonable opportunity of making a representation to the Reserve Bank against the proposed order:

Provided that if, in the opinion of the Reserve Bank, any delay would be detrimental to the interests of the banking company or its depositors, the Reserve Bank may, at the time of giving the opportunity aforesaid or at any time thereafter, by order direct that, pending the consideration of the representation aforesaid, if any, the chairman or, as the case may be, director or chief executive officer or other officer or employee, shall not, with effect from the date of such order—

- (a) act as such chairman or director or chief executive officer or other officer or employee of the banking company;
 - (b) in any way, whether directly or indirectly, be concerned with, or take part in the management of, the banking company.
- (3) (a) Any person against whom an order of removal has been made under subsection (1) may, within thirty days from the date of communication to him of the order, prefer an appeal to the Central Government.
(b) The decision of the Central Government on such appeal, and subject thereto, the order made by the Reserve Bank under sub-section (1), shall be final and shall not be called into question in any court.
 - (4) Where any order is made in respect of a chairman, director or chief executive officer or other officer or employee of a banking company under sub-section (1), he shall cease to be a chairman or, as the case may be, a director, chief executive officer or other officer or employee of the banking company and shall not, in any way, whether directly or indirectly, be concerned with, or take part in the management of, any banking company for such period not exceeding five years as may be specified in the order.
 - (5) If any person in respect of whom an order is made by the Reserve Bank under sub-section (1) or under the proviso to sub-section (2) contravenes the provisions of this section, he shall be punishable with fine which may extend to two hundred and fifty rupees for each day during which such contravention continues.



- (6) Where an order under sub-section (1) has been made, the Reserve Bank may, by order in writing, appoint a suitable person in place of the chairman or director, or chief executive officer or other officer or employee who has been removed from his office under that sub-section, with effect from such date as may be specified in the order.
- (7) Any person appointed as chairman, director or chief executive officer or other officer or employee under this section shall, —
 - (a) hold office during the pleasure of the Reserve Bank and subject thereto for a period not exceeding three years or such further periods not exceeding three years at a time as the Reserve Bank may specify;
 - (b) not incur any obligation or liability by reason only of his being a chairman, director or chief executive officer or other officer or employee or for anything done or omitted to be done in good faith in the execution of the duties of his office or in relation thereto.
- (8) Notwithstanding anything contained in any law or in any contract, memorandum or articles of association, on the removal of a person from office under this section, that person shall not be entitled to claim any compensation for the loss or termination of office.

Power of Reserve Bank to appoint additional directors [Section 36AB]

- (1) If the Reserve Bank is of opinion that in the interest of banking policy or in the public interest or in the interests of the banking company or its depositors it is necessary so to do, it may, from time to time by order in writing, appoint, with effect from such date as may be specified in the order, one or more persons to hold office as additional directors of the banking company:

Proviso omitted by Act 1 of 1984, Section 31 w.e.f. 15-2-1984.

- (2) Any person appointed as additional director in pursuance of this section—
 - (a) shall hold office during the pleasure of the Reserve Bank and subject thereto for a period not exceeding three years or such further periods not exceeding three years at a time as the Reserve Bank may specify;
 - (b) shall not incur any obligation or liability by reason only of his being a director or for any thing done or omitted to be done in good faith in the execution of the duties of his office or in relation thereto; and
 - (c) shall not be required to hold qualification-shares in the banking company.
- (3) For the purpose of reckoning any proportion of the total number of directors of the banking company, any additional director appointed under this section shall not be taken into account.

Part IIA to override other laws [Section 36AC]

Any appointment or removal of a director, chief executive officer or other officer or employee in pursuance of section 36AA or section 36AB shall have effect notwithstanding anything to the contrary contained in the Companies Act, 1956 (1 of 1956) or any other law for the time being in force or in any contract or any other instrument.

Part IIAB to Supersession of Board of Directors in certain cases [Section 36ACA]

- (1) Where the Reserve Bank is satisfied, in consultation with the Central Government, that in the public interest or for preventing the affairs of any banking company being conducted in a manner detrimental to the interest of the depositors or any banking company or for securing the proper management of any banking company, it is necessary so to do, the Reserve Bank may, for reasons to be recorded in writing, by order, supersede the Board of Directors of such banking company for a period not exceeding six months as may be specified in the order:

Provided that the period of supersession of the Board of Directors may be extended from time to time, so, however, that the total period shall not exceed twelve months.

- (2) The Reserve Bank may, on supersession of the Board of Directors of the banking company under sub-section (1) appoint in consultation with the Central Government for such period as it may determine, an Administrator (being an officer of the Central Government or a State Government) who has experience in law, finance, banking, economics or accountancy.
- (3) The Reserve Bank may issue such directions to the Administrator as it may deem appropriate and the Administrator shall be bound to follow such directions.
- (4) Upon making the order of supersession of the Board of Directors of a banking company, notwithstanding anything contained in the Companies Act, 1956,
 - (a) the chairman, managing director and other directors shall, as from the date of supersession, vacate their offices as such;
 - (b) all the powers, functions and duties which may, by or under the provisions of the Companies Act, 1956 or this Act, or any other law for the time being in force, be exercised and discharged by or on behalf of the Board of Directors of such banking company, or by a resolution passed in general meeting of such banking company, shall, until the Board of Directors of such banking company is reconstituted, be exercised and discharged by the Administrator appointed by the Reserve Bank under sub-section (2):

Provided that the power exercised by the Administrator shall be valid notwithstanding that such power is exercisable by a resolution passed in the general meeting of such banking company.

- (5) The Reserve Bank may constitute, in consultation with the Central Government, a committee of three or more persons who have experience in law, finance, banking, economic or accountancy to assist the Administrator in the discharge of his duties.
- (6) The committee shall meet at such times and places and observe such rules of procedure as may be specified by the Reserve Bank.
- (7) The salary and allowances to the Administrator and the members of the committee constituted under sub-section (5) by the Reserve Bank shall be such as may be specified by the Reserve Bank and be payable by the concerned banking company.
- (8) On and before the expiration of two months before the expiry of the period of supersession of the Board of Directors as specified in the order issued under sub-section (1), the Administrator of the banking company, shall call the general meeting of the company to elect new directors and reconstitute its Board of Directors.
- (9) Notwithstanding anything contained in any other law or in any contract, the memorandum or articles of association, no person shall be entitled to claim any compensation for the loss or termination of his office.
- (10) The Administrator appointed under sub-section (2) shall vacate office immediately after the Board of Directors of such banking company has been reconstituted."

Punishments for certain activities in relation to banking companies [Section 36AD]

- (1) No person shall—
 - (a) obstruct any person from lawfully entering or leaving any office or place of business of a banking company or from carrying on any business there, or



- (b) hold, within the office or place of business of any banking company, any demonstration which is violent or which prevents, or is calculated to prevent, the transaction of normal business by the banking company, or
 - (c) act in any manner calculated to undermine the confidence of the depositors in the banking company.
- (2) Whoever contravenes any provision of sub-section (1) without any reasonable excuse shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees, or with both.

Power of Central Government to acquire undertakings of banking companies in certain cases [Section 36AE]

- (1) If, upon receipt of a report from the Reserve Bank, the Central Government is satisfied that a banking company—
- (a) has, no more than one occasion, failed to comply with the directions given to it in writing under section 21 or section 35A, in so far as such directions relate to banking policy, or
 - (b) is being managed in a manner detrimental to the interests of its depositors, and that—
 - (i) in the interests of the depositors of such banking company, or
 - (ii) in the interest of banking policy, or
 - (iii) for the better provision of credit generally or of credit to any particular section of the community or in any particular area,

it is necessary to acquire the undertaking of such banking company, the Central Government may, after such consultation with the Reserve Bank as it thinks fit, by notified order, acquire the undertaking of such company (hereinafter referred to as the acquired bank) with effect from such date as may be specified in this behalf by the Central Government (hereinafter referred to as the appointed day):

Provided that no undertaking of any banking company shall be so acquired unless such banking company has been given a reasonable opportunity of showing cause against the proposed action.

Explanation. — In this Part, —

- (a) “notified order” means an order published in the Official Gazette;
 - (b) “undertaking”, in relation to a banking company incorporated outside India, means the undertaking of the company in India.
- (2) Subject to the other provisions contained in this Part, on the appointed day, the undertaking of the acquired bank and all the assets and liabilities of the acquired bank shall stand transferred to, and vest in, the Central Government.
- (3) The undertaking of the acquired bank and its assets and liabilities shall be deemed to include all rights, powers, authorities and privileges and all property, whether movable or immovable, including, in particular, cash balances, reserve funds, investments, deposits and all other interests and rights in, or arising out of, such property as may be in the possession of or held by, the acquired bank immediately before the appointed day and all books, accounts and documents relating thereto, and shall also be deemed to include all debts, liabilities and obligations, of whatever kind, then existing of the acquired bank.
- (4) Notwithstanding anything contained in sub-section (2), the Central Government may, if it is satisfied that the undertaking of the acquired bank and its assets and liabilities should, instead of vesting in the Central Government, or continuing to so vest, vest in a company established under

any scheme made under this Part or in any corporation (hereinafter in this Part and in the Fifth Schedule referred to as the transferee bank) that Government may, by order, direct that the said undertaking, including the assets and liabilities thereof, shall vest in the transferee bank either on the publication of the notified order or on such other date as may be specified in this behalf by the Central Government.

- (5) Where the undertaking of the acquired bank and the assets and liabilities thereof vest in the transferee bank under sub-section (4), the transferee bank, shall, on and from the date of such vesting, be deemed to have become the transferee of the acquired bank and all the rights and liabilities in relation to the acquired bank shall, on and from the date of such vesting, be deemed to have been the rights and liabilities of the transferee bank.
- (6) Unless otherwise expressly provided by or under this Part, all contracts, deeds, bonds, agreements, powers of attorney, grants of legal representation and other instruments of whatever nature subsisting or having effect immediately before the appointed day and to which the acquired bank is a party or which are in favour of the acquired bank shall be of as full force and effect against or in favour of the Central Government, or as the case may be, of the transferee bank, and may be enforced or acted upon as fully and effectually as if in the place of the acquired bank the Central Government or the transferee bank had been a party thereto or as if they had been issued in favour of the Central Government or the transferee bank, as the case may be.
- (7) If, on the appointed day, any suit, appeal or other proceeding of whatever nature is pending by or against the acquired bank, the same shall not abate, be discontinued or be, in any way, prejudicially affected by reason of the transfer of the undertaking of the acquired bank or of anything contained in this Part, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the Central Government or the transferee bank as the case may be.

Power of the Central Government to make scheme [Section 36AF]

- (1) The Central Government may, after consultation with the Reserve Bank, make a scheme for carrying out the purposes of this Part in relation to any acquired bank.
- (2) In particular, and without prejudice to the generality of the foregoing power, the said scheme may provide for all or any of the following matters, namely: —
 - (a) the corporation, or the company incorporated for the purpose, to which the undertaking including the property, assets and liabilities of the acquired bank may be transferred, and the capital, constitution, name and office thereof;
 - (b) the constitution of the first Board of management (by whatever name called) of the transferee bank, and all such matters in connection therewith or incidental thereto as the Central Government may consider to be necessary or expedient;
 - (c) the continuance of the services of all the employees of the acquired bank (excepting such of them as, not being workmen within the meaning of the Industrial Disputes Act, 1947(14 of 1947), are specifically mentioned in the scheme] in the Central Government or in the transferee bank, as the case may be, on the same terms and conditions so far as may be, as are specified in clauses (i) and (j) of sub-section (5) of section 45;
 - (d) the continuance of the right of any person who, on the appointed day, is entitled to or is in receipt of, a pension or other superannuation or compassionate allowance or benefit, from the acquired bank or any provident, pension or other fund or any authority administering such fund, to be paid by, and to receive from, the Central Government or the transferee bank, as the case may be, or any provident, pension or other fund or any authority administering such fund, the same pension, allowance or benefit so long as he observes the conditions on which the pension, allowance or benefit was granted, and if any question



arises whether he has so observed such conditions, the question shall be determined by the Central Government and the decision of the Central Government thereon shall be final;

- (e) the manner of payment of the compensation payable in accordance with the provisions of this Part to the shareholders of the acquired bank, or where the acquired bank is a banking company incorporated outside India, to the acquired bank in full satisfaction of their, or as the case may be, its claims;
 - (f) the provision, if any, for completing the effectual transfer to the Central Government or the transferee bank of any asset or any liability which forms part of the undertaking of the acquired bank in any country outside India;
 - (g) such incidental, consequential and supplemental matters as may be necessary to secure that the transfer of the business, property, assets and liabilities of the acquired bank to the Central Government or transferee bank, as the case may be, is effectual and complete.
- (3) The Central Government may, after consultation with the Reserve Bank, by notification in the Official Gazette, add to, amend or vary any scheme made under this section.
 - (4) Every scheme made under this section shall be published in the Official Gazette.
 - (5) Copies of every scheme made under this section shall be laid before each House of Parliament as soon as may be after it is made.
 - (6) The provisions of this Part and of any scheme made there under shall have effect notwithstanding anything to the contrary contained in any other provisions of this Act or in any other law or any agreement, award or other instrument for the time being in force.
 - (7) Every scheme made under this section shall be binding on the Central Government or, as the case may be, on the transferee bank and also on all members, creditors, depositors and employees of the acquired bank and of the transferee bank and on any other person having any right, liability, power or function in relation to, or in connection with, the acquired bank or the transferee bank, as the case may be.

Compensation to be given to shareholders of the acquired bank [Section 36AG]

- (1) Every person who, immediately before the appointed day, is registered as a holder of shares in the acquired bank or, when the acquired bank is a banking company incorporated outside India, the acquired bank, shall be given by the Central Government, or the transferee bank, as the case may be, such compensation in respect of the transfer of the undertaking of the acquired bank as it determined in accordance with the principles contained in the Fifth Schedule.
- (2) Nothing contained in sub-section (1) shall affect the rights inter se between the holder of any share in the acquired bank and any other person who may have any interest in such shares and such other person shall be entitled to enforce his interest against the compensation awarded to the holder of such share, but not against the Central Government, or the transferee bank.
- (3) The amount of compensation to be given in accordance with the principles contained in the Fifth Schedule shall be determined in the first instance by the Central Government, or the transferee bank, as the case may be, in consultation with the Reserve Bank, and shall be offered by it to all those to whom compensation is payable under sub-section (1) in full satisfaction thereof.
- (4) If the amount of compensation offered in terms of sub-section (3) is not acceptable to any person to whom the compensation is payable, such person may, before such date as may be notified by the Central Government in the Official Gazette, request the Central Government in writing, to have the matter referred to the Tribunal constituted under section 36AH.
- (5) If, before the date notified under sub-section (4), the Central Government receives requests, in terms of that sub-section, from not less than one-fourth in number of the shareholders holding not

less than one-fourth in value of the paid-up share capital of the acquired bank, or, where the acquired bank is a banking company incorporated outside India, from the acquired bank, the Central Government shall have the matter referred to the Tribunal for decision.

- (6) If, before the date notified under sub-section (4), the Central Government does not receive requests as provided in that sub-section, the amount of compensation offered ' under sub-section (3), and where a reference has been made to the Tribunal, the amount determined by it, shall be the compensation payable under sub-section (!) and shall be final and binding on all parties concerned.

Constitution of the Tribunal [Section 36AH]

- (1) The Central Government may, for the purpose of this Part, constitute a Tribunal which shall consist of a Chairman and two other members.
- (2) The Chairman shall be a person who is, or has been, a Judge of a High Court or of the Supreme Court, and, of the two other members, one shall be a person, who, in the opinion of the Central Government, has had experience of commercial banking and the other shall be a person who is a chartered accountant within the meaning of the Chartered Accountants' Act, 1949 (38 of 1949).
- (3) If, for any reason, a vacancy occurs in the office of the Chairman or any other member of the Tribunal, the Central Government may fill the vacancy by appointing another person thereto in accordance with the provisions of sub-section (2), and any proceeding may be continued before the Tribunal, so constituted, from the stage at which the vacancy occurred.
- (4) The Tribunal may, for the purpose of determining any compensation payable under this part, choose one or more persons having special knowledge or experience of any relevant matter to assist it in the determination of such compensation.

Tribunal to have powers of a civil court [Section 36AI]

- (1) The Tribunal shall have the powers of a civil court, while trying a suit, under the Code of Civil Procedure, , 1908 (5 of 1908) in respect of the following matters, namely :—
 - (a) summoning and enforcing the attendance of any person and examining him on oath;
 - (b) requiring the discovery and production of documents;
 - (c) receiving evidence on affidavits;
 - (d) issuing commissions for the examination of witnesses or documents.
- (2) Notwithstanding anything contained in sub-section (1), or in any other law for the time being in force, the Tribunal shall not compel the Central Government or the Reserve Bank, —
 - (a) to produce any books of account or other documents which the Central Government, or the Reserve Bank, claims to be of a confidential nature;
 - (b) to make any such books or documents part of the record of the proceedings before the Tribunal; or
 - (c) to give inspection of any such books or documents to any party before it or to any other person.

Procedure of the Tribunal [Section 36AJ]

- (1) The Tribunal shall have power to regulate its own procedure.
- (2) The Tribunal may hold the whole or any part of its inquiry in camera
- (3) Any clerical or arithmetical error in any order of the Tribunal or any error arising therein from any



accidental slip or omission may, at any time, be corrected by the Tribunal either of its own motion or on the application of any of the parties.

High Court defined [Section 36B]

In this Part and in Part IIIA "High Court", in relation to a banking company, means the High Court exercising jurisdiction in the place where the registered office of the banking company is situated or, in the case of a banking company incorporated outside India, where its principal place of business in India is situated.

Suspension of business [Section 37]

- (1) The High Court may on the application of a banking company which is temporarily unable to meet its obligations make an order (a copy of which it shall cause to be forwarded to the Reserve Bank) staying the commencement or continuance of all actions and proceedings against the company for a fixed period of time on such terms and conditions as it shall think fit and proper, and may from time to time extend the period so however that the total period of moratorium shall not exceed six months.
- (2) No such application shall be maintainable unless it is accompanied by a report of the Reserve Bank indicating that in the opinion of the Reserve Bank the banking company will be able to pay its debts if the application is granted:

Provided that the High Court may, for sufficient reasons, grant relief under this section even if the application is not accompanied by such report, and where such relief is granted, the High Court shall call for a report from the Reserve Bank on the affairs of the banking company on receipt of which it may either rescind any order already passed or pass such further orders thereon as may be just and proper in the circumstances.

- (3) When an application is made under sub-section (1), the High Court may appoint a special officer who shall forthwith take into his custody or under his control all the assets, books, documents, effects and actionable claims to which the banking company is or appears to be entitled and shall also exercise such other powers as the High Court may deem fit to confer on him, having regard to the interests of the depositors of the banking company.
- (4) Where the Reserve Bank is satisfied that the affairs of a banking company in respect of which an order under sub-section (1) has been made, are being conducted in a manner detrimental to the interests of the depositors, it may make an application to the High Court for the winding up of the company, and where any such application is made, the High Court shall not make any order extending the period for which the commencement or continuance of all actions and proceedings against the company were stayed under that sub-section.

Winding up by High Court [Section 38]

- (1) Notwithstanding anything contained in section 391, section 392, section 433 and section 583 of the Companies Act, 1956 (1 of 1956), but without prejudice to its powers under sub-section (1) of section 37 of this Act, the High Court shall order the winding up of a banking company—
 - (a) if the banking company is unable to pay its debts; or
 - (b) if an application for its winding up has been made by the Reserve Bank under section 37 or this section.
- (2) The Reserve Bank shall make an application under this section for the winding up of a banking company if it is directed so to do by an order under clause (b) of sub-section (4) of section 35.
- (3) The Reserve Bank may make an application under this section for the winding up of a banking company—
 - (a) if the banking company—

- (i) has failed to comply with the requirements specified in section 11; or
 - (ii) has by reason of the provisions of section 22 become disentitled to carry on banking business in India; or
 - (iii) has been prohibited from receiving fresh deposits by an order under clause (a) of sub-section (4) of section 35 or under clause (b) of sub-section (3A) of section 42 of the Reserve Bank of India Act, 1934 (2 of 1934); or
 - (iv) having failed to comply with any requirement of this Act other than the requirements laid in section 11, has continued such failure, or, having contravened any provision of this Act continued such contravention beyond such period or periods as may be specified in that behalf by the Reserve Bank from time to time, after notice in writing of such failure or contravention has been conveyed to the banking company; or
- (b) if in the opinion of the Reserve Bank—
- (i) a compromise or arrangement sanctioned by a court in respect of the banking company cannot be worked satisfactorily with or without modifications; or
 - (ii) the returns, statements or information furnished to it under or in pursuance of the provisions of this Act disclose that the banking company is unable to pay its debts; or
 - (iii) the continuance of the banking company is prejudicial to the interests of its depositors.
- (4) Without prejudice to the provisions contained in section 434 of the Companies Act, 1956 (1 of 1956) a banking company shall be deemed to be unable to pay its debts if it has refused to meet any lawful demand made at any of its offices or branches within two working days, if such demand is made at a place where there is an office, branch or agency of the Reserve Bank, or within five working days, if such demand is made elsewhere, and if the Reserve Bank certifies in writing that the banking company is unable to pay its debts.
- (5) A copy of every application made by the Reserve Bank under sub-section (1) shall be sent by the Reserve Bank to the registrar.

Court liquidator [Section 38A]

- (1) There shall be attached to every High Court a Court liquidator to be appointed by the Central Government for the purpose of conducting all proceedings for the winding up of banking companies and performing such other duties in reference thereto as the High Court may impose.
- (2) Omitted by Act 95 of 1956, Section 14 and Schedule w.e.f. 14-1-1957.
- (3) Omitted by Act 95 of 1956, Section 14 and Schedule w.e.f. 14-1-1957.
- (4) Where having regard to the number of banking companies wound up and other circumstances of the case, the Central Government is of opinion that it is not necessary or expedient to attach for the time being a Court liquidator to a High Court, it may, from time to time, by notification in the Official Gazette, direct that this section shall not have effect in relation to that High Court.

Reserve Bank to be official liquidator [Section 39]

- (1) Notwithstanding anything contained in section 38A of this Act or in section 448 or section 449 of the Companies Act, 1956 (1 of 1956), where in any proceeding for the winding up by the High Court of a banking company, an application is made by the Reserve Bank in this behalf, the Reserve Bank, the State Bank of India or any other bank notified by the Central Government in this behalf or any individual, as stated in such application shall be appointed as the official liquidator of the banking company in such proceeding and the liquidator, if any, functioning in such proceeding shall vacate office upon such appointment.



- (2) Subject to such directions as may be made by the High Court, the remuneration of the official liquidator appointed under this section, the cost and expenses of this establishment and the cost and expenses of the winding up shall be met out of the assets of the banking company which is being wound up, and notwithstanding anything to the contrary contained in any other law for the time being in force, no fees shall be payable to the Central Government, out of the assets of the banking company.

Application of Companies Act to liquidators [Section 39A]

- (1) All the provisions of the Companies Act, 1956 (1 of 1956), relating to a liquidator, in so far as they are not inconsistent with this Act, shall apply to or in relation to a liquidator appointed under section 38A or section 39.
- (2) Any reference to the "official liquidator" in this Part and Part IIIA shall be construed as including a reference to any liquidator of a banking company.

Stay of proceedings [Section 40]

Notwithstanding anything to the contrary contained in section 466 of the Companies Act, 1956 (1 of 1956)], the High Court shall not make any order staying the proceedings in relation to the winding up of a banking company, unless the High Court is satisfied that an arrangement has been made whereby the company can pay its depositors in full as their claims accrue.

Preliminary report by official liquidator [Section 41]

Notwithstanding anything to the contrary contained in section 455 of the Companies Act, 1956 (1 of 1956), where a winding up order has been made in respect of a banking company whether before or after the commencement of the Banking Companies (Second Amendment) Act, 1960 (37 of 1960), the official liquidator shall submit a preliminary report to the High Court within two months from the date of the winding up order or where the winding up order has been made before such commencement, within two months from such commencement, giving the information required by that section so far as it is available to him and also stating the amount of assets of the banking company in cash which are in his custody or under his control on the date of the report and the amount of its assets which are likely to be collected in cash before the expiry of that period of two months in order that such assets may be applied speedily towards the making of preferential payments under section 530 of the Companies Act, 1956, and in the discharge, as far as possible, of the liabilities and obligations of the banking company to its depositors and other creditors in accordance with the provisions hereinafter contained; and the official liquidator shall make for the purposes aforesaid every endeavour to collect in cash as such of the assets of the banking company as practicable.

Notice to preferential claimants and secured and unsecured creditors [Section 41A]

Within fifteen days from the date of the winding up order of a banking company or where the winding up order has been made before the commencement of the Banking Companies (Second Amendment) Act, 1960 (37 of 1960), within one month from such commencement, the official liquidator shall, for the purpose of making an estimate of the debts and liabilities of the banking company (other than its liabilities and obligations to its depositors), by notice served in such manner as the Reserve Bank may direct, call upon—

- (a) every claimant entitled to preferential payment under section 530 of the Companies Act, 1956 (1 of 1956), and
 - (b) every secured and every unsecured creditor, to send to the official liquidator within one month from the date of the service of the notice a statement of the amount claimed by him.
- (2) Every notice under sub-section (1) sent to a claimant having a claim under section 530 of the Companies Act, 1956 (1 of 1956), shall state that if a statement of the claim is not sent to the

official liquidator before the expiry of the period of one month from the date of the service, the claim shall not be treated as a claim entitled to be paid under section 530 of the Companies Act, 1956, in priority to all other debts but shall be treated as an ordinary debt due by the banking company.

- (3) Every notice under sub-section (1) sent to a secured creditor shall require him to value his security before the expiry of the period of one month from the date of the service of the notice and shall state that if a statement of the claim together with the valuation of the security is not sent to the official liquidator before the expiry of the said period, then, the official liquidator shall himself value the security and such valuation shall be binding on the creditor.
- (4) If a claimant fails to comply with the notice sent to him under sub-section (1), his claim will not be entitled to be paid under section 530 of the Companies Act, 1956 (1 of 1956), in priority to all other debts but shall be treated as an ordinary debt due by the banking company; and if a secured creditor fails to comply with the notice sent to him under sub-section (1), the official liquidator shall himself value the security and such valuation shall be binding on the creditor.

Power to dispense with meetings of creditors, etc [Section 42]

Notwithstanding anything to the contrary contained in section 460 of the Companies Act, 1956 (1 of 1956), the High Court may, in the proceedings for winding up a banking company, dispense with any meetings of creditors or contributories if it considers that no object will be secured thereby sufficient to justify the delay and expense.

Booked depositors' credits to be deemed proved [Section 43]

In any proceeding for the winding up of a banking company, every depositor of the banking company shall be deemed to have filed his claim for the amount shown in the books of the banking company as standing to his credit and, notwithstanding anything to the contrary contained in section 474 of the Companies Act, 1956 (1 of 1956), the High Court shall presume such claims to have been proved, unless the official liquidator shows that there is reason for doubting its correctness.

Preferential payments to depositors [Section 43A]

- (1) In every proceeding for the winding up of a banking company where a winding up order has been made, whether before or after the commencement of the Banking Companies (Second Amendment) Act, 1960, (37 of 1960) within three months from the date of the winding up order or where the winding up order has been made before such commencement, within three months therefrom, the preferential payments referred to in section 530 of the Companies Act, 1956 (1 of 1956), in respect of which statements of claims have been sent within one month from the date of the service of the notice referred to in section 41 A, shall be made by the official liquidator or adequate provision for such payments shall be made by him.
- (2) After the preferential payments as aforesaid have been made or adequate provision has been made in respect thereof, there shall be paid within the aforesaid period of three months—
 - (a) in the first place to every depositor in the savings bank account of the banking company a sum of two hundred and fifty rupees or the balance at his credit, whichever is less; and thereafter;
 - (b) in the next place, to every other depositor of the banking company a sum of two hundred and fifty rupees or the balance at his credit, whichever is less, in priority to all other debts from out of the remaining assets of the banking company available for payment to general creditors:

Provided that the sum total of the amounts paid under clause (a) and clause (b) to any one person who in his own name (and not jointly with any other person) is a depositor in (he savings bank account of the banking company and also a depositor in any other account, shall not exceed the sum of two hundred and fifty rupees.



- (3) Where within the aforesaid period of three months full payment cannot be made of the amounts required to be paid under clause (a) or clause (b) of sub-section (2) with the assets in cash, the official liquidator shall pay within that period to every depositor under clause (a) or, as the case may be, clause (b) of that sub-section on a pro rata basis so much of the amount due to the depositor under that clause as the official liquidator is able to pay with those assets; and shall pay the rest of that amount to every such depositor as and when sufficient assets are collected by the official liquidator in cash.
- (4) After payments have been made first to depositors in the savings bank account and then to the other depositors in accordance with the foregoing provisions, the remaining assets of the banking company available for payment to general creditors shall be utilised for payment on a pro rata basis of the debts of the general creditors and of the further sums, if any, due to the depositors; and after making adequate provision for payment on a pro rata basis as aforesaid of the debts of the general creditors, the official liquidator shall, as and when the assets of the company are collected in cash, make payment on a pro rata basis as aforesaid, of the further sums, if any, which may remain due to the depositors referred to in clause (a) and clause (b) of sub-section (2).
- (5) In order to enable the official liquidator to have in his custody or under his control in cash as much of the assets of the banking company as possible, the securities given to every secured creditor may be redeemed by the official liquidator—
 - (a) where the amount due to the creditor is more than the value of the securities as assessed by him or, as the case may be, as assessed by the official liquidator, on payment of such value; and
 - (b) where the amount due to the creditor is equal to or less than the value of the securities as so assessed, on payment of the amount due:

Provided that where the official liquidator is not satisfied with the valuation made by the creditor, he may apply to the High Court for making a valuation,
- (6) When any claimant, creditor or depositor to whom any payment is to be made in accordance with the provisions of this section, cannot be found or is not readily traceable, adequate provision shall be made by the official liquidator for such payment.
- (7) For the purposes of this section, the payments specified in each of the following clauses shall be treated as payments of a different class, namely: —
 - (a) payments to preferential claimants under section 530 of the Companies Act, 1956 (1 of 1956);
 - (b) payments under clause (a) of sub-section (2) to the depositors in the savings bank account;
 - (c) payments under clause (b) of sub-section (2) to the other depositors;
 - (d) payments to the general creditors and payments to the depositors in addition to those specified in clause (a) and clause (b) of sub-section (2).
- (8) The payments of each different class specified in sub-section (7) shall rank equally among themselves and be paid in full unless the assets are insufficient to meet them, in which case they shall abate in equal proportion.
- (9) Nothing contained in sub-sections (2), (3), (4), (7) and (8) shall apply to a banking company in respect of the depositors of which the Deposit Insurance Corporation is liable under section 16 of the Deposit Insurance Corporation Act, 1961, (47 of 1961).
- (10) After preferential payments referred to in sub-section (1) have been made or adequate provision

has been made in respect thereof, the remaining assets of the banking company referred to in sub-section (9) available for payment to general creditors shall be utilised for payment on pro rata basis of the debts of the general creditors and of the sums due to the depositors:

Provided (that where any amount in respect of any deposit is to be paid by the liquidator to the Deposit Insurance Corporation under section 21 of the Deposit Insurance Corporation Act, 1961 (47 of 1961), only the balance, if any, left after making the said payment shall be payable to the depositor.

Powers of High Court in voluntary winding up [Section 44]

- (1) Notwithstanding anything to the contrary contained in section 484 of the Companies Act, 1956 (1 of 1956), no banking company may be voluntarily wound up unless the Reserve Bank certifies in writing that the company is able to pay in full all its debts to its creditors as they accrue.
- (2) The High Court may, in any case where a banking company is being wound up voluntarily, make an order that the voluntary winding up shall continue, but subject to the supervision of the court.
- (3) Without prejudice to the provisions contained in sections 441 and 521 of the Companies Act, 1956 (1 of 1956), the High Court may of its own motion and shall on the application of the Reserve Bank, order the winding up of a banking company by the High Court in any of the following cases, namely: —
 - (a) where the banking company is being wound up voluntarily and at any stage during the voluntary winding up proceedings the company is not able to meet its debts as they accrue; or
 - (b) where the banking company is being wound up voluntarily or is being wound up subject to the supervision of the court and the High Court is satisfied that the voluntary winding up or winding up subject to the supervision of the court cannot be continued without detriment to the interests of the depositors.

Procedure for amalgamation of banking companies [Section 44A]

- (1) Notwithstanding anything contained in any law for the time being in force, no banking company shall be amalgamated with another banking company, unless a scheme containing the terms of such amalgamation has been placed in draft before the shareholders of each of the banking companies concerned separately, and approved by a resolution passed by a majority in number representing two-thirds in value of the shareholders of each of the said companies, present either in person or by proxy at a meeting called for the purpose.
- (2) Notice of every such meeting as is referred to in sub-section (1) shall be given to every shareholder of each of the banking companies concerned in accordance with the relevant articles of association indicating the time, place and object of the meeting, and shall also be published at least once a week for three consecutive weeks in not less than two newspapers which circulate in the locality or localities where the registered offices of the banking companies concerned are situated, one of such newspapers being in a language commonly understood in the locality or localities.
- (3) Any shareholder, who has voted against the scheme of amalgamation at the meeting or has given notice in writing at or prior to the meeting of the company concerned or to the presiding officer of the meeting that he dissents from the scheme of amalgamation, shall be entitled, in the event of the scheme being sanctioned by the Reserve Bank, to claim from the banking company concerned, in respect of the shares held by him in that company, their value as determined by the Reserve Bank when sanctioning the scheme and such determination by the Reserve Bank as to the value of the shares (to be paid to the dissenting shareholder shall be final for all purposes.



- (4) If the scheme of amalgamation is approved by the requisite majority of shareholders in accordance with the provisions of this section, it shall be submitted to the Reserve Bank for sanction and shall, if sanctioned by the Reserve Bank by an order in writing passed in this behalf, be binding on the banking companies concerned and also on all the shareholders thereof.
- (5) Omitted by Act 55 of 1963, Section 19 w.e.f. 1-2-1964.
- (6) On the sanctioning of a scheme of amalgamation by the Reserve Bank, the property of the amalgamated banking company shall, by virtue of the order of sanction, be transferred to and vest in, and the liabilities of the said company shall, by virtue of the said order be transferred to, and become the liabilities of, the banking company which under the scheme of amalgamation is to acquire the business of the amalgamated banking company, subject in all cases to the provisions of the scheme as sanctioned.
- (6A) Where a scheme of amalgamation is sanctioned by the Reserve Bank under the provisions of this section, the Reserve Bank may, by a further order in writing, direct that on such date as may be specified therein the banking company (hereinafter in this section referred to as the amalgamated banking company) which by reason of the amalgamation will cease to function, shall stand dissolved and any such direction shall take effect notwithstanding anything to the contrary contained in any other law.
- (6B) Where the Reserve Bank directs a dissolution of the amalgamated banking company, it shall transmit a copy of the order directing such dissolution to the Registrar before whom the banking company has been registered and on receipt of such order the Registrar shall strike off the name of the company.
- (6C) An order under sub-section (4) whether made before or after the commencement of section 19 of the Banking Laws (Miscellaneous Provisions) Act, 1963 (55 of 1963) shall be conclusive evidence that all the requirements of this section relating to amalgamation have been complied with, and a copy of the said order certified in writing by an officer of the Reserve Bank to be a true copy of such order and a copy of the scheme certified in the like manner to be a true copy thereof shall, in all legal proceedings (whether in appeal or otherwise and whether instituted before or after the commencement of the said section 19), be admitted as evidence to the same extent as the original order and the original scheme.
- (7) Nothing in the foregoing provisions of this section shall affect the power of the Central Government to provide for the amalgamation of two or more banking companies under section 396 of the Companies Act, 1956 (1 of 1956):
- Provided that no such power shall be exercised by the Central Government except after consultation with the Reserve Bank.

Restriction on compromise or arrangement between banking company and creditors [Section 44B]

- (1) Notwithstanding anything contained in any law for the time being in force, no High Court shall sanction a compromise or arrangement between a banking company and its creditors or any class of them or between such company and its members or any class of them or sanction any modification in any such compromise or arrangement unless the compromise or arrangement or modification, as the case may be, is certified by the Reserve Bank in writing as not being incapable of being worked and as not being detrimental to the interests of the depositors of such banking company.
- (2) Where an application under section 39 of the Companies Act, 1956 (1 of 1956), is made in respect of a banking company, the High Court may direct the Reserve Bank to make an inquiry in relation to the affairs of the banking company and the conduct of its directors and when such direction is given, the Reserve Bank shall make such inquiry and submit its report to the High Court.

Power of Reserve Bank to apply to Central Government for suspension of business by a banking company and to prepare scheme of reconstitution of amalgamation [Section 45]

- (1) Notwithstanding anything contained in the foregoing provisions of this Part or in any other law or any agreement or other instrument, for the time being in force, where it appears to the Reserve Bank that there is good reason so to do, the Reserve Bank may apply to the Central Government for an order of moratorium in respect of a banking company.
- (2) The Central Government, after considering the application made by the Reserve Bank under sub-section (1), may make an order of moratorium staying the commencement or continuance of all actions and proceedings against the company for a fixed period of time on such terms and conditions as it thinks fit and proper and may from time to time extend the period so however that the total period of moratorium shall not exceed six months.
- (3) Except as otherwise provided by any directions given by the Central Government in the order made by it under sub-section (2) or at any time thereafter the banking company shall not during the period of moratorium make any payment to any depositors or discharge any liabilities or obligations to any other creditors.
- (4) During the period of moratorium, if the Reserve Bank is satisfied that—
 - (a) in the public interest; or
 - (b) in the interests of the depositors; or
 - (c) in order to secure the proper management of the banking company; or
 - (d) in the interests of the banking system of the country as a whole, it is necessary so to do, the Reserve Bank may prepare a scheme—
 - (i) for the reconstruction of the banking company, or
 - (ii) for the amalgamation of the banking company with any other banking institution (in this section referred to as "the transferee bank").
- (5) The scheme aforesaid may contain provisions for all or any of the following matters, namely:
 - (a) the constitution, name and registered office, the capital, assets, powers, rights, interests, authorities and privileges, the liabilities, duties and obligations of the banking company on its reconstruction or as the case may be, of the transferee bank;
 - (b) in the case of amalgamation of the banking company, the transfer to the transferee bank of the business, properties, assets and liabilities of the banking company on such terms and conditions as may be specified in the scheme;
 - (c) any change in the Board of directors, or the appointment of a new Board of directors, of the banking company on its reconstruction or, as the case may be, of the transferee bank and the authority of whom, the manner in which, and the other terms and conditions on which, such change or appointment shall be made and in the case of appointment of a new Board of directors or of any director the period for which such appointment shall be made;
 - (d) the alteration of the memorandum and articles of association of the banking company on its reconstruction or, as the case may be, of the transferee bank for the purpose of altering the capital thereof or for such other purposes as may be necessary to give effect to the reconstruction or amalgamation;
 - (e) subject to the provisions of the scheme, the continuation by or against the banking company on its reconstruction or, as the case may be, the transferee bank, of any actions or proceedings pending against the banking company immediately before the date of the order of moratorium;



- (f) the reduction of the interest or rights which the members, depositors and other creditors have in or against the banking company before its reconstruction or amalgamation to such extent as the Reserve Bank considers necessary in the public interest or in the interest of the members, depositors and other creditors or for the maintenance of the business of the banking company;
- (g) the payment in cash or otherwise to depositors and other creditors in full satisfaction of their claim—
 - (i) in respect of their interest or rights in or against the banking company before its reconstruction or amalgamation; or
 - (ii) where their interest or rights aforesaid in or against the banking company has or have been reduced under clause (f), in respect of such interest or rights as so reduced;
- (h) the allotment to the members of the banking company for shares held by them therein before its reconstruction or amalgamation whether their interest in such shares has been reduced under clause
- (i) or not, of shares in the banking company on its reconstruction or, as the case may be, in the transferee bank and where any members claim payment in cash and not allotment of shares, or where it is not possible to allot shares to any members, the payment in cash to those members in full satisfaction of their claim—
 - (i) in respect of their interest in shares in the banking company before its reconstruction or amalgamation; or
 - (ii) where such interest has been reduced under clause (f) in respect of their interest in shares as so reduced;
 - (iii) the continuance of the services of all the employees of the banking company (excepting such of them as not being workmen within the meaning of the Industrial Disputes Act, 1947 (14 of 1947), are specifically mentioned in the scheme) in the banking company itself on its reconstruction or, as the case may be, in the transferee bank at the same remuneration and on the same terms and conditions of service, which they were getting, or as the case may be, by which they were being governed, immediately before the date of the order of moratorium:

Provided that the scheme shall contain a provision that—

- (i) the banking company shall pay or grant not later than the expiry of the period of three years from the date on which the scheme is sanctioned by the Central Government, to the said employees the same remuneration and the same terms and conditions of service 44[as are, at the time of such payment or grant, applicable] to employees of corresponding rank or status of a comparable banking company to be determined for this purpose by the Reserve Bank (whose determination in this respect shall be final);
- (ii) the transferee bank shall pay or grant not later than the expiry of the aforesaid period of three years, to the said employees the same remuneration and the same terms and conditions of service as are, at the time of such payment or grant, applicable to the other employees corresponding rank or status of the transferee bank subject to the qualifications and experience of the said employees being the same as or equivalent to those of such other employees of the transferee bank:

Provided further that if in any case under clause (ii) of the first proviso any doubt or difference as to whether the qualification and experience of any of the said employees are the same as or equivalent to the qualifications and experience of the

other employees of corresponding rank or status of the transferee bank 45[the doubt or difference shall be referred, before the expiry of a period of three years from the date of the payment or grant mentioned in that clause, to the Reserve Bank whose decision thereon shall be final;

- (j) notwithstanding anything contained in clause (i) where any of the employees of the banking company not being workmen within the meaning of the Industrial Disputes Act, 1947 (14 of 1947), are specifically mentioned in the scheme under clause (i) or where any employees of the banking company have by notice in writing given to the banking company, or, as the case may be, the transferee bank at any time before the expiry of the one month next following the date on which the scheme is sanctioned by the Central Government, intimated their intention of not becoming employees of the banking company on its reconstruction or, as the case may be, of the transferee bank, the payment to such employees of compensation, if any, to which they are entitled under the Industrial Disputes Act, 1947, and such pension, gratuity, provident fund and other retirement benefits ordinarily admissible to them under the rules or authorisations of the banking company immediately before the date of the order of moratorium;
 - (k) any other terms and conditions for the reconstruction or amalgamation of the banking company;
 - (l) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out.
- (6) (a) A copy of the scheme prepared by the Reserve Bank shall be sent in draft to the banking company and also to the transferee bank and any other banking company concerned in the amalgamation, for suggestions and objections, if any, within such period as the Reserve Bank may specify for this purpose.
- (b) The Reserve Bank may make such modifications, if any, in the draft scheme as it may consider necessary in the light of the suggestions and objections received from the banking company and also from the transferee bank, and any other banking company concerned in the amalgamation and from any members, depositors or other creditors of each of those companies and the transferee bank.
- (7) The scheme shall thereafter be placed before the Central Government for its sanction and the Central Government may sanction the scheme without any modifications or with such modifications as it may consider necessary, and the scheme as sanctioned by the Central Government shall come into force on such date as the Central Government may specify in this behalf:
- Provided that different dates may be specified for different provisions of the scheme.
- (7A) The sanction accorded by the Central Government under sub-section (7), whether before or after the commencement of section 21 of the Banking Laws (Miscellaneous Provisions) Act, 1963 (55 of 1963) shall be conclusive evidence that all that requirements of this section relating to reconstruction, or, as the case may be, amalgamation have been complied with and a copy of the sanctioned scheme certified in writing by an officer of the Central Government to be a true copy thereof, shall, in all legal proceedings (whether in appeal or otherwise and whether instituted before or after the commencement of the said section 21), be admitted as evidence to the same extent . as the original scheme.
- (8) On and from the date of the coming into operation of the scheme or any provision thereof, the scheme or such provision shall be binding on the banking company, or, as the case may be, on the transferee bank and any other banking company concerned in the amalgamation and also on all the members, depositors and other creditors and employees of each of those companies and of the transferee bank, and on any other person having any right or liability in relation to any



of those companies or the transferee bank including the trustees or other persons managing, or connected in any other manner with, any provident fund or other fund maintained by any of those companies or the transferee bank.

- (9) On and from the date of the coming into operation or, or as the case may be, the date specified in this behalf in, the scheme, the properties and assets of the banking company shall, by virtue of and to the extent provided in the scheme, stand transferred to, and vest in, and the liabilities of the banking company shall, by virtue of and to the extent provided in the scheme, stand transferred to, and become the liabilities of the transferee bank.
- (10) If any difficulty arises in giving effect to the provisions of the scheme, the Central Government may by order do anything not inconsistent with such provisions which appears to it necessary or expedient for the purpose of removing the difficulty.
- (11) Copies of the scheme or of any order made under sub-section (10) shall be laid before both Houses of Parliament, as soon as may be, after the scheme has been sanctioned by the Central Government, or, as the case may be, the order has been made.
- (12) Where the scheme is a scheme for amalgamation of the banking company, any business acquired by the transferee bank under the scheme or under any provision thereof shall, after the coming into operation of the scheme or such provision, be carried on by the transferee bank in accordance with the law governing the transferee bank, subject to such modifications in that law or such exemptions of the transferee bank from the operation of any provisions thereof as the Central Government on the recommendation of the Reserve Bank may, by notification in the Official Gazette, make for the purpose of giving full effect to the scheme:

Provided that no such modification or exemption shall be made so as to have effect for a period of more than seven years from the date of the acquisition of such business.

- (13) Nothing in this section shall be deemed to prevent the amalgamation with a banking institution by a single scheme of several banking companies in respect of each of which an order of moratorium has been made under this section.
- (14) The provisions of this section and of any scheme made under it shall have effect notwithstanding anything to the contrary contained in any other provisions of this Act or in any other law or any agreement, award or other instrument for the time being in force.
- (15) In this section, "banking institution" means any banking company and includes the State Bank of India or a subsidiary bank or a corresponding new bank.

Explanation.—References in this section of the terms and conditions of service as applicable to an employee shall not be construed as extending to the rank and status of such employee.

Part III A to override other laws [Section 45A]

The provisions of this Part and the rules made thereunder shall have effect notwithstanding anything inconsistent therewith contained in the Companies Act, 1956 (1 of 1956) or the Code of Civil Procedure, 1908 (5 of 1908), or the Code of Criminal Procedure, 1973 (2 of 1974) or any other law for the time being in force or any Instrument having effect by virtue of any such law; but the provisions of any such law or Instrument insofar as the same are not varied by, or inconsistent with, the provisions of this Part or rules made thereunder shall apply to all proceedings under this Part.

Power of High Court to decide all claims in respect of banking companies [Section 45B]

The High Court shall, save as otherwise expressly provided in section 45C, have exclusive jurisdiction to entertain and decide any claim made by or against a banking company which is being wound up (including claims by or against any of its branches in India) or any application made under section 391 of the Companies Act, 1956 (1 of 1956) by or in respect of a banking company or any question of priorities or any other question whatsoever, whether of law or fact, which may relate to

or arise in the course of the winding up of a banking company, whether such claim or question has arisen or arises or such application has been made or is made before or after the date of the order for the winding up of the banking company or before or after the commencement of the Banking Companies (Amendment) Act, 1953 (52 of 1953).

Transfer of pending proceedings [Section 45C]

- (1) Where a winding up order is made or has been made in respect of a banking company, no suit or other legal proceeding, whether civil or criminal, in respect of which the High Court has jurisdiction under this Act and which is pending in any other court immediately before the commencement of the Banking Companies (Amendment) Act, 1953 (52 of 1953), or the date of the order for the winding up of the banking company, whichever is later, shall be proceeded with except in the manner hereinafter provided.
- (2) The official liquidator shall, within three months from the date of the winding up order or the commencement of the Banking Companies (Amendment) Act, 1953 (52 of 1953), whichever is later, or such further time as the High Court may allow, submit to the High Court a report containing a list of all such pending proceedings together with particulars thereof.
- (3) On receipt of a report under sub-section (2), the High Court may, if it so thinks fit, give the parties concerned an opportunity to show cause why the proceedings should not be transferred to itself and after making an inquiry in such manner as may be provided by rules made under section 45U, it shall make such order as it deems fit transferring to itself all or such of the pending proceedings as may be specified in the order and such proceedings shall thereafter be disposed of by the High Court.
- (4) If any proceedings pending in a court is not so transferred to the High Court under sub-section (3), such proceeding shall be continued in the court in which the proceeding was pending.
- (5) Nothing in this section shall apply to any proceeding pending in appeal before the Supreme Court or a High Court.

Settlement of list of debtors [Section 45D]

- (1) Notwithstanding anything to the contrary contained in any law for the time being in force, the High Court may settle in the manner hereinafter provided a list of debtors of a banking company which is being wound up.
- (2) Subject to any rules that may be made under section 52, the official liquidator shall, within six months from the date of the winding up order or the commencement of the Banking Companies (Amendment) Act, 1953 (52 of 1953), whichever is later, from time to time, file to the High Court lists of debtors containing such particulars as are specified in the Fourth Schedule:

Provided that such lists may, with the leave of the High Court, be filed after the expiry of the said period of six months.
- (3) On receipt of any list under sub-section (2), the High Court shall, wherever necessary, cause notices to be issued on all persons affected and after making an inquiry in such manner as may be provided by rules made under section 45U, it shall make an order settling the list of debtors:

Provided that nothing in this section shall debar the High Court from settling any such list in part as against such of the persons whose debts have been settled without settling the debts of all the persons placed on the list.
- (4) At the time of the settlement of any such list, the High Court shall pass an order for the payment of the amount due by each debtor and make such further orders as may be necessary in respect of the relief claimed, including reliefs against any guarantor or in respect of the realisation of any security.



- (5) Every such order shall, subject to the provisions for appeal, be final and binding for all purposes as between the banking company on the one hand and the person against whom the order is passed all persons claiming through or under him on the other hand, and shall be deemed to be a decree in a suit.
- (6) In respect of every such order, the High Court shall issue a certificate specifying clearly the reliefs granted and the names and descriptions of the parties against whom such reliefs have been granted, the amount of costs awarded and by whom, and out of what funds and in what proportions, such costs are to be paid; and every such certificate shall be deemed to be a certified copy of the decree for all purposes including execution.
- (7) At the time of settling the list of debtors or at any other time prior or subsequent thereto, the High Court shall have power to pass any order in respect of a debtor on the application of the official liquidator for the realisation, management, protection, preservation or sale of any property given as security to the banking company and to give such powers to the official liquidator to carry out the aforesaid directions as the High Court thinks fit.
- (8) The High Court shall have power to sanction a compromise in respect of any debt and to order the payment of any debt by Instalments.
- (9) In any case in which any such list is settled ex parte as against any person, such person may, within thirty days from the date of the order settling the list, apply to the High Court for an order to vary such list, so far as it concerns him, and if the High Court is satisfied that he was prevented by any sufficient cause from appearing on the date fixed for the settlement of such list and that he has a good defence to the claim of the banking company on merits, the High Court may vary the list and pass such orders in relation thereto as it thinks fit:

Provided that the High Court may, if it so thinks fit, entertain the application after the expiry of the said period of thirty days.

- (10) Nothing in this section shall—
 - (a) apply to a debt which has been secured by a mortgage of immovable property, if a third party has any interest in such immovable property; or
 - (b) prejudice the rights of the official liquidator to recover any debt due to a banking company under any other law for the time being in force.

Special provisions to make calls on contributories [Section 45E]

Notwithstanding that the list of the contributories has not been settled under section 467 of the Companies Act, 1956 (1 of 1956), the High Court may, if it appears to it necessary or expedient so to do, at any time after making a winding up order, make a call on and order payment thereof by any contributory under sub-section (1) of section 470 of the Companies Act, 1956 (1 of 1956), if such contributory has been placed on the list of contributories by the official liquidator and has not appeared to dispute his liability.

Documents of banking company to be evidence [Section 45F]

- (1) Entries in the books of account or other documents of a banking company which is being wound up shall be admitted in evidence in all legal proceedings; and all such entries may be proved either by the production of the books of account or other documents of the banking company containing such entries or by the production of a copy of the entries, certified by the official liquidator under his signature and stating that it is a true copy of the original entries and that such original entries are contained in the books of account or other documents of the banking company in his possession.
- (2) Notwithstanding anything to the contrary contained in the Indian Evidence Act, 1872 (1 of 1872), all such entries in the books of account or other documents of a banking company shall,

as against the directors, officers and other employees of the banking company in respect of which the winding up order has been made, by prima facie evidence of the truth of all matters purporting to be therein recorded.

Public examination of directors and auditors [Section 45G]

- (1) Where an order has been made for the winding up of a banking company, the official liquidator shall submit a report whether in his opinion any loss has been caused to the banking company since its formation by any act or omission (whether or not a fraud has been committed by such 'act or omission) of any person in the promotion or formation of the banking company or of any director or auditor of the banking company.
- (2) If, on consideration of the report submitted under sub-section(1), the High Court is of opinion that any person who has taken part in the promotion or formation of the banking company or has been a director or an auditor of the banking company should be publicly examined, it should hold a public sitting on a date to be appointed for that purpose and direct that such person, director or auditor shall attend there at and shall be publicly examined as to the promotion or formation or the conduct of the business of the banking company, or as to his conduct and dealings, insofar as they relate to the affairs of the banking company:

Provided that no such person shall be publicly examined unless he has been given an opportunity to show cause why he should not be so examined.

- (3) The official liquidator shall take part in the examination and for that purpose may, if specially authorized by the High Court in that behalf, employ such legal assistance as may be sanctioned by the High Court.
- (4) Any creditor or contributory may also take part in the examination either personally or by any person entitled to appear before the High Court.
- (5) The High Court may put such questions to the person examined as it thinks fit.
- (6) The person examined shall be examined on oath and shall answer all such questions as the High Court may put or allow to be put to him.
- (7) A person ordered to be examined under this section may, at his own cost, employ any person entitled to appear before the High Court who shall be at liberty to put to him such questions as the High Court may deem just for the purpose of enabling him to explain or qualify any answer given by him:

Provided that if he is, in the opinion of the High Court, exculpated from any charges made or suggested against him, the High Court may allow him such costs in its discretion as it may deem fit.

- (8) Notes of the examination shall be taken down in writing, and shall be read over to or by, and signed by, the person examined and may thereafter be used in evidence against him in any proceeding, civil or criminal, and shall be open to the inspection of any creditor or contributory at all reasonable times.
- (9) Where on such examination, the High Court, is of opinion (whether a fraud has been committed or not)—
 - (a) that a person, who has been a director of the banking company, is not fit to be a director of a company, or
 - (b) that a person, who has been an auditor of the banking company or a partner of a firm acting as such auditor, is not fit to act as an auditor of a company or to be a partner of a firm acting as such auditor, the High Court may make an order that person shall not, without the leave of the High Court, be a director of, or in any way, whether directly or indirectly, be



concerned or take part in the management of an company or, as the case may be, act as an auditor of, or be a partner of firm acting as auditors of any company for such period not exceeding five years as may be specified in the order.

Special provisions for assessing damages against delinquent directors, etc [Section 45H]

- (1) Where an application is made to the High Court under section 543 of the Companies Act, 1956(1 of 1956), against any promoter, director, manager, liquidator or officer of a banking company for repayment or restoration of any money or property and the applicant makes out a prima facie case against such person, the High Court shall make an order against such person to repay and restore the money or property unless he proves that he is not liable to make the repayment or restoration either wholly or in part:

Provided that where such an order is made jointly against two or more such persons, they shall be jointly and severally liable to make the repayment or restoration of the money or property.

- (2) Where an application is made, to the High Court under section 543 of the Companies Act, 1956 (1 of 1956), and the High Court has reason to believe that a property belongs to any promoter, director, manager, liquidator or officer of the banking company, whether the property stands in the name of such person or any other person at an ostensible owner, then the High Court may, at any time, whether before or after making an order under sub-section (1), direct the attachment of such property, or such portion thereof, as it thinks fit and the property so attached shall remain subject to attachment unless the ostensible owner can prove to the satisfaction of the High Court that he is the real owner and the provisions of the Code of Civil Procedure, 1908 (5 of 1908), relating to attachment of property shall, as far as may be, apply to such attachment.

Duty of directors and officers of banking company to assist in the realisation or property [Section 45-I]

Every director or other officer of a banking company which is being wound up shall give such assistance to the official liquidator as he may reasonably require in connection with the realisation and distribution of the property of the banking company.

Special provisions for punishing offences in relation to banking companies being wound up [Section 45J]

- (1) The High Court may, if it thinks fit, take cognizance of and try in a summary way and offence alleged to have been committed by any person who has taken part in the promotion or formation of the banking company which is being wound , up or by any director, manager or officer thereof:

Provided that the offence is one punished under this Act or under the Companies Act, 1956 (1 of 1956).

- (2) When trying any such offence as aforesaid, the High Court may also try any other offence not referred to in sub-section (1) which is an offence with which the accused may, under the Code of Criminal Procedure, 1973 (2 of 1974), be charged at the same trial.
- (3) In any case tried summarily under sub-section (1), the High Court—
 - (a) need not summon any witness, if it is satisfied that the evidence of such witness will not be material;
 - (b) shall not be bound to adjourn a trial for any purpose unless such adjournment is, in the opinion of the High Court, necessary in the interests of justice;
 - (c) shall, before passing any sentence, record judgment embodying the substance of the evidence and also the particulars specified in section 263 of the Code of Criminal Procedure, 1973 (2 of 1974), so far as that section may be applicable, and nothing contained in sub-section (2) of section 262 of the Code of Criminal Procedure, 1973 (2 of 1974), shall apply to any such trial.

- (4) All offences in relation to winding up alleged to have been committed by any person specified in sub-section (1) which are punishable under this Act or under the Companies Act, 1956(1 of 1956), and which are not tried in a summary way under ' sub-section (1) shall, notwithstanding anything to the contrary in that Act or the Code of Criminal Procedure, 1973 (2 of 1974), or in any other law for the time being in force, be taken cognizance of and tried by a Judge of the High Court other than the Judge for the time being dealing with the proceedings for the winding up of the banking company.
- (5) Notwithstanding anything to the contrary contained in the Code of Criminal Procedure, 1973 (2 of 1974), the High Court may take cognizance of any offence under this section, without the accused being committed to it for trial.

Power of High court to enforce schemes of arrangements, etc [Section 45K]

[Rep. by the Banking Companies (Amendment) Act, 1959, Section 31 (w.e.f. 1-10-1959).]

Public examination of directors and auditors, etc., in respect of a banking company under schemes of arrangement [Section 45L]

- (1) Where an application for sanction a compromise or arrangement in respect of a banking company is made under section 39 of the Companies Act, 1956 (1 of 1956), or where such sanction has been given and the High Court is of opinion, whether on a report of the Reserve Bank or otherwise, that any ' person who has taken part in the promotion or formation of the banking company or has been a director or auditor of the banking company should be publicly examined, it may direct such examination of such person and the provisions of section 45G shall, as far as may be, apply to the banking company as they apply to a banking company which is being wound up.
- (2) Where a compromise or arrangement is sanctioned under section 391 of the Companies Act, 1956 (1 of 1956), in respect of a banking company, the provisions of section 543 of the said Act and of section 45H of this Act shall, as far as may be, apply to the banking company as they apply to a banking company which is being wound up as if the order sanctioning the compromise or arrangement were an order for the winding up of the banking company.
- (3) Where a scheme of reconstruction or amalgamation of a banking company has been sanctioned by the Central Government under section 45 and the Central Government is of opinion that any person who has taken part in the promotion or formation of the banking company or has been a director or auditor of the banking company should be publicly examined, that Government may apply to the High Court for the examination of such person and if on such examination the High Court finds (whether a fraud has been committed or not) that that person is not fit to be a director of a company or to act as an auditor of a company or to be a partner of a firm acting as such auditors, the Central Government shall make an order that that person shall not, without the leave of the Central Government, be a director of, or in any way, whether directly or indirectly, be concerned or take part in the management of any company or, as the case may be, act as an auditor of, or be a partner of a firm acting as auditors of, any company for such period not exceeding five years as may be specified in the order.
- (4) Where a scheme of reconstruction or amalgamation of a banking company has been sanctioned by the Central Government under section 45, the provisions of section 543 of the Companies Act, 1956 (1 of 1956), and of section 45H of this Act shall, as far as may be, apply to the banking company as they apply to a banking company which is being wound up as if the order sanctioning the scheme of reconstruction or amalgamation, as the case may be, were an order for the winding up of the banking company; and any reference in the said section 543 to the application of the official liquidator shall be construed as a reference to the application of the Central Government.



Special provisions for banking companies working under schemes of arrangement at the commencement of the Amendment Act [Section 45M]

Where any compromise or arrangement sanctioned in respect of a banking company under section 391 of the Companies Act, 1956 (1 of 1956) is being worked at the commencement of the Banking Companies (Amendment) Act, 1953 (52 of 1953) the High Court may, if it so thinks fit, on the application of such banking company, —

- (a) excuse any delay in carrying out any of the provisions of the compromise or arrangement; or
- (b) allow the banking company to settle the list of its debtors in accordance with the provisions of section 45D and in such a case, the provisions of the said section shall, as far as may be, apply to the banking company as they apply to a banking company which is being wound up as if the order sanctioning the compromise or arrangement were an order for the winding up of the banking company.

Appeals [Section 45N]

- (1) An Appeal shall lie from any order or decision of the High Court in a civil proceeding under this Act when the amount or value of the subject-matter of the claim exceeds five thousand rupees.
- (2) The High Court may by rules provide for an appeal against any order made under section 45J and the conditions subject to which any such appeal would lie.
- (3) Subject to the provisions of sub-section (1) and sub-section (2) and notwithstanding anything contained in any other law for the time being in force, every order or decision of the High Court shall be final and binding for all purposes as between the banking company on the one hand, and all persons who are parties thereto and all persons claiming through or under them or any of them, on the other hand.

Special period of limitation [Section 45-O]

- (1) Notwithstanding anything to the contrary contained in the Indian Limitation Act, 1908 (9 of 1908) or in any other law for the time being in force, in computing the period of limitation prescribed for a suit or application by a banking company which is being wound up, the period commencing from the date of the presentation of the petition for the winding up of the banking company shall be excluded.
- (2) Notwithstanding anything to the contrary contained in the Indian Limitation Act, 1908 (9 of 1908) or section 543 of the Companies Act, 1956 (1 of 1956) or in any other law for the time being in force, there shall be no period of limitation for the recovery of arrears of calls from any director of a banking company which is being wound up or for the enforcement by the banking company against any of its directors of any claim based on a contract, express or implied; and in respect of all other claims by the banking company against its directors, the period of limitation shall be twelve years from the date of the accrual of such claims or five years from the date of the first appointment of the liquidator, whichever is longer.
- (3) The provisions of this section, insofar as they relate to banking companies being wound up, shall also apply to a banking company in respect of which a petition for the winding up has been presented before the commencement of the Banking Companies (Amendment) Act, 1953 (52 of 1953).

Reserve Bank to tender advice in winding up proceeding [Section 45P]

Where in any proceeding for the winding up of a banking company in which any person other than the Reserve Bank has been appointed as the official liquidator and the High Court has directed the official liquidator to obtain the advice of the Reserve Bank on any matter (which it is hereby empowered to do), it shall be lawful for the Reserve Bank to examine the record of any such proceeding and tender such advice on the matter as it may think fit.

Power to Inspect [Section 45Q]

- (1) The Reserve Bank shall, on being directed so to do by the Central Government or by the High Court, cause an Inspection to be made by one or more of its officers of a banking company which is being wound up and its books and accounts.
- (2) On such Inspection, the Reserve Bank shall submit its report to the Central Government and the High Court.
- (3) If the Central Government, on consideration of the report of the Reserve Bank, is of opinion that there has been a substantial irregularity in the winding up proceedings, it may bring such irregularity to the notice of the High Court for such action as the High Court may think fit.
- (4) On receipt of the report of the Reserve Bank under sub-section (2) or on any irregularity being brought to its notice by the Central Government under sub-section (3), the High Court may, if it deems fit, after giving notice to and hearing the Central Government in regard to the report, give such directions as it may consider necessary.

Power to call for returns and information [Section 45R]

The Reserve Bank may, at any time by a notice in writing, require the liquidator of a banking company to furnish it, within such time as may be specified in the notice or such further time as the Reserve Bank may allow, any statement or information relating to or connected with the winding up of the banking company; and it shall be the duty of every liquidator to comply with such requirements.

Explanation. —For the purposes of this section and section 45Q, a banking company working under a compromise or arrangement but prohibited from receiving fresh deposits, shall, as far as may be, deemed to be banking company which is being wound up.

Chief Presidency Magistrate and District Magistrate to assist official liquidator in taking charge of property of banking company being wound up [Section 45S]

- (1) For the purpose of enabling the official liquidator or the special officer appointed under sub-section (3) of section 37 to take into his custody or under his control, all property, effects and actionable claims to which a banking company is or appears to be entitled, the official liquidator or the special officer, as the case may be, may request in writing the Chief Metropolitan Magistrate or the Chief Judicial Magistrate, within whose jurisdiction any property, books of accounts or other documents of such banking company may be situate or be found, to take possession thereof, and the Chief Metropolitan Magistrate or the Chief Judicial Magistrate, as the case may be, shall, on such request being made to him, —
 - (a) take possession of such property, books of accounts or other documents, and
 - (b) forward them to the official liquidator or the special officer.
- (2) Where any such property and effects are in the possession of the Chief Metropolitan Magistrate or the Chief Judicial Magistrate, as the case may be, such Magistrate shall, on request in writing being made to him by the official liquidator or the special officer referred to in sub-section (1), sell such property and effects and forward the net proceeds of the sale to the official liquidator or the special officer:

Provided that such sale shall, as far as practicable, be effected by public auction.
- (3) For the purpose of securing compliance with the provisions of sub-section (1), the Chief Metropolitan Magistrate or the Chief Judicial Magistrate may take or cause to be taken such steps and use of force as may, in his opinion, be necessary.
- (4) No act of the Chief Metropolitan Magistrate or the Chief Judicial Magistrate done in pursuance of this section shall be called in question in any court or before any authority.



Enforcement of orders and decisions of High Court [Section 45T]

- (1) All orders made in any civil proceeding by a High Court may be enforced in the same manner in which decrees of such court made in any suit pending therein may be enforced.
- (2) Notwithstanding anything to the contrary contained in the Code of Civil Procedure, 1908(5 of 1908), a liquidator may apply for the execution of a decree by a court, other than the one which made it on production of a certificate granted under subsection (6) of section 45D and on his certifying to such other court in writing the amount remaining due or relief remaining unenforced under the decree.
- (3) Without prejudice to the provisions of sub-section (1) or sub-section (2), any amount found due to the banking company by an order or decision of the High Court, may, with the leave of the High Court, be recovered by the liquidator in the same manner as an arrear of land revenue and for the purpose of such recovery the liquidator may forward to the Collector within whose jurisdiction the property of the person against whom any order or decision of the High Court has been made is situate, a certificate under his signature specifying the amount so due and the person by whom it is payable.
- (4) On receipt of a certificate under sub-section (3), the Collector shall proceed to recover from such person the amount specified therein as if it were an arrear of land revenue:

Provided that without prejudice to any other powers of the Collector, he shall, for the purposes of recovering the said amount, have all the powers which, under the Code of Civil Procedure, 1908 (5 of 1908), a civil court has for the purpose of the recovery of an amount due under a decree.

Power of High Court to make rules [Section 45U]

The High Court may make rules consistent with this Act and the rules made under section 52 prescribing—

- (a) the manner in which inquiries and proceedings under Part III or Part IIIA may be held;
- (b) the offences which may be tried summarily;
- (c) the authority to which, and the conditions subject to which, appeals may be preferred and the manner in which such appeals may be filed and heard;
- (d) any other matter for which provision has to be made for enabling the High Court to effectively exercise its functions under this Act.

References to directors, etc., shall be construed as including references to past directors, etc. [Section 45V]

For the removal of doubts it is hereby declared that any reference in this Part to a director, manager, liquidator, officer or auditor of a banking company shall be construed as including a reference to any past or present director, manager, liquidator, officer or auditor of the banking company.

Part II not to apply to banking companies being wound up [Section 45W]

Nothing contained in Part II shall apply to a banking company which is being wound up.

Validation of certain proceedings [Section 45X]

Notwithstanding anything contained in section 45B or any other provision of this Part or in section 11 of the Banking Companies (Amendment) Act, 1950 (20 of 1950), no proceeding held, judgment delivered or decree or order made before the commencement of the Banking Companies (Amendment) Act, 1953 (52 of 1953), by any court other than the High Court in respect of any matter over which the High Court has jurisdiction under this Act shall be invalid or be deemed ever to have been invalid merely by reason of the fact that such proceeding, judgment, decree or order was held, delivered or made by a court other than the High Court.

Power of Central Government to make rules for the preservation of records [Section 45Y]

The Central Government may, after consultation with the Reserve Bank and by notification in the Official Gazette, make rules specifying the periods for which—

- (a) a banking company shall preserve its books, accounts and other documents; and
- (b) a banking company shall preserve and keep with itself different instruments paid by it.

Return of paid instruments to customers [Section 45Z]

- (1) Where a banking company is required by its customer to return to him a paid instrument before the expiry of the period specified by rules made under section 45Y, the banking company shall not return the instrument except after making and keeping in its possession a true copy of all relevant parts of such instrument, such copy being made by a mechanical or other process which in itself ensures the accuracy of the copy.
- (2) The banking company shall be entitled to recover from the customer the cost of making such copies of the instrument.

Explanation.—In this section, “customer” includes a Government department and a corporation incorporated by or under any law.

Nomination for payment of depositors' money [Section 45ZA]

- (1) Where a deposit is held by a banking company to the credit of one or more persons, the depositor or, as the case may be, all the depositors together, may nominate, in the prescribed manner, one person to whom in the event of the death of the sole depositor or the death of all the depositors, the amount of deposit may be returned by the banking company.
- (2) Notwithstanding anything contained in any other law for the time being in force or in any disposition, whether testamentary or otherwise, in respect of such deposit, where a nomination made in the prescribed manner purports to confer on any person the right to receive the amount of deposit from the banking company, the nominee shall, on the death of the sole depositor or, as the case may be, on the death of all the depositors, become entitled to all the rights of the sole depositor or, as the case may be, of the depositors, in relation to such deposit to the exclusion of all other persons, unless the nomination is varied or cancelled in the prescribed manner.
- (3) Where the nominee is a minor, it shall be lawful for the depositor making the nomination to appoint in the prescribed manner any person to receive the amount of deposit in the event of his death during the minority of the nominee.
- (4) Payment by a banking company in accordance with the provisions of this section shall constitute a full discharge to the banking company of its liability in respect of the deposit:

Provided that nothing contained in this sub-section shall affect the right or claim which any person may have against the person to whom any payment is made under this section.

Notice of claims of other persons regarding deposits not receivable [Section 45ZB]

No notice of the claim of any person, other than the person or persons in whose name a deposit is held by a banking company, shall be receivable by the banking company, nor shall the banking company be bound by any such notice though even expressly given to it:

Provided that where any decree, order, certificate or other authority from a court of competent jurisdiction relating to such deposit is produced before a banking company, the banking company shall take due note of such decree, order, certificate or other authority.

Nomination for return of articles kept in safe custody with banking company [Section 45ZC]

- (1) Where any person leaves any article in safe custody with a banking company, such person may



nominate, in the prescribed manner, on person to whom, in the event of the death of the person leaving the article in safe custody, such article may be returned by the banking company.

- (2) Where the nominee is a minor, it shall be lawful for the person making the nomination to appoint in the prescribed manner any person to receive the article deposited in the event of his death during the minority of the nominee.
- (3) The banking company shall, before returning any articles under this section to the nominee or the person appointed under sub-section (2), prepare, in such manner as may be directed by the Reserve Bank from time to time, an inventory of the said articles which shall be signed by such nominee or person and shall deliver a copy of the inventory so prepared to such nominee or person.
- (4) Notwithstanding anything contained in any other law for the time being in force or in any disposition, whether testamentary or otherwise, in respect of such article, where a nomination made in the prescribed manner purports to confer on any person the right to receive the article from the banking company, the nominee shall, on the death of the person leaving the article in safe custody, become entitled to the return of the article to the exclusion of all other persons, unless the nomination is varied or cancelled in the prescribed manner:

Provided that nothing contained in this section shall affect the right or claim which any person may have against the person to whom the article is returned in pursuance of this sub-section.

Notice of claims of other persons regarding articles not receivable [Section 452D]

No notice of the claim of any person, other than the person or persons in whose name any article is held by a banking company in safe custody, shall be receivable by the banking company, nor shall the banking company be bound by any such notice even though expressly given to it:

Provided that where any decree, order, certificate or other authority from a court of competent jurisdiction relating to such article is produced before a banking company, the banking company shall take due note of such decree, order, certificate or other authority.

Release of contents of safety lockers [Section 452E]

- (1) Where an individual is the sole hirer of a locker from a banking company, whether such locker is located in the safe deposit vault of such banking company or elsewhere, such individual may nominate one person to whom, in the event of the death of such individual, the banking company may give access to the locker and liberty to remove the contents of the locker.
- (2) Where any such locker is hired from a banking company by two or more individuals jointly and under the contract of hire, the locker is to be operated under the joint signatures of two or more of such hirers, such hirers may nominate one or more persons to whom, in the event of the death of such joint hirer or hirers, the banking company may give, jointly with the surviving joint hirer or joint hirers, as the case may be, access to the locker and liberty to remove the contents of such locker.
- (3) Every nomination under sub-section (1) or sub-section (2) shall be made in the prescribed manner.
- (4) The banking company shall, before permitting the removal of the contents of any locker by any nominee or jointly by any nominee and survivors as aforesaid, prepare, in such manner as may be directed by the Reserve Bank from time to time, an inventory of the contents of the locker which shall be signed by such nominee or jointly by such nominee and survivors and shall deliver a copy of the inventory so prepared to such nominee or nominee and survivors.
- (5) On the removal of the contents of any locker by any nominee or jointly by any nominee and survivors as aforesaid, the liability of the banking company in relation to the contents of the locker shall stand discharged.

- (6) No suit, prosecution or other legal proceedings shall lie against a banking company for any damage caused or likely to be caused, for allowing access to any locker, and liberty to remove the contents of such locker, in pursuance of the provisions of subsection (1) or sub-section (2) as the case may be.

Notice of claims of oilier persons regarding safety lockers not receivable [Section 45ZF]

No notice of the claim of any person, other than hirer or hirers of a locker, shall be receivable by a banking company nor shall the banking company be bound by any such notice even though expressly given to it:

Provided that where any decree, order, certificate or other authority from a court of competent jurisdiction relating to the locker or its contents is produced before the banking company, the banking company shall take due note of such decree, order, certificate or other authority.

Penalties [Section 46]

- (1) Whoever in any return, balance-sheet or other document or in any information required or furnished by or under or for the purposes of any provision of this Act, willfully makes a statement which is false in any material particular, knowing it to be false, or willfully omits to make a material statement, shall be punishable with imprisonment for a term which may extend to three years or with fine, which may extend to one crore rupees or with both.
- (2) If any person fails to produce any book, account or other document or to furnish any statement or information which under sub-section (2) of section 35 it is his duty to produce or furnish, or to answer any question relating to the business of a banking company which is asked by an officer making an inspection or scrutiny under that section he shall be punishable with a fine which may extend to twenty lakh rupees in respect of each offence, and if he persists in such refusal, to a further fine which may extend to fifty thousand rupees for every day during which the offence continues.
- (3) If any deposits are received by a banking company in contravention of an order under clause (a) of sub-section (4) of section 35, every director or other officer of the banking company, unless he proves that the contravention took place without his knowledge or that he exercised all due diligence to prevent it shall be deemed to be guilty of such contravention and shall be punishable with a fine which may extend to twice the amount of the deposits so received.
- (4) If any other provision of this Act is contravened or if any default is made in—
 - (i) complying with any requirement of this Act or of any order, rule or direction made or condition imposed thereunder, or
 - (ii) carrying out the terms of, or the obligations under, a scheme sanctioned under sub-section (7) of section 45,
by any person, such person shall be punishable with fine which may extend to one crore rupees or twice the amount involved in such contravention or default where such amount is quantifiable, whichever is more, and where a contravention or default is a continuing one, with a further fine which may extend to one lakh rupees for every day, during which the contravention or default continues.
- (5) Where a contravention or default has been committed by a company, every person who, at the time the contravention or default was committed, was in charge of, and was responsible to, the company, for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the contravention or default and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act if he proves that the contravention or default was committed



without his knowledge or that he exercised all due diligence to prevent the contravention or default.

- (6) Notwithstanding anything contained in sub-section (5), where a contravention or default has been committed by a company, and it is proved that the same was committed with the consent or connivance of, or is attributable to any gross negligence on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that contravention or default and shall be liable to be proceeded against and punished accordingly.

Explanation. —For the purposes of this section, —

- (a) “company” means any body corporate and includes a firm or other association of individuals, and
- (b) “direction”, in relation to a firm, means a partner in the firm.

Chairman, director, etc., to be public servants for the purposes of Chapter IX of the Indian Penal Code [Section 46A]

Every Chairman who is appointed on a whole-time basis, managing director, director, auditor liquidator, manager and any other employee of a banking company shall be deemed to be a public servant for the purposes of Chapter IX of the Indian Penal Code (45 of 1860).

Cognizance of offences [Section 47]

No court shall take a cognizance of any offence punishable under sub-section (5) of section 36AA or section 46 except upon complaint in writing made by an officer of the Reserve Bank or, as the case may be, the National Bank generally or specially authorised in writing in this behalf by the Reserve Bank, or as the case may be, the National Bank and no court other than that of a Metropolitan Magistrate or a Judicial Magistrate of the first class or any court superior thereto shall try any such offence.

Power of Reserve Bank to impose penalty [Section 47A]

- (1) Notwithstanding anything contained in section 46, if a contravention or default of the nature referred to in sub-section (2) or sub-section (3) or sub-section (4) of section 46, as the case may be, is made by a banking company, then, the Reserve Bank may impose on such banking company—
- (a) where the contravention or default is of the nature referred to in sub-section (2) of section 46, a penalty not exceeding twenty lakh rupees in respect of each offence and if the contravention or default persists, a further penalty not exceeding fifty thousand rupees for everyday, after the first day, during which the contravention or default continues;
- (b) where the contravention is of the nature referred to in sub-section (3) of section 46, a penalty not exceeding twice the amount of the deposits in respect of which such contravention was made;
- (c) where the contravention or default is of the nature referred to in sub-section (4) of section 46, a penalty not exceeding one crore rupees or twice the amount involved in such contravention or default where such amount is quantifiable, whichever is more, and where such contravention or default is a continuing one, a further penalty which may extend to one lakh rupees for everyday, after the first day, during which the contravention or default continues.”.
- (2) For the purpose of adjudging the penalty under sub-section (1), the Reserve Bank shall serve notice on the banking company requiring it to show cause why the amount specified in the notice should not be imposed and a reasonable opportunity of being heard shall also be given to such banking company.

- (4) No complaint shall be filed against any banking company in any court of law in respect of any contravention or default in respect of which any penalty has been imposed by the Reserve Bank under this section.
- (5) Any penalty imposed by the Reserve Bank under this section shall be payable within a period of fourteen days from the date on which notice issued by the Reserve Bank demanding payment of the sum is served on the banking company and in the event of failure of the banking company to pay the sum within such period, may be levied on a direction made by the principal civil court having jurisdiction in the area where the registered office of the banking company is situated; or, in the case of a banking company incorporated outside India, where its principal place of business in India is situated:

Provided that no such direction shall be made except on an application made to the court by the Reserve Bank or any officer authorised by that Bank in this behalf.
- (6) The court which makes a direction under sub-section (5) shall issue a certificate specifying the sum payable by the banking company and every such certificate shall be enforceable in the same manner as if it were a decree made by the court in a civil suit.
- (7) Where any complaint has been filed against any banking company in any court in respect of the contravention or default of the nature referred to in sub-section (3) or, as the case may be, sub-section (4) of section 46, then, no proceedings for the imposition of any penalty on the banking company shall be taken under this section.

Application of fines [Section 48]

A court imposing any fine under this Act may direct that the whole or any part thereof shall be applied in or towards payment of the costs of the proceedings, or in or towards the rewarding of the person on whose information the fine is recovered.

Special provisions for private banking companies [Section 49]

The exemptions, whether express or implied, in favour of a private company in sections 90, 165, 182, 204 and 255, clauses (a) and (b) of sub-section (1) of section 293 and sections 300, 388A and 416 of the Companies Act, 1956 (1 of 1956), shall not operate in favour of a private company which is a banking company.

Restriction on acceptance of deposits withdrawable by cheque [Section 49A]

No person other than a banking company, the Reserve Bank, the State Bank of India or any other banking institution, firm or other person notified by the Central Government in this behalf on the recommendation of the Reserve Bank shall accept from the public deposits of money withdrawable by cheque:

Provided that nothing contained in this section shall apply to any savings bank scheme run by the Government.

Change of name by a banking company [Section 49B]

Notwithstanding anything contained in section 21 of the Companies Act, 1956 (1 of 1956), the Central Government shall not signify its approval to the change of name of any banking company unless the Reserve Bank certifies in writing that it has no objection to such change.

Alteration of memorandum of a banking company [Section 49C]

Notwithstanding anything contained in the Companies Act, 1956 (1 of 1956), no application for the confirmation of the alteration of the memorandum of a banking company shall be maintainable unless the Reserve Bank certifies that there is no objection to such alteration.



Certain claims for compensation barred [Section 50]

No person shall have any right, whether in contract or otherwise, to any compensation for any loss incurred by reason of the operation of any of the provisions contained in sections 10, 12A, 16, 35A, 35B, 36, 43A and 45 or by reason of the compliance by a banking company with any order or direction given to it under this Act.

Application of certain provisions to the State Bank of India and other notified banks [Section 51]

- (1) Without prejudice to the provisions of the State Bank of India Act, 1955 (23 of 1955) or any other enactment, the provisions of sections 10, 13 to 15, 17, 19 to 21A, 23 to 28, 29 excluding sub-section (3) sub-section (1B), (1C) and (2) of sections 29A, 30, 31, 34, 35, 35A, 36 excluding clause (a) of sub-section (1) 45Y to 45ZF, 46 to 48 50, 52 and 53 shall also apply; so far as may be, to and in relation to the State Bank of India or any corresponding new bank or a Regional Rural Bank or any subsidiary bank as they apply to and in relation to banking companies:

Provided that—

- (a) nothing contained in clause (c) of sub-section (1) of section 10 shall apply to the chairman of the State Bank of India or to a managing director of any subsidiary bank insofar as the said clause precludes him from being a director of, or holding an office in, any institution approved by the Reserve Bank;
 - (b) nothing contained in sub-clause (iii) of clause (b) of sub-section (1) of section 20 shall apply to any bank referred to in sub-section (1), insofar as the said sub-clause (iii) of clause (b) precludes that bank from entering into any commitment for granting any loan or advance to or on behalf of a company (not being a Government company) in which not less than forty per cent of the paid-up capital is held (whether singly or taken together) by the Central Government or the Reserve Bank or a corporation owned by that bank; and
 - (c) nothing contained in section 46 or in section 47A shall apply to, —
 - (i) an officer of the Central Government or the Reserve Bank, nominated or appointed as director of the State Bank of India or any corresponding new bank or a Regional Rural Bank or any subsidiary bank or a banking company; or
 - (ii) an officer of the State Bank of India or a corresponding new bank or a Regional Rural Bank or a subsidiary bank nominated or appointed as director of any of the said banks (not being the bank of which he is an officer) or of a banking company.;
- (2) References to a banking company in any rule or direction relating to any provision of this Act referred to in sub-section (1) shall, except where such rule or direction provides otherwise, be construed as referring also to the State Bank of India, a corresponding new bank, a Regional Rural Bank and a subsidiary bank.

Power of Central Government to make rules [Section 52]

- (1) The Central Government may, after consultation with the Reserve Bank, make rules to provide for all matters for which provision is necessary or expedient for the purpose of giving effect to the provisions of this Act and all such rules shall be published in the Official Gazette.
- (2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for the details to be included in the returns required by (his Act and the manner in which such returns shall be submitted and the form in which the official liquidator may file lists of debtors to the court having jurisdiction under Part III or Part IIIA and the particulars which such lists may contain and any other matter which has to be, or may be, prescribed.
- (3) Omitted by Act 1 of 1984, Section 4 w.e.f. 15-2-1984.

- (4) The Central Government may by rules made under this section annul, alter or add to, all or any of the provisions of the Fourth Schedule.
- (5) Every rule made by the Central Government under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

Power to exempt in certain cases [Section 53]

- (1) The Central Government may, on the recommendation of the Reserve Bank, declare, by notification in the Official Gazette, that any or all of the provisions of this Act shall not apply to any banking company or institution or to any class of banking companies either generally or for such period as may be specified] either generally or for such period as may be specified.
- (2) A copy of every notification proposed to be issued under sub-section (1) relating to any banking company or institution or any class, of banking companies or any branch of a banking company or an institution as the case may be, functioning or located in any Special Economic Zone established under the Special Economic Zones Act, 2005 (28 of 2005) shall be laid in draft before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in disapproving the issue of the notification or both Houses agree in making any modification in the notification, the notification shall not be issued or, as the case may be, shall be issued only in such modified form as may be agreed upon by both the Houses.]

Protection of action taken under Act [Section 54]

- (1) No suit or other legal proceeding shall be lie against the Central Government, the Reserve Bank or any officer for anything which is in good faith done or intended to be done in pursuance of this Act.
- (2) Save as otherwise expressly provided by or under this Act, no suit or other legal proceeding shall lie against the Central Government, the Reserve Bank or any officer for any damage caused or likely to be caused by anything in good faith done or intended to be done in pursuance of this Act.

Amendment of Act 2 of 1934 [Section 55]

The Reserve Bank of India Act, 1934 shall be amended in the manner specified in the fourth column of the First Schedule, and the amendments to section 18 thereof as specified in the said Schedule shall be deemed to have had effect on and from the 20th day of September, 1947.

Power to remove difficulties [Section 55A]

If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order, as occasion requires, do anything (not inconsistent with the provisions of this Act) which appears to it to be necessary for the purpose of removing the difficulty:

Provided that no such power shall be exercised after the expiry of a period of three years from the commencement of section 20 of the Banking Laws (Amendment) Act, 1968 (58 of 1968).

Act to apply to co-operative societies subject to modifications [Section 56]

The provisions of this Act, as in force for the time being, shall apply to, or in relation to, cooperative



societies as they apply to, or in relation to banking companies subject to the following modifications, namely:—

- (a) throughout this Act, unless the context otherwise requires,—
 - (i) references to a “banking company” or “the company” or “such company” shall be construed as references to a co-operative bank;
 - (ii) reference to “commencement of this Act” shall be construed as reference to commencement of the Banking Laws (Application to Co-operative Societies) Act, 1965 (23 of 1965);
- (b) in section 2, the words and figures “the Companies Act, 1956 (1 of 1956) and” shall be omitted;
- (c) in section 5,—
 - (i) after clause (cc), the following clauses shall be inserted, namely:—
 - (ccii) “Co-operative bank” means a state co-operative bank, a central co-operative bank and a primary co-operative bank;
 - (cciii) “co-operative credit society” means a co-operative society, the primary object of which is to provide financial accommodation to its members and includes a co-operative land mortgage bank;
 - (cciiia) “co-operative society” means a society registered or deemed to have been registered under any Central Act for the time being in force relating to the multi-State Co-operative Societies, or any other Central or State law relating to Co-operative Societies for the time being in force;
 - (cciiib) “director” in relation to a co-operative society, includes a member of any committee or body for the time being vested with the management of the affairs of that society;
 - (cciiia) “multi-State co-operative bank” means a multi-State co-operative society which is a primary co-operative bank;
 - (cciiib) “multi-State co-operative society” means a multi-State co-operative society registered as such under any Central Act for the time being in force relating to the multi-State co-operative societies but does not include a national co-operative society and a federal co-operative;
 - (cciv) “primary agricultural credit society” means a co-operative society,—
 - (1) the primary object or principal business of which is to provide financial accommodation to its members for agricultural purposes or for purposes connected with agricultural activities (including the marketing of crops); and
 - (2) the bye-laws of which do not permit admission of any other co-operative society as member:

Provided that this sub-clause shall not apply to the admission of a co-operative bank as a member by reason of such co-operative bank subscribing to the share capital of such co-operative society out of funds provided by the State Government for the purpose;
 - (ccv) “primary co-operative bank” means a co-operative society, other than a primary agricultural credit society,—
 - (1) the primary object or principal business of which is the transaction of banking business;
 - (2) the paid-up share capital and reserves of which are not less than one lakh of rupees; and
 - (3) the bye-laws of which do not permit admission of any other co-operative society as a member:

Provided that this sub-clause shall not apply to the admission of a co-operative bank as a

member by reason of such co-operative bank subscribing to the share capital of such co-operative society out of funds provided by the State Government for the purpose;

(ccvi) "primary credit society" means a co-operative society, other than a primary agricultural credit society,—

- (1) the primary object or principal business of which is the transaction of banking business;
- (2) the paid-up share capital and reserves of which are less than one lakh of rupees; and
- (3) the bye-laws of which do not permit admission of any other co-operative society as a member;

Provided that this sub-clause shall not apply to the admission of a co-operative bank as a member by reason of such co-operative bank subscribing to the share capital of such co-operative society out of funds provided by the State Government for the purpose.

Explanation. —If any dispute arises as to the primary object or principal business of any co-operative society referred to in clauses (cciv), (ccv) and (ccvi), a determination thereof by the Reserve Bank shall be final;

(ccvii) "central co-operative bank", "primary rural credit society" and "state co-operative bank" shall have the meaning respectively assigned to them in the National Bank for Agriculture and Rural Development Act, 1981;

(ii) clauses (ff), (h) and (nb) shall be omitted;

(d) for section 5A, the following section shall be substituted, namely:—

"5A. Act to override bye-laws, etc.—

- (1) The provisions of this Act shall have effect, notwithstanding anything to the contrary contained in the bye-laws of a co-operative society, or in any agreement executed by it, or in any resolution passed by it in general meeting, or by its Board of Directors or other body entrusted with the management of its affairs, whether the same be registered, executed or passed; as the case may be before or after the commencement of the Banking Laws (Application to Co-operative Societies Act, 1965 (23 of 1965).
- (2) Any provision contained in the bye-laws, agreement or resolution aforesaid shall, to the extent to which it is repugnant to the provisions of this Act, become or be void, as the case may be."

(e) in section 6, in sub-section (1),—

- (i) in clause (b), the words, "but excluding the business of a managing agent or secretary and treasurer of company" shall be omitted;
- (ii) in clause (d), after the word "company", the words "co-operative society" shall be inserted;
- (iii) in clause (m), after the word "company", the words "or co-operative society" shall be inserted;

(f) for section 7, the following section shall be substituted, namely: —

"7. Use of words "bank", "banker" or "banking". —

- (1) No co-operative society other than a co-operative bank shall use as part of its name or in connection with its business any of the words "bank", "banker" or "banking", and no co-operative society shall carry on the business of banking in India unless it uses as part of its name at least of such words.



(2) Nothing in this section apply to—

- (a) a primary credit society, or
- (b) a co-operative society formed for the protection of the mutual interest of co-operative banks or co-operative land mortgage banks, or
- (c) any co-operative society, not being a primary credit society, formed by the employees of—
 - (i) a banking company or the State Bank of India or a corresponding new bank or a subsidiary bank of such banking company, State Bank of India or a corresponding new bank, or
 - (ii) a co-operative bank or a primary credit society or a co-operative land mortgage bank, insofar as the word “bank”, “banker” or “banking” appears as part of the name of the employer bank, or as the case may be, of the bank whose subsidiary the employer bank is.”;

(fi) in section 8, for the proviso, the following proviso shall be substituted, namely:

“Provided that this section shall not apply—

(a) to any such business as aforesaid which was in the course of being transacted on the commencement of clause (iii) of section 42 of the Banking Laws (Amendment) Act, 1983, so, however, that the said business shall be completed before the expiry of one year from such commencement; or

(b) to any business as is specified in pursuance of clause (o) of sub-section (1) of section 6.”;

(fii) in section 9, for the second proviso, the following provisos shall be substituted, namely:—

“Provided further that in the case of a primary credit society which becomes a primary co-operative bank after the commencement of clause (iii) of section 42 of the Banking Laws (Amendment) Act, 1983, the period of seven years shall commence from the day it so becomes a primary co-operative bank:

Provided also that the Reserve Bank may, in any particular case, extend the aforesaid period of seven years by such period as it may consider necessary where it is satisfied that such extension would be in the interests of the depositors of the co-operative bank.”;

(g) sections 10, 10A, 10B, 10BB, 10C, and 10D shall be omitted;

(h) for section 11, the following section shall be substituted, namely:—

“11. Requirement as to minimum paid-up capital and reserves. —

(1) Notwithstanding any law relating to co-operative societies for the time being in force, no co-operative bank shall commence or carry on the business of banking in India unless the aggregate value of its paid-up capital and reserves is not less than one lakh of rupees:

Provided that nothing in this sub-section shall apply to—

- (a) any such bank which is carrying on such business at the commencement of the Banking Laws (Application to Co-operative Societies) Act, 1965 (23 of 1965), for a period of three years from such commencement; or
- (b) to a primary credit society which becomes a primary co-operative bank after such commencement, for a period of two years from the date it so becomes a primary co-operative bank or for such further period not exceeding one year, the Reserve Bank, having regard to the interests of the depositors of the primary co-operative bank, may think fit in any particular case to allow.

- (2) For the purpose of this section, "value" means the real or exchangeable value and not the nominal value which may be shown in the books of the co-operative bank concerned.
- (3) If any dispute arises in computing the aggregate value of the paid-up capital and reserves of any co-operative bank, a determination thereof by the Reserve Bank shall be final for the purposes of this section;
- (i) sections 12, 12A, 13 and 15 to 17 shall be omitted;
- (j)) For section 18, the following section shall be substituted, namely: —

18. Cash reserve. —

- (1) Every co-operative bank, not being a co-operative bank for the time being included in the Second Schedule to the Reserve Bank of India Act, 1934 (hereinafter referred to as a "a scheduled Co-operative Bank"), shall maintain in India by way of cash reserve with itself or by way of balance in a current account with the Reserve Bank or the State co-operative bank of the State concerned or by way of net balance in current accounts, or, in the case of a primary co-operative bank, with the central cooperative bank of the district concerned, or in one or more of the aforesaid ways, a sum equivalent to such per cent of the total of its demand and time liabilities in India, as on the last Friday of the second preceding fortnight a the Reserve Bank may specify, by notification in the official Gazette, from time to time having regard to the needs for securing the monetary stability in the country sand shall submit to the Reserve Bank before the fifteenth day of every month a return showing the amount so held on alternate Fridays during a month with particulars of its demand and time liabilities in India on such Fridays or if any such Friday is a public holiday under the Negotiable Instruments Act, 1881 (26 of 1881) at the close of business on the preceding working day.

Explanation. —In this section and in section 24—

- (a) "liabilities in India" shall not include—
 - (i) the paid-up capital or the reserves or any credit balance in the profit and loss account of the co-operative bank;
 - (ii) any advance taken from a State Government, the Reserve Bank, the Exim Bank, the Reconstruction Bank, the National Housing Bank the National Bank the Small Industries Bank or from the National Co-operative Development Corporation established under section 3 of the National Co-operative Development Corporation Act, 1962 (26 of 1962), by the bank;
 - (iii) in the case of a Central co-operative bank, also any deposit of money with it representing the reserves fund or any part thereof maintained with it by any other co-operative society within its area of operation, and in the case a Central co-operative bank, also an advance taken by it from the Co-operative bank of the State concerned;
 - (iv) in the case of a primary co-operative bank, also any advance taken by it from the Co-operative bank of the State concerned or the Central cooperative bank of the district concerned;
 - (v) in the case of any co-operative bank, which has granted an advance against any balance maintained with it, such balance to the extent of the amount outstanding in respect of such advance; and
 - (vi) in the case of any co-operative bank, the amount of any advance or other credit arrangement drawn and availed of against approved securities;



- (b) "fortnight" shall mean the period from Saturday to the second following Friday, both days inclusive;
 - (c) "net balance in current accounts" shall, in relation to a co-operative bank, mean the excess, if any, of the aggregate of the credit balances in current account maintained by that co-operative bank with the State Bank of India or a subsidiary bank or a corresponding new bank or IDBI Bank Ltd., over the aggregate of the credit balances in current accounts held by the said banks with such co-operative bank;
 - (d) for the purpose of computation of liabilities, the aggregate of the liabilities of a co-operative bank to the State Bank of India, a subsidiary bank, a corresponding new bank, a Regional Rural bank, a banking company or any other financial institution notified by the Central Government in this behalf shall be reduced by the aggregate of the liabilities of all such banks and institutions to the cooperative bank;
 - (e) any cash with a co-operative bank or any balance held by a co-operative bank with another bank, shall not, to the extent such cash or such balances represents the balance in, or investment of, Agricultural Credit Stabilisation Fund of such co-operative bank, be deemed to be cash maintained in India.
- (1A) If the balance held by co-operative bank referred to in sub-clause (cci) of clause (c) of section 56 of the Banking Regulation Act, 1949 (10 of 1949), at the close of business on any day is below the minimum specified under sub-section (1), such co-operative bank shall, without prejudice to the provisions of any other law for the time being in force, be liable to pay to the Reserve Bank, in respect of that day, penal interest at a rate of three per cent, above the bank rate on the amount by which such balance falls short of the specified minimum, and if the shortfall continues further, the penal interest so charged shall be increased to a rate of five per cent, above the bank rate in respect of each subsequent day during which the default continues.
- (1B) Notwithstanding anything contained in this section, if the Reserve Bank is satisfied, on an application in writing by the defaulting co-operative bank, that such defaulting co-operative bank had sufficient cause for its failure to comply with the provisions of sub-section (1), it may not demand the payment of the penal interest.
- (1C) The Reserve Bank may, for such period and subject to such conditions as may be specified, grant to any co-operative bank such exemptions from the provisions of this section as it thinks fit with reference to all or any of its officers or with reference to the whole or any part of its assets and liabilities":
- (2) The Reserve Bank may, for the purposes of this section and section 24, specify from time to time, with reference to any transaction or class of transactions, that such transaction or transactions shall be regarded as liability in India of a co-operative bank, and, if any question arises to whether any transaction or class of transactions shall be regarded for the purposes of this section and section 24, as liability in India of a co-operative bank, the decision of the Reserve Bank thereon, shall be final."
- (k) for section 19, the following section shall be substituted, namely:—
- "19. Restriction on holding shares in other co-operative societies. —
- No co-operative bank shall hold shares in any other co-operative society except to such extent and subject to such conditions as the Reserve Bank may specify in that behalf:
- Provided that nothing contained in this section shall apply to—
- (i) shares acquired through funds provided by the State Government for that purpose;

- (ii) in the case of a Central co-operative bank, the holding of shares in the State co-operative bank to which it is affiliated;
- (iii) in the case of a primary co-operative bank, the holding of shares in the Central co-operative bank to which it is affiliated or in the State cooperative bank of the State in which it is registered:

Provided further that where any shares are held by a co-operative bank in contravention of this section at the commencement of the Banking Laws (Application to Co-operative Societies) Act, 1965 (23 of 1965), the co-operative bank shall without delay report the matter to the Reserve Bank and shall, notwithstanding anything contained in this section, be entitled to hold the shares for such period and on such conditions as the Reserve Bank may specify"

- (L) for section 20 of the principal Act, the following section shall be substituted, namely:

"20. Restrictions on loans and advances. —

- (1) No co-operative bank shall—

(a) make any loans or advances on the security of its own shares; or

(b) grant unsecured loans or advances—

(i) to any of its directors; or

(ii) to firms or private companies in which any of its directors is interested as partner of managing agent or guarantor or to individuals in cases where any of its directors is a guarantor; or

(iii) to any company in which the chairman of the Board of directors of the co-operative bank (where the appointment of a chairman is for a fixed term) is interested as its managing agent, or where there is no managing agent, as its chairman or managing director:

Provided that nothing in clause (b) shall apply to the grant of unsecured loans or advances—

(a) made by a co-operative bank—

(i) against bills for supplies or services made or rendered to government or bills of exchange arising out of bona fide commercial or trade transactions, or

(ii) in respect whereof trust-receipts are furnished to the co-operative bank;

(b) made by a primary co-operative bank to any of its directors or to any other person within such limits and on such terms and conditions as may be approved by the Reserve Bank in this behalf.

- (2) Every co-operative bank shall, before the close of the month succeeding that to which the return relates, submit to the Reserve Bank a return in the prescribed form and manner showing all unsecured loans and advances granted by it to companies in cases other than those in which the co-operative bank is prohibited under sub-section (1) to make unsecured loans and advances in which any of its directors is interested as director or managing agent or guarantor.
- (3) If, on examination of any return submitted under sub-section (2), it appears to the Reserve Bank that any loans or advances referred to in that subsection are being granted to the detriment of the interests of the depositors of the co-operative bank, the Reserve Bank may, by order in writing prohibit the co-operative bank from granting any such further loans or advances or impose such restrictions on the grant thereof as it thinks fit, and may by like



order direct the co-operative bank to secure the re-payment of such loans or advance within such time as may be specified in the order”;

(m) in section 20A, in sub-section (1). —

- (i) the words and figures “Notwithstanding anything to the contrary contained in section 293 of the Companies Act, 1956 (1 of 1956),” shall be omitted;
- (ii) in clause (a), for the words “any of its directors”, the words “any of its past or present directors” shall be substituted;

(n) in section 21, in sub-section (2), in clauses (c) and (d), for the words “any one company, firm, association of persons or individuals”, the words “any one party” shall be substituted;

(o) in section 22,—

- (i) for sub-sections(1) and (2) the following sub-sections shall be substituted, namely:—

“(1) Save as hereinafter provided, no co-operative society shall carry on banking business in India unless—

- (a) it is a co-operative bank and holds a licence issued in that behalf by the Reserve Bank, to such conditions, if any, as the Reserve Bank may deem fit to impose:

Provided that nothing in this sub-section shall apply to a co-operative society, not being a primary credit society or a co-operative bank carrying on banking business at the commencement of the Banking Laws (Application to Co-operative Societies) Act, 1965 (23 of 1965), for a period of one year from such commencement.

“Provided further that nothing in this sub-section shall apply to a primary credit society carrying on banking business on or before the commencement of the Banking Laws (Amendment) Act, 2012, for a period of one year or for such further period not exceeding three years, as the Reserve Bank may, after recording the reasons in writing for so doing, extend.”;

- (2) Every co-operative society carrying on business as a co-operative bank at the commencement of the Banking Laws (Application to Co-operative Societies) Act, 1965 (23 of 1965) shall before the expiry of three months from the commencement, every co-operative bank which comes into existence as a result of the division of any other co-operative society carrying on business as a co-operative bank, or the amalgamation of two or more co-operative societies carrying on banking business shall, before the expiry of three months from its so coming into existence, “even’ primary credit society which had become a primary co-operative bank on or before the commencement of the Banking Laws (Amendment) Act, 2012, shall before the expiry of three months from the date on which it had become a primary co-operative bank” and every co-operative society shall before commencing banking Business in India, apply in writing to the Reserve Bank for a licence under this section:

Provided that nothing in clause (b) of sub-section (1) shall be deemed to prohibit—

- (i) a co-operative society carrying on business as a co-operative bank at the commencement of the Banking Law (Application to Co-operative Societies) Act, 1965 (23 of 1965); or
- (ii) a co-operative bank which has come into existence as a result of the division of any other co-operative society carrying on business as a cooperative bank, or the amalgamation of two or more co-operative societies carrying on banking business at the commencement of the Banking Laws (Application to Co-operative Societies) Act, 1965 (23 of 1965) or at any time “thereafter”;

22A. Validation of licences granted by Reserve Bank to multi-State co-operative societies.-- Notwithstanding anything contained in any law or, judgment delivered or decree or order of any court made,--

- (a) no licence, granted to a multi-State co-operative society by the Reserve Bank under section 22, which was subsisting on the date of commencement of the Banking Regulation (Amendment) and Miscellaneous Provisions Act, 2004, shall be invalid or be deemed ever to have been invalid merely by the reason of such judgment, decree or order;
- (b) every licence, granted to a multi-State co-operative society by the Reserve Bank under section 22, which was subsisting on the date of commencement of the Banking Regulation (Amendment) and Miscellaneous Provisions Act, 2004, shall be valid and be deemed always to have been validly granted in accordance with law;
- (c) a multi-State co-operative society whose application for grant of licence for carrying on banking business was pending with the Reserve Bank on the date of commencement of the Banking Regulation (Amendment) and Miscellaneous Provisions Act, 2004 shall be eligible to carry on banking business until it is granted a licence in pursuance of section 22 or is, by a notice in writing notified by the Reserve Bank that the licence cannot be granted to it;

(p) in section 23, —

(i) for sub-section (1), the following sub-section shall be substituted, namely:—

“(1) Without obtaining the prior permission of the Reserve Bank, no co-operative bank shall open a new place of business or change otherwise than within the same city, town or village, the location of an existing place of business:

Provided that nothing in this sub-section shall apply to—

- (a) the opening for a period not exceeding one month of temporary place of business within a city, town or village or the environs thereof within which the co-operative bank already has a place of business, for the purpose of affording banking facilities to the public on the occasion of an exhibition, a conference or a mela or any like occasion;
- (b) the opening or changing the location of branches by a Central cooperative bank within the area of its operation”;

16(ii) after sub-section (4), the following sub-section shall be inserted, namely:—

“(4A) Any co-operative bank other than a primary co-operative bank requiring the permission of the Reserve Bank under this section shall forward its application to the Reserve Bank through the National Bank which shall give its comments on the merits of the application and sent it to the Reserve Bank:

Provided that the co-operative bank shall also send an advance copy of the application directly to the Reserve Bank.;

(q) in section 24, —

(ii) for sub-section (2) and (2A), the following sub-sections shall be substituted, namely:—

“(2) In computing the amount for the purposes of sub-section (1),—

- (a) any balances maintained in India by a co-operative bank in current account with the Reserve Bank or by way of net balance in current accounts, and in the case of a scheduled State Co-operative Bank, also the balance required under section 42 of the Reserve Bank of India Act, 1934 (2 of 1934), to be so maintained,



- (b) any balances maintained by a Central co-operative bank with the State co-operative bank of the State concerned, and
- (c) any balances maintained by a primary co-operative bank with Central co-operative bank of the district concerned or with the State cooperative bank of the State concerned, shall be deemed to be cash maintained in India.

(2A) A scheduled co-operative bank, in addition to the average daily balance which it is, or may be. required to maintain under section 42 of the Reserve Bank of India Act, 1934 (2 of 1934) and every other co-operative bank, in addition to the cash reserve which it is required to maintain under section 18, shall maintain in India, assets, the value of which shall not be less than such percentage not exceeding forty per cent, of the total of its demand and time liabilities in India as on last Friday of the second preceding fortnight as the Reserve Bank may, by notification in the Official Gazette, specify from time to time and such assets shall be maintained in such form and manner, as may be specified in such notification." ;

(qq) after section 24, the following section shall be inserted, namely: —

“24A. Power to exempt. —

Without prejudice to the provisions of section 53, the Reserve Bank may, by notification in the Official Gazette, declare that, for such period and subject to such conditions as may be specified in such notification the whole or any part of the provisions of section 18 or section 24, as may be specified therein, shall not apply to any co-operative bank or class of co-operative banks, with reference to all or any of the offices of such co-operative bank or banks, or with reference to the whole or any part of the assets and liabilities of such co-operative bank or banks.”

- (r) section 25 shall be omitted;
- (ri) in the second proviso to section 26, for the expression “regional rural Bank” the expression “co-operative bank, other than a primary co-operative bank” shall be substituted;
- (rii) in section 27, for sub-section (3) the following sub-section shall be substituted, namely:—

“(3) Every co-operative bank, other than a primary co-operative bank, shall submit a copy of the return which it submits to the Reserve Banks, under sub-section (1) also to the National Bank and the powers exercisable by the Reserve Bank under sub-section (2) may also be exercised by the National Bank in relation to co-operative banks, other than primary co-operative banks.

(s) for sections 29, the following section shall be substituted namely:—

(sa) Audit.-

- (1) Without prejudice to anything contained in any other law for the time being in force, where the Reserve Bank is satisfied that it is necessary in the public interest or in the interest of the co-operative bank or its depositors so to do. it may at any time by general or special order direct that an additional audit of the co-operative bank accounts, for any such transactions or class of transactions or for such period or periods as may be specified in the order, shall be conducted and may by the same or a different order appoint a person duly qualified under any law for the time being in force to be an auditor of companies to conduct such audit, and the auditor shall comply with such directions and make a report of such audit to the Reserve Bank and forward a copy thereof to the co-operative bank.
- (2) ‘the expenses of, or incidental to, the additional audit specified in the order made by the Reserve Bank shall be borne by the co-operative bank.
- (3) The auditor referred to in sub-section (1) shall have such powers, exercise such functions vested in and discharge the duties and be subject to the liabilities and penalties imposed

on auditors of companies by section 227 of the Companies Act, 1956 and also that of the auditors, if any, appointed by the law establishing, constituting or forming the co-operative bank to the extent the provisions of the Companies Act, 1956 are not inconsistent with the provisions of such law.

- (4) In addition to the matters referred to in the order under sub-section (1) the auditor shall state in his report-
- (a) whether or not the information and explanation required by him have been found to be satisfactory;
 - (b) whether or not the transactions of the co-operative bank which came to his notice have been within the powers of the co-operative bank;
 - (c) whether or not the returns received from branch offices of the co-operative bank have been found adequate for the purpose of his audit,
 - (d) whether the profit and loss accounts, shows a true balance or profit or loss for the period covered by such account;
 - (e) any other matter which he considers should be brought to the notice of the Reserve Bank and the shareholders of the co-operative bank." '.

"29. Accounts and Balance Sheet. —

- (1) At the expiration of each year ending with the 30th days of June, or at the expiration of a period of twelve months ending with such date as the Central Government may, by notification in the Official Gazette, specify in this behalf every co-operative bank, in respect of all business transacted by it, shall prepare with reference to that year or the period a balance sheet and profit and loss account as on the last working day of the year or the period in the Forms set out in the Third Schedule as near there to as circumstances admit:

Provided that with a view to facilitating the transition from one period of accounting to another period of accounting under this sub-section, the Central Government may, by order published in the Official Gazette, make such provisions as it considers necessary or expedient for the preparation of, or for other matters relating to, the balance-sheet or profit and loss account in respect of the concerned year or period, as the case may be.

- (2) The balance-sheet and profit and loss account shall be signed by the manager or the principal officer of the bank and where there are more than three directors of the bank, by at least three of those directors, or where there are not more than three directors, by all the directors.
- (3) The Central Government, after giving not less than three months' notice of its intention so to do by a notification in the Official Gazette, may from time to time by a like notification amend the Forms set out in the Third Schedule."

(t) in section 31, —

- (i) for the words "within three months" and "of three months", the words "within six months" and "of six months" shall, respectively, be substituted;
- (ii) for the second proviso, the following proviso shall be substituted, namely:
"Provided further that a co-operative bank, other than a primary cooperative bank, shall furnish such returns also to the National Bank."

(u) sections 32 to 34 shall be omitted;



- (v) in section 34A, sub-section (3) shall be omitted;
- (w) in section 35,—
 - (i) in sub-section (1),—
 - (a) for the words and figures "section 235 of the Companies Act, 1956(1 of 1956)", the words "any law relating to co-operative societies for the time being in force" shall be substituted;
 - (b) the following proviso shall be inserted at the end, namely: —

"Provided that the Reserve Bank may, if it considers it necessary or expedient so to do, cause an inspection to be made of a primary co-operative bank under this sub-section by one or more officers of a State co-operative bank in the State in which such primary cooperative bank is registered;
 - (ii) in sub-section (4), clause (b) shall be omitted.
 - (iii) after sub-section (4), the following sub-section shall be inserted, namely:—

"(4A) Without prejudice to the provisions of sub-section (4), the Reserve Bank may, if it considers it necessary or expedient so to do supply a copy of the report on any inspection or scrutiny to the State co-operative bank and the Registrar of co-operative societies of the State in which the bank which has been inspected or whose affairs have been scrutinised is registered.;
 - (iv) in sub-section (6), for the expressions "regional rural banks' and "regional rural bank", wherever they occur, the expressions "co-operative banks other than primary cooperative bank" shall, respectively, be substituted.
 - (v) the Explanation shall be omitted;
- (x) in section 35A, in sub-section (1), in clause (c), for the words "any banking company", the words "the banking business of any co-operative bank" shall be substituted;
- (y) section 35B shall be omitted;
- (z) in section 36, in sub-section (1), —
 - (a) clause (b) shall be omitted;
 - (b) for clause (d), the following clause shall be substituted, namely:—
 - (d) at any time, if it is satisfied that for the reorganisation or expansion of co-operative credit on sound lines it is necessary so to do by an order in writing and on such terms and conditions as may be specified therein,—
 - (i) depute one or more of its officers to watch the proceedings at any meeting of the Board of directors of the co-operative bank or of any other body constituted by it and require the co-operative bank to give an opportunity to the officer so deputed to be heard at such meetings and to offer such advice on such matters as the officer may consider necessary or proper for the reorganisation and expansion of co-operative credit on sound lines, and also require such officer to send a report of such proceedings to the Reserve Bank;
 - (ii) appoint one or more of its officers to observe the manner in which the affairs of the co-operative bank or its offices or branches are being conducted and make a report thereon;
- (za) in section 36A,—

“(1) The provisions of section 11, section 18 and section 24 shall not apply to a co-operative bank which has been refused a licence under section 22 of whose licence has been cancelled under that section or which is or has been prohibited or precluded from accepting deposits by virtue of any order made under this Act or of any alteration made in its bye-laws.

“(3) Subject to the provisions of sub-sections (1) and (2), a co-operative society carrying on business as a primary co-operative bank at the commencement of the Banking Laws (Application to Co-operative Societies) Act, 1965 (23 of 1965), or a co-operative society which becomes a primary co-operative bank after such commencement shall, notwithstanding that it does not at any time thereafter satisfy the requirements of the definition of primary co-operative bank in clause (ccv) of section 5, continue to be a primary co-operative bank within the meaning of this Act, and may, with the approval of the Reserve Bank and subject to such terms and conditions as the Reserve Bank may specify in that behalf, continue to carry on the business of banking.”;

(Zaa) “36AAA Supersession of Board of directors of a multi-state co-operative bank .

- (1) Where the Reserve Bank is satisfied that in the public interest or for preventing the affairs of a multi-State co-operative bank being conducted in a manner detrimental to the interest of the depositors or of the multi-State co-operative bank or for securing the proper management of the multi-State co-operative bank, it is necessary so to do, the Reserve Bank may, for reasons to be recorded in writing, by order, supersede the Board of directors of such multi-State co-operative bank for a period not exceeding five years as may be specified in the order, which may be extended from time to time, so, however, that total period shall not exceed five years.
- (2) The Reserve Bank may, on supersession of the Board of directors of the multi-State co-operative bank under sub-section (1) appoint an Administrator for such period as it may determine.
- (3) The Reserve Bank may issue such directions to the Administrator as it may deem appropriate and the Administrator shall be bound to follow such directions.
- (4) Upon making the order of supersession of the Board of directors of a multi-State co-operative bank,--
 - (a) the chairman, managing director and other directors as from the date of supersession of the Board shall vacate their offices as such;
 - (b) all the powers, functions and duties which may, by or under the provisions of the Multi-State Co-operative Societies Act, 2002 (39 of 2002) or this Act or any other law for the time being in force, be exercised and discharged by or on behalf of the Board of directors of such a multi-State co-operative bank or by a resolution passed in general meeting of such co-operative bank, shall, until the Board of directors of such co-operative bank is reconstituted, be exercised and discharged by the Administrator appointed by the Reserve Bank under sub-section (2):

Provided that the power exercised by the Administrator shall be valid notwithstanding that such power is exercisable by a resolution passed in the general meeting of such multi-State co-operative bank.

- (5)
 - (a) The Reserve Bank may constitute a committee of three or more persons who have experience in law, finance, banking, administration or accountancy to assist the Administrator in discharge of his duties.
 - (b) The committee shall meet at such times and places and observe such rules of procedure as may be specified by the Reserve Bank.

- (6) The salary and allowances to the Administrator and the members of the committee constituted by the Reserve Bank shall be such as may be Specified by the Reserve Bank and be payable by the concerned multi-State co-operative bank.
- (7) On and before expiration of period of supersession of the Board of directors as specified in the order issued under sub-section (1), the Administrator of the multi-State co-operative bank shall call the general meeting of the society to elect new directors.
- (8) Notwithstanding anything contained in any other law or in any contract, or bye-laws of a multi-State co-operative bank, no person shall be entitled to claim any compensation for the loss or termination of his office.
- (9) The Administrator appointed under sub-section (2) shall vacate office immediately after the Board of directors of the multi-State co-operative society has been constituted.

36AAB Order of winding up multi-State co-operative bank to be final in certain cases. Where a multi-State co-operative bank, being an eligible cooperative bank, has been registered under section 13A of the Deposit Insurance and Credit Guarantee Corporation Act, 1961 (47 of 1961), as an insured bank, and subsequently -

- (a) in pursuance of a scheme prepared with the previous approval of the Reserve Bank under section 18 of the Multi-State Co-operative Societies Act, 2002 (39 of 2002), an order sanctioning a scheme of compromise and arrangement or reorganisation or reconstruction has been made; or
- (b) on requisition by the Reserve Bank, an order for winding up of the multi-State co-operative bank has been made under section 87 of the Multi-State Co-operative Societies Act, 2002 (39 of 2002); or
- (c) an order for the supersession of the Board and the appointment of an Administrator therefore has been made under section 36AAA, such order for sanctioning the scheme of compromise and arrangement or reorganisation or reconstruction under clause (a) or the winding up of the multi-State co-operative bank under clause (b) or an order for the supersession of the Board and the appointment of an Administrator under clause (c) shall not be liable to be called in question in any manner.

36AAC Reimbursement to the Deposit Insurance Corporation by liquidator or transferee bank. Where a multi-State co-operative bank, being an insured bank within the meaning of the Deposit Insurance and Credit Guarantee Corporation Act, 1961 (47 of 1961), is wound up and the Deposit Insurance Corporation has become liable to the depositors of the insured bank under sub-section (1) or sub-section (2) of section 16 of that Act, the Deposit Insurance Corporation shall be reimbursed by the liquidator or such other person in the circumstances, to the extent and in the manner provided in section 21 of that Act".]

- (i) in sub-section (4) the word "or" occurring at the end of clause (i) and clause (ii) shall be omitted;
 - (ii) in clause (a) of the Explanation, after the words "includes a", the words "co- operative society" shall be inserted;
- (zd) in section 47, the words brackets, figures and letters "sub-section (5) of section 36AA or" shall be omitted;
 - (ze) section 49 shall be omitted;
 - (zf) in section 49A, for the proviso, the following proviso shall be substituted, namely:—
"Provided that nothing contained in this section shall apply to—

- (a) a primary credit society—
- (b) any other co-operative society accepting such deposits at the commencement of the Banking Laws (Application to Co-operative Societies) Act, 1965 (23 of 1965), for a period of one year from the date of such commencement; and
- (c) any savings bank scheme run by the Government”;
- (zg) sections 49B and 49C shall be omitted;
- (zh) in section 50, the figures and letters “10,12A, 16”, “35B”, and “43A” shall be omitted;
- (zi) section 51 shall be omitted;
- (zj) in section 52,—
 - (i) in sub-section (2) the words, figures and letter “and the form in which official liquidator may file lists of debtors to the court jurisdiction under Part III or Part IIIA and the particulars which such lists may contain” shall be omitted;
 - (ii) sub-section (4) shall be omitted;
- (zji) in section 54, after the expression “Reserve Bank”, wherever it occurs, the expression “or the National Bank” shall be inserted;
- (zk) For section 65 and the First Schedule, the following section shall be substituted, namely:—

“55, Act 18 of 1891 and Act 46 of 1949 to apply in relation to co-operative banks.—

 - (1) The Bankers’ Books Evidence Act, 1891 shall apply in relation to a co-operative bank as it applies in relation to a bank as defined in section 2 of that Act.
 - (2) The Banking Companies (Legal Practitioners’ Clients’ Accounts) Act, 1949 shall apply in relation to a co-operative bank as it applies in relation to a banking company as defined in section 2 of that Act.”



5.2 THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002

An Act to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto.

BE it enacted by Parliament in the Fifty-third year of Republic of India as follows: --

Short title, extent and commencement [Section 1]

- (1) This Act may be called the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
- (2) It extends to the whole of India.
- (3) It shall be deemed to have come into force on the 21st day of June, 2002.

Definitions [Section 2]

- (1) In this Act, unless the context otherwise requires,--
 - (a) "Appellate Tribunal" means a Debts Recovery Appellate Tribunal established under sub-section (1) of section 8 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993;
 - (b) "asset reconstruction" means acquisition by any securitisation company or reconstruction company of any right or interest of any bank or financial institution in any financial assistance for the purpose of realisation of such financial assistance;
 - (c) "bank" means--
 - (i) a banking company; or
 - (ii) a corresponding new bank; or
 - (iii) the State Bank of India; or
 - (iv) a subsidiary bank; or
 - (v) such other bank which the Central Government may, by notification, specify for the purposes of this Act;
 - (d) "banking company" shall have the meaning assigned to it in clause (c) of section 5 of the Banking Regulation Act, 1949;
 - (e) "Board" means the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992;
 - (f) "borrower" means any person who has been granted financial assistance by any bank or financial institution or who has given any guarantee or created any mortgage or pledge as security for the financial assistance granted by any bank or financial institution and includes a person who becomes borrower of a securitisation company or reconstruction company consequent upon acquisition by it of any rights or interest of any bank or financial institution in relation to such financial assistance;
 - (g) "Central Registry" means the registry set up or cause to be set up under sub-section (1) of section 20;
 - (h) "corresponding new bank" shall have the meaning assigned to it in clause (da) of section 5 of the Banking Regulation Act, 1949;

- (ha) "debt" shall have the meaning assigned to it in clause (g) of section 2 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993;
- (i) "Debts Recovery Tribunal" means the Tribunal established under sub-section (1) of section 3 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993;
- (j) "default" means non-payment of any principal debt or interest thereon or any other amount payable by a borrower to any secured creditor consequent upon which the account of such borrower is classified as non-performing asset in the books of account of the secured creditor;
- (k) "financial assistance" means any loan or advance granted or any debentures or bonds subscribed or any guarantees given or letters of credit established or any other credit facility extended by any bank or financial institution;
- (l) "financial asset" means debt or receivables and includes--
 - (i) a claim to any debt or receivables or part thereof, whether secured or unsecured; or
 - (ii) any debt or receivables secured by, mortgage of, or charge on, immovable property; or
 - (iii) a mortgage, charge, hypothecation or pledge of movable property; or
 - (iv) any right or interest in the security, whether full or part underlying such debt or receivables; or
 - (v) any beneficial interest in property, whether movable or immovable, or in such debt, receivables, whether such interest is existing, future, accruing, conditional or contingent; or
 - (vi) any financial assistance;
- (m) "financial institution" means--
 - (i) a public financial institution within the meaning of section 4A of the Companies Act, 1956;
 - (ii) any institution specified by the Central Government under sub-clause (ii) of clause (h) of section 2 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993;
 - (iii) the International Finance Corporation established under the International Finance Corporation (Status, Immunities and Privileges) Act, 1958;
 - (iv) any other institution or non-banking financial company as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934, which the Central Government may, by notification, specify as financial institution for the purposes of this Act;
- (n) "Hypothecation" means a charge in or upon any movable property, existing or future, created by a borrower in favour of a secured creditor without delivery of possession of the movable property to such creditor, as a security for financial assistance and includes floating charge and crystallisation of such charge into fixed charge on movable property;
- (o) "non-performing asset" means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset,--
 - (a) in case such bank or financial institution is administered or regulated by any authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or body;
 - (b) in any other case, in accordance with the directions or guidelines relating to assets classifications issued by the Reserve Bank;



- (p) "notification" means a notification published in the Official Gazette;
- (q) "obligor" means a person liable to the originator, whether under a contract or otherwise, to pay a financial asset or to discharge any obligation in respect of a financial asset, whether existing, future, conditional or contingent and includes the borrower;
- (r) "originator" means the owner of a financial asset which is acquired by a securitisation company or reconstruction company for the purpose of securitisation or asset reconstruction;
- (s) "prescribed" means prescribed by rules made under this Act;
- (t) "property" means--
 - (i) immovable property;
 - (ii) movable property;
 - (iii) any debt or any right to receive payment of money, whether secured or unsecured;
 - (iv) receivables, whether existing or future;
 - (v) intangible assets, being know-how, patent, copyright, trade mark, licence, franchise or any other business or commercial right of similar nature;
- (u) "qualified institutional buyer" means a financial institution, insurance company, bank, state financial corporation, state industrial development corporation, trustee or securitisation company or reconstruction company which has been granted a certificate of registration under sub-section (4) of section 3 or any asset management company making investment on behalf of mutual fund or a foreign institutional investor registered under the Securities and Exchange Board of India Act, 1992 or regulations made thereunder, or any other body corporate as may be specified by the Board;
- (v) "reconstruction company" means a company formed and registered under the Companies Act, 1956 for the purpose of asset reconstruction;
- (w) "Registrar of Companies" means the Registrar as defined in clause (40) of section 2 of the Companies Act, 1956;
- (x) "Reserve Bank" means the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934;
- (y) "scheme" means a scheme inviting subscription to security receipts proposed to be issued by a securitisation company or reconstruction company under that scheme;
- (z) "securitisation" means acquisition of financial assets by any securitisation company or reconstruction company from any originator, whether by raising of funds by such securitisation company or reconstruction company from qualified institutional buyers by issue of security receipts representing undivided interest in such financial assets or otherwise;
- (za) "securitisation company" means any company formed and registered under the Companies Act, 1956 for the purpose of securitisation;
- (zb) "security agreement" means an agreement, instrument or any other document or arrangement under which security interest is created in favour of the secured creditor including the creation of mortgage by deposit of title deeds with the secured creditor;
- (zc) "secured asset" means the property on which security interest is created;
- (zd) "secured creditor" means any bank or financial institution or any consortium or group of banks or financial institutions and includes—

- (i) debenture trustee appointed by any bank or financial institution; or
 - (ii) securitisation company or reconstruction company, whether acting as such or managing a trust set up by such securitisation company or reconstruction company for the securitisation or reconstruction, as the case may be; or
 - (iii) any other trustee holding securities on behalf of a bank or financial institution, in whose favour security interest is created for due repayment by any borrower of any financial assistance;
- (ze) "secured debt" means a debt which is secured by any security interest;
- (zf) "security interest" means right, title and interest of any kind whatsoever upon property, created in favour of any secured creditor and includes any mortgage, charge, hypothecation, assignment other than those specified in section 31;
- (zg) "security receipt" means a receipt or other security, issued by a securitization company or reconstruction company to any qualified institutional buyer pursuant to a scheme, evidencing the purchase or acquisition by the holder thereof, of an undivided right, title or interest in the financial asset involved in securitisation;
- (zh) "sponsor" means any person holding not less than ten per cent of the paid up equity capital of a securitisation company or reconstruction company;
- (zi) "State Bank of India" means the State Bank of India constituted under section 3 of the State Bank of India Act, 1955;
- (zj) "subsidiary bank" shall have the meaning assigned to it in clause (k) of section 2 of the State Bank of India (Subsidiary Banks) Act, 1959.
- (2) Words and expressions used and not defined in this Act but defined in the Indian Contract Act, 1872 or the Transfer of Property Act, 1882 or the Companies Act, 1956 or the Securities and Exchange Board of India Act, 1992 shall have the same meanings respectively assigned to them in those Acts.

REGULATION OF SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS OF BANKS AND FINANCIAL INSTITUTIONS

Registration of securitisation companies or reconstruction companies [Section 3]

- (1) No securitisation company or reconstruction company shall commence or carry on the business of securitisation or asset reconstruction without--
- (a) obtaining a certificate of registration granted under this section; and
 - (b) having the owned fund of not less than two crore rupees or such other amount not exceeding fifteen per cent of total financial assets acquired or to be acquired by the securitisation company or reconstruction company, as the Reserve Bank may, by notification, specify:
- Provided that the Reserve Bank may, by notification, specify different amounts of owned fund for different class or classes of securitization companies or reconstruction companies:
- Provided further that a securitisation company or reconstruction company, existing on the commencement of this Act, shall make an application for registration to the Reserve Bank before the expiry of six months from such commencement and notwithstanding anything contained in this sub-section may continue to carry on the business of securitisation or asset reconstruction until a certificate of registration is granted to it or, as the case may be, rejection of application for registration is communicated to it.
- (2) Every securitisation company or reconstruction company shall make an application for registration to the Reserve Bank in such form and manner as it may specify.



- (3) The Reserve Bank may, for the purpose of considering the application for registration of a securitisation company or reconstruction company to commence or carry on the business of securitisation or asset reconstruction, as the case may be, require to be satisfied, by an inspection of records or books of such securitisation company or reconstruction company, or otherwise, that the following conditions are fulfilled, namely:-
- (a) that the securitisation company or reconstruction company has not incurred losses in any of the three preceding financial years;
 - (b) that such securitisation company or reconstruction company has made adequate arrangements for realisation of the financial assets acquired for the purpose of securitisation or asset reconstruction and shall be able to pay periodical returns and redeem on respective due dates on the investments made in the company by the qualified institutional buyers or other persons;
 - (c) that the directors of securitisation company or reconstruction company have adequate professional experience in matters related to finance, securitisation and reconstruction;
 - (d) that the board of directors of such securitisation company or reconstruction company does not consist of more than half of its total number of directors who are either nominees of any sponsor or associated in any manner with the sponsor or any of its subsidiaries;
 - (e) that any of its directors has not been convicted of any offence involving moral turpitude;
 - (f) that a sponsor, is not a holding company of the securitisation company or reconstruction company, as the case may be, or, does not otherwise hold any controlling interest in such securitisation company or reconstruction company;
 - (g) that securitisation company or reconstruction company has complied with or is in a position to comply with prudential norms specified by the Reserve Bank.
 - (h) that securitisation company or reconstruction company has complied with one or more conditions specified in the guidelines issued by the Reserve Bank for the said purpose.
- (4) The Reserve Bank may, after being satisfied that the conditions specified in sub-section (3) are fulfilled, grant a certificate of registration to the securitisation company or the reconstruction company to commence or carry on business of securitisation or asset reconstruction, subject to such conditions which it may consider, fit to impose.
- (5) The Reserve Bank may reject the application made under sub-section (2) if it is satisfied that the conditions specified in sub-section (3) are not fulfilled:
- Provided that before rejecting the application, the applicant shall be given a reasonable opportunity of being heard.
- (6) Every securitisation company or reconstruction company, shall obtain prior approval of the Reserve Bank for any substantial change in its management or change of location of its registered office or change in its name:
- Provided that the decision of the Reserve Bank, whether the change in management of a securitisation company or a reconstruction company is a substantial change in its management or not, shall be final.
- Explanation.**—For the purposes of this section, the expression “substantial change in management” means the change in the management by way of transfer of shares or amalgamation or transfer of the business of the company.

Cancellation of certificate of registration [Section 4]

- (1) The Reserve Bank may cancel a certificate of registration granted to a securitisation company or a reconstruction company, if such company--
 - (a) ceases to carry on the business of securitisation or asset reconstruction; or
 - (b) ceases to receive or hold any investment from a qualified institutional buyer; or
 - (c) has failed to comply with any conditions subject to which the certificate of registration has been granted to it; or
 - (d) at any time fails to fulfil any of the conditions referred to in clauses (a) to (g) of sub-section (3) of section 3; or
 - (e) fails to--
 - (i) comply with any direction issued by the Reserve Bank under the provisions of this Act; or
 - (ii) maintain accounts in accordance with the requirements of any law or any direction or order issued by the Reserve Bank under the provisions of this Act; or
 - (iii) submit or offer for inspection its books of account or other relevant documents when so demanded by the Reserve Bank; or
 - (iv) obtain prior approval of the Reserve Bank required under sub-section (6) of section 3:

Provided that before cancelling a certificate of registration on the ground that the securitisation company or reconstruction company has failed to comply with the provisions of clause (c) or has failed to fulfil any of the conditions referred to in clause (d) or sub-clause (iv) of clause (e), the Reserve Bank, unless it is of the opinion that the delay in cancelling the certificate of registration granted under sub-section (4) of section 3 shall be prejudicial to the public interest or the interests of the investors or the securitisation company or the reconstruction company, shall give an opportunity to such company on such terms as the Reserve Bank may specify for taking necessary steps to comply with such provisions or fulfilment of such conditions.

- (2) A securitisation company or reconstruction company aggrieved by the order of cancellation of certificate of registration may prefer an appeal, within a period of thirty days from the date on which such order of cancellation is communicated to it, to the Central Government:

Provided that before rejecting an appeal such company shall be given a reasonable opportunity of being heard.

- (3) A securitisation company or reconstruction company, which is holding investments of qualified institutional buyers and whose application for grant of certificate of registration has been rejected or certificate of registration has been cancelled shall, notwithstanding such rejection or cancellation, be deemed to be a securitisation company or reconstruction company until it repays the entire investments held by it (together with interest, if any) within such period as the Reserve Bank may direct.

Acquisition of rights or interest in financial assets [Section 5]

- (1) Notwithstanding anything contained in any agreement or any other law for the time being in force, any securitisation company or reconstruction company may acquire financial assets of any bank or financial institution--
 - (a) by issuing a debenture or bond or any other security in the nature of the debenture, for consideration agreed upon between such company and the bank or financial institution, incorporating therein such terms and conditions as may be agreed upon between them; or



- (b) by entering into an agreement with such bank or financial institution for the transfer of such financial assets to such company on such terms and conditions as may be agreed upon between them.
- (2) If the bank or financial institution is a lender in relation to any financial assets acquired under sub-section (1) by the securitisation company or the reconstruction company, such securitisation company or reconstruction company shall, on such acquisition, be deemed to be the lender and all the rights of such bank or financial institution shall vest in such company in relation to such financial assets.
- (3) Unless otherwise expressly provided by this Act, all contracts, deeds, bonds, agreements, powers-of-attorney, grants of legal representation, permissions, approvals, consents or no-objections under any law or otherwise and other instruments of whatever nature which relate to the said financial asset and which are subsisting or having effect immediately before the acquisition of financial asset under sub-section (1) and to which the concerned bank or financial institution is a party or which are in favour of such bank or financial institution shall, after the acquisition of the financial assets, be of as full force and effect against or in favour of the securitisation company or reconstruction company, as the case may be, and may be enforced or acted upon as fully and effectually as if, in the place of the said bank or financial institution, securitisation company or reconstruction company, as the case may be, had been a party thereto or as if they had been issued in favour of the securitisation company or reconstruction company, as the case may be.
- (4) If, on the date of acquisition of financial asset under sub-section (1), any suit, appeal or other proceeding of whatever nature relating to the said financial asset is pending by or against the bank or financial institution, save as provided in the third proviso to sub-section (1) of section 15 of the Sick Industrial Companies (Special Provisions) Act, 1985 the same shall not abate, or be discontinued or be, in any way, prejudicially affected by reason of the acquisition of financial asset by the securitisation company or reconstruction company, as the case may be, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the securitisation company or reconstruction company, as the case may be.

Transfer of pending applications to any one of Debts Recovery Tribunals in certain cases [Section 5A]

- (1) If any financial asset, of a borrower acquired by a securitisation company or reconstruction company, comprise of secured debts of more than one bank or financial institution for recovery of which such banks or financial institutions has filed applications before two or more Debts Recovery Tribunals, the securitisation company or reconstruction company may file an application to the Appellate Tribunal having jurisdiction over any of such Tribunals in which such applications are pending for transfer of all pending applications to any one of the Debts Recovery Tribunals as it deems fit.
- (2) On receipt of such application for transfer of all pending applications under sub-section (1), the Appellate Tribunal may, after giving the parties to the application an opportunity of being heard, pass an order for transfer of the pending applications to any one of the Debts Recovery Tribunals.
- (3) Notwithstanding anything contained in the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, any order passed by the Appellate Tribunal under sub-section (2) shall be binding on all the Debts Recovery Tribunals referred to in sub-section (1) as if such order had been passed by the Appellate Tribunal having jurisdiction on each such Debts Recovery Tribunal.
- (4) Any recovery certificate, issued by the Debts Recovery Tribunal to which all the pending applications are transferred under sub-section (2), shall be executed in accordance with the provisions contained in sub-section (23) of section 19 and other provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 shall, accordingly, apply to such execution.

Notice to obligor and discharge of obligation of such obligor [Section 6]

- (1) The bank or financial institution may, if it considers appropriate, give a notice of acquisition of financial assets by any securitisation company or reconstruction company, to the concerned obligor and any other concerned person and to the concerned registering authority (including Registrar of Companies) in whose jurisdiction the mortgage, charge, hypothecation, assignment or other interest created on the financial assets have been registered.
- (2) Where a notice of acquisition of financial asset under sub-section (1) is given by a bank or financial institution, the obligor, on receipt of such notice, shall make payment to the concerned securitisation company or reconstruction company, as the case may be, and payment made to such company in discharge of any of the obligations in relation to the financial asset specified in the notice shall be a full discharge to the obligor making the payment from all liability in respect of such payment.
- (3) Where no notice of acquisition of financial asset under sub-section (1) is given by any bank or financial institution, any money or other properties subsequently received by the bank or financial institution, shall constitute monies or properties held in trust for the benefit of and on behalf of the securitisation company or reconstruction company, as the case may be, and such bank or financial institution shall hold such payment or property which shall forthwith be made over or delivered to such securitisation company or reconstruction company, as the case may be, or its agent duly authorised in this behalf.

Issue of security by raising of receipts or funds by securitisation company or reconstruction company [Section 7]

- (1) Without prejudice to the provisions contained in the Companies Act, 1956, Securities Contracts (Regulation) Act, 1956, and the Securities and Exchange Board of India Act, 1992, any securitisation company or reconstruction company, may, after acquisition of any financial asset under sub-section (1) of section 5, offer security receipts to qualified institutional buyers (other than by offer to public) for subscription in accordance with the provisions of those Acts.
- (2) A securitisation company or reconstruction company may raise funds from the qualified institutional buyers by formulating schemes for acquiring financial assets and shall keep and maintain separate and distinct accounts in respect of each such scheme for every financial asset acquired out of investments made by a qualified institutional buyer and ensure that realisations of such financial asset is held and applied towards redemption of investments and payment of returns assured on such investments under the relevant scheme.
- (2-A) (a) The scheme for the purpose of offering security receipts under sub-section (1) or raising funds under sub-section (2), may be in the nature of a trust to be managed by the securitisation company or reconstruction company, and the securitisation company or reconstruction company shall hold the assets so acquired or the funds so raised for acquiring the assets, in trust for the benefit of the qualified institutional buyers holding the security receipts or from whom the funds are raised.
(b) The provisions of the Indian Trust Act, 1882 shall, except in so far as they are inconsistent with the provisions of this Act, apply with respect to the trust referred to in clause (a) above.
- (3) In the event of non-realisation under sub-section (2) of financial assets, the qualified institutional buyers of a securitisation company or reconstruction company, holding security receipts of not less than seventy-five per cent of the total value of the security receipts issued under a scheme by such company, shall be entitled to call a meeting of all the qualified institutional buyers and every resolution passed in such meeting shall be binding on the company.
- (4) The qualified institutional buyers shall, at a meeting called under sub-section (3), follow the same procedure, as nearly as possible as is followed at meetings of the board of directors of the securitisation company or reconstruction company, as the case may be.



Exemption from registration of security receipt [Section 8]

Notwithstanding anything contained in sub-section (1) of section 17 of the Registration Act, 1908 ,--

- (a) any security receipt issued by the securitisation company or reconstruction company, as the case may be, under sub-section (1) of section 7, and not creating, declaring, assigning, limiting or extinguishing any right, title or interest, to or in immovable property except insofar as it entitles the holder of the security receipt to an undivided interest afforded by a registered instrument; or
- (b) any transfer of security receipts, shall not require compulsory registration.

Measures for assets reconstruction [Section 9]

Without prejudice to the provisions contained in any other law for the time being in force, a securitisation company or reconstruction company may, for the purposes of asset reconstruction, having regard to the guidelines framed by the Reserve Bank in this behalf, provide for any one or more of the following measures, namely:--

- (a) the proper management of the business of the borrower, by change in, or take over of, the management of the business of the borrower;
- (b) the sale or lease of a part or whole of the business of the borrower;
- (c) rescheduling of payment of debts payable by the borrower;
- (d) enforcement of security interest in accordance with the provisions of this Act;
- (e) settlement of dues payable by the borrower;
- (f) taking possession of secured assets in accordance with the provisions of this Act.

Other functions of Securitisation Company or Reconstruction Company [Section 10]

- (1) Any securitisation company or reconstruction company registered under section 3 may--

- (a) act as an agent for any bank or financial institution for the purpose of recovering their dues from the borrower on payment of such fee or charges as may be mutually agreed upon between the parties;
- (b) act as a manager referred to in clause (c) of sub-section (4) of section 13 on such fee as may be mutually agreed upon between the parties;
- (c) act as receiver if appointed by any court or tribunal:

Provided that no securitisation company or reconstruction company shall act as a manager if acting as such gives rise to any pecuniary liability.

- (2) Save as otherwise provided in sub-section (1), no securitisation company or reconstruction company which has been granted a certificate of registration under sub-section (4) of section 3, shall commence or carry on, without prior approval of the Reserve Bank, any business other than that of securitisation or asset reconstruction:

Provided that a securitisation company or reconstruction company which is carrying on, on or before the commencement of this Act, any business other than the business of securitisation or asset reconstruction or business referred to in sub-section (1), shall cease to carry on any such business within one year from the date of commencement of this Act.

Explanation.—For the purposes of this section, “securitisation company” or “reconstruction company” does not include its subsidiary.

Resolution of disputes [Section 11]

Where any dispute relating to securitisation or reconstruction or non-payment of any amount due in-

cluding interest arises amongst any of the parties, namely, the bank or financial institution or securitisation company or reconstruction company or qualified institutional buyer, such dispute shall be settled by conciliation or arbitration as provided in the Arbitration and Conciliation Act, 1996, as if the parties to the dispute have consented in writing for determination of such dispute by conciliation or arbitration and the provisions of that Act shall apply accordingly.

Power of Reserve Bank to determine policy and issue directions [Section 12]

- (1) If the Reserve Bank is satisfied that in the public interest or to regulate financial system of the country to its advantage or to prevent the affairs of any securitisation company or reconstruction company from being conducted in a manner detrimental to the interest of investors or in any manner prejudicial to the interest of such securitisation company or reconstruction company, it is necessary or expedient so to do, it may determine the policy and give directions to all or any securitisation company or reconstruction company in matters relating to income recognition, accounting standards, making provisions for bad and doubtful debts, capital adequacy based on risk weights for assets and also relating to deployment of funds by the securitisation company or reconstruction company, as the case may be, and such company shall be bound to follow the policy so determined and the directions so issued.
- (2) Without prejudice to the generality of the power vested under sub-section (1), the Reserve Bank may give directions to any securitisation company or reconstruction company generally or to a class of securitisation companies or reconstruction companies or to any securitisation company or reconstruction company in particular as to--
 - (a) the type of financial asset of a bank or financial institution which can be acquired and procedure for acquisition of such assets and valuation thereof;
 - (b) the aggregate value of financial assets which may be acquired by any securitisation company or reconstruction company.

Power of Reserve Bank to call for statements and information [Section 12A]

The Reserve Bank may at any time direct a securitisation company or reconstruction company to furnish it within such time as may be specified by the Reserve Bank, with such statements and information relating to the business or affairs of such securitisation company or reconstruction company (including any business or affairs with which such company is concerned) as the Reserve Bank may consider necessary or expedient to obtain for the purposes of this Act.

ENFORCEMENT OF SECURITY INTEREST

Enforcement of security interest [Section 13]

- (1) Notwithstanding anything contained in section 69 or section 69A of the Transfer of Property Act, 1882, any security interest created in favour of any secured creditor may be enforced, without the intervention of court or tribunal, by such creditor in accordance with the provisions of this Act.
- (2) Where any borrower, who is under a liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or any instalment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under sub-section (4).
- (3) The notice referred to in sub-section (2) shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non-payment of secured debts by the borrower.
- (3-A) If, on receipt of the notice under sub-section (2), the borrower makes any representation or raises any objection, the secured creditor shall consider such representation or objection and if the



secured creditor comes to the conclusion that such representation or objection is not acceptable or tenable, he shall communicate within one week of receipt of such representation or objection the reasons for non-acceptance of the representation or objection to the borrower:

Provided that the reasons so communicated or the likely action of the secured creditor at the stage of communication of reasons shall not confer any right upon the borrower to prefer an application to the Debts Recovery Tribunal under section 17 or the Court of District Judge under section 17A.

- (4) In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely:--

- (a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;
- (b) take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset:

Provided that the right to transfer by way of lease, assignment or sale shall be exercised only where the substantial part of the business of the borrower is held as security for the debt:

Provided further that where the management of whole of the business or part of the business is severable, the secured creditor shall take over the management of such business of the borrower which is relatable to the security for the debt.

- (c) appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;
 - (d) require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.
- (5) Any payment made by any person referred to in clause (d) of sub-section (4) to the secured creditor shall give such person a valid discharge as if he has made payment to the borrower.
- (6) Any transfer of secured asset after taking possession thereof or take over of management under sub-section (4), by the secured creditor or by the manager on behalf of the secured creditor shall vest in the transferee all rights in, or in relation to, the secured asset transferred as if the transfer had been made by the owner of such secured asset.
- (7) Where any action has been taken against a borrower under the provisions of sub-section (4), all costs, charges and expenses which, in the opinion of the secured creditor, have been properly incurred by him or any expenses incidental thereto, shall be recoverable from the borrower and the money which is received by the secured creditor shall, in the absence of any contract to the contrary, be held by him in trust, to be applied, firstly, in payment of such costs, charges and expenses and secondly, in discharge of the dues of the secured creditor and the residue of the money so received shall be paid to the person entitled thereto in accordance with his rights and interests.
- (8) If the dues of the secured creditor together with all costs, charges and expenses incurred by him are tendered to the secured creditor at any time before the date fixed for sale or transfer, the secured asset shall not be sold or transferred by the secured creditor, and no further step shall be taken by him for transfer or sale of that secured asset.
- (9) In the case of financing of a financial asset by more than one secured creditors or joint financing of a financial asset by secured creditors, no secured creditor shall be entitled to exercise any or all of the rights conferred on him under or pursuant to sub-section (4) unless exercise of such right is agreed upon by the secured creditors representing not less than three-fourth in value of the

amount outstanding as on a record date and such action shall be binding on all the secured creditors:

Provided that in the case of a company in liquidation, the amount realised from the sale of secured assets shall be distributed in accordance with the provisions of section 529A of the Companies Act, 1956:

Provided further that in the case of a company being wound up on or after the commencement of this Act, the secured creditor of such company, who opts to realise his security instead of relinquishing his security and proving his debt under proviso to sub-section (1) of section 529 of the Companies Act, 1956, may retain the sale proceeds of his secured assets after depositing the workmen's dues with the liquidator in accordance with the provisions of section 529-A of that Act:

Provided also that the liquidator referred to in the second proviso shall intimate the secured creditors the workmen's dues in accordance with the provisions of section 529A of the Companies Act, 1956 and in case such workmen's dues cannot be ascertained, the liquidator shall intimate the estimated amount of workmen's dues under that section to the secured creditor and in such case the secured creditor may retain the sale proceeds of the secured assets after depositing the amount of such estimated dues with the liquidator:

Provided also that in case the secured creditor deposits the estimated amount of workmen's dues, such creditor shall be liable to pay the balance of the workmen's dues or entitled to receive the excess amount, if any, deposited by the secured creditor with the liquidator:

Provided also that the secured creditor shall furnish an undertaking to the liquidator to pay the balance of the workmen's dues, if any.

Explanation. - For the purposes of this sub-section,--

- (a) "record date" means the date agreed upon by the secured creditors representing not less than three-fourth in value of the amount outstanding on such date;
 - (b) "amount outstanding" shall include principal, interest and any other dues payable by the borrower to the secured creditor in respect of secured asset as per the books of account of the secured creditor.
- (10) Where dues of the secured creditor are not fully satisfied with the sale proceeds of the secured assets, the secured creditor may file an application in the form and manner as may be prescribed to the Debts Recovery Tribunal having jurisdiction or a competent court, as the case may be, for recovery of the balance amount from the borrower.
- (11) Without prejudice to the rights conferred on the secured creditor under or by this section, the secured creditor shall be entitled to proceed against the guarantors or sell the pledged assets without first taking any of the measures specified in clauses (a) to (d) of sub-section (4) in relation to the secured assets under this Act.
- (12) The rights of a secured creditor under this Act may be exercised by one or more of his officers authorised in this behalf in such manner as may be prescribed.
- (13) No borrower shall, after receipt of notice referred to in sub-section (2), transfer by way of sale, lease or otherwise (other than in the ordinary course of his business) any of his secured assets referred to in the notice, without prior written consent of the secured creditor.

Chief Metropolitan Magistrate or District Magistrate to assist secured creditor in taking possession of secured asset [Section 14]

- (1) Where the possession of any secured assets is required to be taken by the secured creditor or if any of the secured asset is required to be sold or transferred by the secured creditor under the provisions of this Act, the secured creditor may, for the purpose of taking possession or control



of any such secured asset, request, in writing, the Chief Metropolitan Magistrate or the District Magistrate within whose jurisdiction any such secured asset or other documents relating thereto may be situated or found, to take possession thereof, and the Chief Metropolitan Magistrate or, as the case may be, the District Magistrate shall, on such request being made to him--

- (a) take possession of such asset and documents relating thereto; and
 - (b) forward such assets and documents to the secured creditor.
- (2) For the purpose of securing compliance with the provisions of sub-section (1), the Chief Metropolitan Magistrate or the District Magistrate may take or cause to be taken such steps and use, or cause to be used, such force, as may, in his opinion, be necessary.
- (3) No act of the Chief Metropolitan Magistrate or the District Magistrate done in pursuance of this section shall be called in question in any court or before any authority.

Manner and effect of take over of management [Section 15]

- (1) When the management of business of a borrower is taken over by a securitisation company or reconstruction company under clause (a) of section 9 or, as the case may be, by a secured creditor under clause (b) of sub-section (4) of section 13, the secured creditor may, by publishing a notice in a newspaper published in English language and in a newspaper published in an Indian language in circulation in the place where the principal office of the borrower is situated, appoint as many persons as it thinks fit--
- (a) in a case in which the borrower is a company as defined in the Companies Act, 1956, to be the directors of that borrower in accordance with the provisions of that Act; or
 - (b) in any other case, to be the administrator of the business of the borrower.
- (2) On publication of a notice under sub-section (1),--
- (a) in any case where the borrower is a company as defined in the Companies Act, 1956, all persons holding office as directors of the company and in any other case, all persons holding any office having power of superintendence, direction and control of the business of the borrower immediately before the publication of the notice under sub-section (1), shall be deemed to have vacated their offices as such;
 - (b) any contract of management between the borrower and any director or manager thereof holding office as such immediately before publication of the notice under sub-section (1), shall be deemed to be terminated;
 - (c) the directors or the administrators appointed under this section shall take such steps as may be necessary to take into their custody or under their control all the property, effects and actionable claims to which the business of the borrower is, or appears to be, entitled and all the property and effects of the business of the borrower shall be deemed to be in the custody of the directors or administrators, as the case may be, as from the date of the publication of the notice;
 - (d) the directors appointed under this section shall, for all purposes, be the directors of the company of the borrower and such directors or, as the case may be, the administrators appointed under this section, shall alone be entitled to exercise all the powers of the directors or, as the case may be, of the persons exercising powers of superintendence, direction and control, of the business of the borrower whether such powers are derived from the memorandum or articles of association of the company of the borrower or from any other source whatsoever.

- (3) Where the management of the business of a borrower, being a company as defined in the Companies Act, 1956, is taken over by the secured creditor, then, notwithstanding anything contained in the said Act or in the memorandum or articles of association of such borrower,--
 - (a) it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company;
 - (b) no resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;
 - (c) no proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court, except with the consent of the secured creditor.
- (4) Where the management of the business of a borrower had been taken over by the secured creditor, the secured creditor shall, on realisation of his debt in full, restore the management of the business of the borrower to him.

No compensation to directors for loss of office [Section 16]

- (1) Notwithstanding anything to the contrary contained in any contract or in any other law for the time being in force, no managing director or any other director or a manager or any person in charge of management of the business of the borrower shall be entitled to any compensation for the loss of office or for the premature termination under this Act of any contract of management entered into by him with the borrower.
- (2) Nothing contained in sub-section (1) shall affect the right of any such managing director or any other director or manager or any such person in charge of management to recover from the business of the borrower, moneys recoverable otherwise than by way of such compensation.

Right to appeal [Section 17]

- (1) Any person (including borrower), aggrieved by any of the measures referred to in sub-section (4) of section 13 taken by the secured creditor or his authorised officer under this Chapter, may make an application alongwith such fee, as may be prescribed to the Debts Recovery Tribunal having jurisdiction in the matter within forty-five days from the date on which such measure had been taken:

Provided that different fees may be prescribed for making the application by the borrower and the person other than the borrower.

Explanation. - For the removal of doubts, it is hereby declared that the communication of the reasons to the borrower by the secured creditor for not having accepted his representation or objection or the likely action of the secured creditor at the stage of communication of reasons to the borrower shall not entitle the person (including borrower) to make an application to the Debts Recovery Tribunal under this sub-section.

- (2) The Debts Recovery Tribunal shall consider whether any of the measures referred to in sub-section (4) of section 13 taken by the secured creditor for enforcement of security are in accordance with the provisions of this Act and the rules made thereunder.
- (3) If, the Debts Recovery Tribunal, after examining the facts and circumstances of the case and evidence produced by the parties, comes to the conclusion that any of the measures referred to in sub-section(4) of section 13, taken by the secured creditor are not in accordance with the provisions of this Act and the rules made thereunder, and require restoration of the management of the business to the borrower or restoration of possession of the secured assets to the borrower, it may by order, declare the recourse to any one or more measures referred to in sub-section (4) of section 13 taken by the creditors assets as invalid and restore the possession of the secured assets to the borrower or restore the management of the business to the borrower, as the case



may be, and pass such order as it may consider appropriate and necessary in relation to any of the recourse taken by the secured creditor under sub-section (4) of section 13.

- (4) If, the Debts Recovery Tribunal declares the recourse taken by a secured creditor under sub-section (4) of section 13, is in accordance with the provisions of this Act and the rules made thereunder, then, notwithstanding anything contained in any other law for the time being in force, the secured creditor shall be entitled to take recourse to one or more of the measures specified under sub-section (4) of section 13 to recover his secured debt.
- (5) Any application made under sub-section (1) shall be dealt with by the Debts Recovery Tribunal as expeditiously as possible and disposed of within sixty days from the date of such application:
Provided that the Debts Recovery Tribunal may, from time to time, extend the said period for reasons to be recorded in writing, so, however, that the total period of pendency of the application with the Debts Recovery Tribunal, shall not exceed four months from the date of making of such application made under sub-section (1).
- (6) If the application is not disposed of by the Debts Recovery Tribunal within the period of four months as specified in sub-section (5), any part to the application may make an application, in such form as may be prescribed, to the Appellate Tribunal for directing the Debts Recovery Tribunal for expeditious disposal of the application pending before the Debts Recovery Tribunal and the Appellate Tribunal may, on such application, make an order for expeditious disposal of the pending application by the Debts Recovery Tribunal.
- (7) Save as otherwise provided in this Act, the Debts Recovery Tribunal shall, as far as may be, dispose of the application in accordance with the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and the rules made thereunder.

Making of application to Court of District Judge in certain cases [Section 17A]

In the case of a borrower residing in the State of Jammu and Kashmir, the application under section 17 shall be made to the Court of District Judge in that State having jurisdiction over the borrower which shall pass an order on such application.

Explanation.- For the removal of doubts, it is hereby declared that the communication of the reasons to the borrower by the secured creditor for not having accepted his representation or objection or the likely action of the secured creditor at the stage of communication of reasons shall not entitle the person (including borrower) to make an application to the Court of District Judge under this section.

Appeal to Appellate Tribunal [Section 18]

- (1) Any person aggrieved, by any order made by the Debts Recovery Tribunal under section 17, may prefer an appeal alongwith such fee, as may be prescribed to the Appellate Tribunal within thirty days from the date of receipt of the order of Debts Recovery Tribunal:
Provided that different fees may be prescribed for filing an appeal by the borrower or by the person other than the borrower:
Provided further that no appeal shall be entertained unless the borrower has deposited with the Appellate Tribunal fifty per cent. of the amount of debt due from him, as claimed by the secured creditors or determined by the Debts Recovery Tribunal, whichever is less:
Provided also that the Appellate Tribunal may, for the reasons to be recorded in writing, reduce the amount to not less than twenty-five per cent of debt referred to in the second proviso.
- (2) Save as otherwise provided in this Act, the Appellate Tribunal shall, as far as may be, dispose of the appeal in accordance with the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and rules made thereunder.

Validation of fees levied [Section 18A]

Any fee levied and collected for preferring, before the commencement of the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2004, an appeal to the Debts Recovery Tribunal or the Appellate Tribunal under this Act, shall be deemed always to have been levied and collected in accordance with law as if amendments made to sections 17 and 18 of this Act by sections 11 and 12 of the said Act were in force at all material times.

Appeal to High Court in certain cases [Section 18B]

Any borrower residing in the State of Jammu and Kashmir and aggrieved by any order made by the Court of District Judge under section 17A may prefer an appeal, to the High Court having jurisdiction over such Court, within thirty days from the date of receipt of the order of the Court of District Judge:

Provided that no appeal shall be preferred unless the borrower has deposited, with the Jammu and Kashmir High Court, fifty per cent of the amount of the debt due from him as claimed by the secured creditor or determined by the Court of District Judge, whichever is less:

Provided further that the High Court may, for the reasons to be recorded in writing, reduce the amount to not less than twenty-five per cent of the debt referred to in the first proviso.

Right of borrower to receive compensation and costs in certain cases [Section 19]

If the Debts Recovery Tribunal or the Court of District Judge, on an application made under section 17 or section 17A or the Appellate Tribunal or the High Court on an appeal preferred under section 18 or section 18A, holds that the possession of secured assets by the secured creditor is not in accordance with the provisions of this Act and rules made thereunder and directs the secured creditors to return such secured assets to the concerned borrowers, such borrower shall be entitled to the payment of such compensation and costs as may be determined by such Tribunal or Court of District Judge or Appellate Tribunal or the High Court referred to in section 18B.

CENTRAL REGISTRY

Central Registry [Section 20]

- (1) The Central Government may, by notification, set-up or cause to be set-up from such date as it may specify in such notification, a registry to be known as the Central Registry with its own seal for the purposes of registration of transaction of securitisation and reconstruction of financial assets and creation of security interest under this Act.
- (1) The head office of the Central Registry shall be at such place as the Central Government may specify and for the purpose of facilitating registration of transactions referred to in sub-section (1), there may be established at such other places as the Central Government may think fit, branch offices of the Central Registry.
- (3) The Central Government may, by notification, define the territorial limits within which an office of the Central Registry may exercise its functions.
- (4) The provisions of this Act pertaining to the Central Registry shall be in addition to and not in derogation of any of the provisions contained in the Registration Act, 1908, the Companies Act, 1956, the Merchant Shipping Act, 1958, the Patents Act, 1970, the Motor Vehicles Act, 1988 and the Designs Act, 2000 or any other law requiring registration of charges and shall not affect the priority of charges or validity thereof under those Acts or laws.

Central Registrar [Section 21]

- (1) The Central Government may, by notification, appoint a person for the purpose of registration of transactions relating to securitisation, reconstruction of financial assets and security interest created over properties, to be known as the Central Registrar.



- (2) The Central Government may appoint such other officers with such designations as it thinks fit for the purpose of discharging, under the superintendence and direction of the Central Registrar, such functions of the Central Registrar under this Act as he may, from time to time, authorise them to discharge.

Register of securitisation, reconstruction and security interest transactions [Section 22]

- (1) For the purposes of this Act, a record called the Central Register shall be kept at the head office of the Central Registry for entering the particulars of the transactions relating to--
 - (a) securitisation of financial assets;
 - (b) reconstruction of financial assets; and
 - (c) creation of security interest.
- (2) Notwithstanding anything contained in sub-section (1), it shall be lawful for the Central Registrar to keep the records wholly or partly in computer, floppies, diskettes or in any other electronic form subject to such safeguards as may be prescribed.
- (3) Where such register is maintained wholly or partly in computer, floppies, diskettes or in any other electronic form, under sub-section (2), any reference in this Act to entry in the Central Register shall be construed as a reference to any entry as maintained in computer or in any other electronic form.
- (4) The register shall be kept under the control and management of the Central Registrar.

Filing of transactions of securitisation, reconstruction and creation of security interest [Section 23]

The particulars of every transaction of securitisation, asset reconstruction or creation of security interest shall be filed, with the Central Registrar in the manner and on payment of such fee as may be prescribed, within thirty days after the date of such transaction or creation of security, by the securitisation company or reconstruction company or the secured creditor, as the case may be:

Provided that the Central Registrar may allow the filing of the particulars of such transaction or creation of security interest within thirty days next following the expiry of the said period of thirty days on payment of such additional fee not exceeding ten times the amount of such fee.

Modification of security interest registered under this Act [Section 24]

Whenever the terms or conditions, or the extent or operation, of any security interest registered under this Chapter, are, or is, modified, it shall be the duty of the securitisation company or the reconstruction company or the secured creditor, as the case may be, to send to the Central Registrar, the particulars of such modification, and the provisions of this Chapter as to registration of a security interest shall apply to such modification of such security interest.

Securitisation company or reconstruction company or secured creditor to report satisfaction of security interest [Section 25]

- (1) The securitisation company or reconstruction company or the secured creditor, as the case may be, shall give intimation to the Central Registrar of the payment or satisfaction in full, of any security interest relating to the securitisation company or the reconstruction company or the secured creditor and requiring registration under this Chapter, within thirty days from the date of such payment or satisfaction.
- (1A) On receipt of intimation under sub-section (1), the Central Registrar shall order that a memorandum of satisfaction shall be entered in the Central Register.
- (2) If the concerned borrower gives an intimation to the Central Registrar for not recording the payment or satisfaction referred to in sub-section (1), the Central Registrar shall on receipt of such intimation cause a notice to be sent to the securitisation company or reconstruction company

or the secured creditor calling upon it to show cause within a time not exceeding fourteen days specified in such notice, as to why payment or satisfaction should not be recorded as intimated to the Central Registrar.

- (3) If no cause is shown, the Central Registrar shall order that a memorandum of satisfaction shall be entered in the Central Register.
- (4) If cause is shown, the Central Registrar shall record a note to that effect in the Central Register, and shall inform the borrower that he has done so.

Right to inspect particulars of securitisation, reconstruction and security interest transactions [Section 26]

- (1) The particulars of securitisation or reconstruction or security interest entered in the Central Register of such transactions kept under section 22 shall be open during the business hours for inspection by any person on payment of such fee as may be prescribed.
- (2) The Central Register, referred to in sub-section (1) maintained in electronic form, shall also be open during the business hours for the inspection of any person through electronic media on payment of such fee as may be prescribed.

OFFENCES AND PENALTIES

Penalties [Section 27]

If a default is made--

- a. in filing under section 23, the particulars of every transaction of any securitisation or asset reconstruction or security interest created by a securitisation company or reconstruction company or secured creditor; or
- b. in sending under section 24, the particulars of the modification referred to in that section; or
- c. in giving intimation under section 25,

every company and every officer of the company or the secured creditor and every officer of the secured creditor who is in default shall be punishable with fine which may extend to five thousand rupees for every day during which the default continues.

Penalties for non-compliance of direction of Reserve Bank [Section 28]

If any securitisation company or reconstruction company fails to comply with any direction issued by the Reserve Bank under section 12 or section 12A, such company and every officer of the company who is in default, shall be punishable with fine which may extend to five lakh rupees and in the case of a continuing offence, with an additional fine which may extend to ten thousand rupees for every day during which the default continues.

Offences [Section 29]

If any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules made there under, he shall be punishable with imprisonment for a term which may extend to one year, or with fine, or with both.

Cognizance of offence [Section 30]

No court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the First Class shall try an offence punishable under this Act.

MISCELLANEOUS

Provisions of this Act not to apply in certain cases [Section 31]

The provisions of this Act shall not apply to--



- (a) a lien on any goods, money or security given by or under the Indian Contract Act, 1872; or the Sale of Goods Act, 1930 or any other law for the time being in force;
- (b) a pledge of movables within the meaning of section 172 of the Indian Contract Act, 1872;
- (c) creation of any security in any aircraft as defined in clause (1) of section 2 of the Aircraft Act, 1934;
- (d) creation of security interest in any vessel as defined in clause (55) of section 3 of the Merchant Shipping Act, 1958;
- (e) any conditional sale, hire-purchase or lease or any other contract in which no security interest has been created;
- (f) any rights of unpaid seller under section 47 of the Sale of Goods Act, 1930;
- (g) any properties not liable to attachment (excluding the properties specifically charged with the debt recoverable under this Act) or sale under the first proviso to sub-section (1) of section 60 of the Code of Civil Procedure, 1908;
- (h) any security interest for securing repayment of any financial asset not exceeding one lakh rupees;
- (i) any security interest created in agricultural land;
- (j) any case in which the amount due is less than twenty per cent of the principal amount and interest thereon.

Protection of action taken in good faith [Section 32]

No suit, prosecution or other legal proceedings shall lie against any secured creditor or any of his officers or manager exercising any of the rights of the secured creditor or borrower for anything done or omitted to be done in good faith under this Act.

Offences by companies [Section 33]

- (1) Where an offence under this Act has been committed by a company, every person who at the time the offence was committed was in charge of, and was responsible to, the company, for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

- (2) Notwithstanding anything contained in sub-section (1), where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Explanation.— For the purposes of this section,—

- (a) “company” means any body corporate and includes a firm or other association of individuals; and
- (b) “director”, in relation to a firm, means a partner in the firm.

Civil Court not to have jurisdiction [Section 34]

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which a Debts Recovery Tribunal or the Appellate Tribunal is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be

taken in pursuance of any power conferred by or under this Act or under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993.

The provisions of this Act to override other laws [Section 35]

The provisions of this Act shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.

Limitation [Section 36]

No secured creditor shall be entitled to take all or any of the measures under sub-section (4) of section 13, unless his claim in respect of financial asset is made within the period of limitation prescribed under the Limitation Act, 1963.

Application of other laws not barred [Section 37]

The provisions of this Act or the rules made thereunder shall be in addition to, and not in derogation of, the Companies Act, 1956, the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 or any other law for the time being in force.

Power of Central Government to make rules [Section 38]

- (1) The Central Government may, by notification and in the Electronic Gazette as defined in clause (s) of section 2 of the Information Technology Act, 2000, make rules for carrying out the provisions of this Act.
- (2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:--
 - (a) the form and manner in which an application may be filed under sub-section (10) of section 13;
 - (b) the manner in which the rights of a secured creditor may be exercised by one or more of his officers under sub-section (12) of section 13;
 - (ba) the fee for making an application to the Debts Recovery Tribunal under sub-section (1) of section 17;
 - (bb) the form of making an application to the Appellate Tribunal under sub-section (6) of section 17;
 - (bc) the fee for preferring an appeal to the Appellate Tribunal under sub-section (1) of section 18;
 - (c) the safeguards subject to which the records may be kept under sub-section (2) of section 22;
 - (d) the manner in which the particulars of every transaction of securitisation shall be filed under section 23 and fee for filing such transaction;
 - (e) the fee for inspecting the particulars of transactions kept under section 22 and entered in the Central Register under sub-section (1) of section 26;
 - (f) the fee for inspecting the Central Register maintained in electronic form under sub-section (2) of section 26;
 - (g) any other matter which is required to be, or may be, prescribed, in respect of which provision is to be, or may be, made by rules.
- (3) Every rule made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately



following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

Certain provisions of this Act to apply after Central Registry is set up or caused to be set up [Section 39]

The provisions of sub-sections (2), (3) and (4) of section 20 and sections 21, 22, 23, 24, 25, 26 and 27 shall apply after the Central Registry is set up or caused to be set up under sub-section (1) of section 20.

Power to remove difficulties [Section 40]

- (1) If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order published in Official Gazette, make such provisions not inconsistent with the provisions of this Act as may appear to be necessary for removing the difficulty:

Provided that no order shall be made under this section after the expiry of a period two years from the commencement of this Act.

- (2) Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

Amendments of certain enactments [Section 41]

The enactments specified in the Schedule shall be amended in the manner specified therein.

Repeal and saving [Section 42]

- (1) The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Second) Ordinance, 2002, is hereby repealed.
- (2) Notwithstanding such repeal, any thing done or any action taken under the said Act shall be deemed to have been done or taken under the corresponding provisions of this Act.

5.3 THE PREVENTION OF MONEY LAUNDERING ACT, 2002

Money laundering poses a serious threat not only to the financial sector of country but also pose a serious threat to its integrity and sovereignty of the country. It may be a proxy war of the anti-national elements including alien enemies to sabotage the financial sector of the country if not tackled properly. It is the process by which criminals conceal the origin and ownership of the proceeds of crime, by legitimizing illegally obtained money, by channeling surreptitiously through legitimate business channels and integrating those to financial system in a variety of ways like bank deposits, investments or through transfer from one place or person to another.

To achieve the objective of preventing laundering of money and other associate activities a comprehensive legislation was needed. Accordingly the Prevention Money Laundering Bill 1998 was introduced in the Parliament which was further referred to the Standing Committee on Finance which presented its report on 4th March 1999 to the Lok Sabha. The Central Government broadly accepted the recommendations of the Standing Committee and incorporated them in the said bill along with other desired changes. The Bill was passed by both the Houses of Parliament and received the assent of the President on 17th January 2003 and came to be known as **the Prevention of Money Laundering Act 2002(15th of 2003)(PMLA)**.

The act of money laundering has been criminalized in India through the enactment of the Prevention of Money Laundering Act, 2002. Persons and entities who indulge in or assist in the process or activity connected with the proceeds of scheduled crime as defined under the said Act and in projecting it as untainted property are guilty of the said offence of money laundering under **Section 3** of the Act. With money laundering becoming an international/global menace rocking the economic and financial edifice of various countries, India has become a member of Financial Action Task Force(FATF) in 2010.

The Act contains **75 sections** spread over **10 chapters** and **one schedule**. The Act was last amended vide **the Prevention of Money-laundering (Amendment) Act,2009** and another bill titled **"The Prevention of Money Laundering(Amendment) Bill 2011"** is lying pending in the Parliament [Note: the Prevention of Money Laundering(Amendment) Bill 2011 was introduced in the Lok Sabha 28th November 2012. The Act is yet to be notified by the Central Government]. The Amendment Act when passed and notified would widen the coverage of the law and makes it more stringent and bring it in line with the similar legislation of other countries. The bill extends the meaning of Money Laundering Act to include activities such as concealment and possession of proceeds of crime. The Amendment Bill(2011) also put onus on the banks, Financial Institutions, Intermediaries or person carrying on a specified business to report such instances by introducing the concept of a "Reporting Entity". Currently under PMLA fine upto five lakh can be imposed, the proposed amendment bill proposes to do away with the limit.

EXTENT AND COMMENCEMENT

Date of enforcement of the Act: 1st July 2005

Coverage: The Act extends to whole of India.

CONCEPTS AND DEFINITIONS

Section 2 of the Prevention of Money Laundering Act, 2002 defines various terms.

(1) In this Act unless the context otherwise requires,-

- (a) **"Adjudicating Authority"** means an Adjudicating Authority appointed under sub-section (1) of section 6;
- (b) **"Appellate Tribunal"** means the Appellate Tribunal established under **section 25**;
- (c) **"Assistant Director"** means an Assistant Director appointed under sub-section (1) of **section 49**;



- (d) **“Attachment”** means prohibition of transfer, conversion, disposition or movement of property by an order issued under Chapter III;
- [(da) **“Authorised person”** means an authorised person as defined in clause (c) of **section 2 of the Foreign Exchange Management Act, 1999;**]
- (e) **“Banking company”** means a banking company or a co-operative bank to which **the Banking Regulation Act, 1949** applies and includes any bank or banking institution referred to in **section 51** of that Act;
- (f) **“Bench”** means a Bench of the Appellate Tribunal;
- (g) **“Chairperson”** means Chairperson of the Appellate Tribunal;
- (h) **“Chit fund company”** means a company managing, conducting or supervising, as foreman, agent or in any other capacity, chits as defined in **section 2 of the Chit Funds Act, 1982;**
- (i) **“Co-operative bank”** shall have the same meaning as assigned to it in clause (dd) of **section 2** of the Deposit Insurance and Credit Guarantee Corporation Act, 1961;
- (j) **“Deputy Director”** means a Deputy Director appointed under sub-section (1) of section 49;
- [(ja) **“Designated business or profession”** means carrying on activities for playing games of chance for cash or kind, and includes such activities associated with casino or such other activities as the Central Government may, by notification, so designate, from time to time;]
- (k) **“Director”** or **“Additional Director”** or **“Joint Director”** means a Director or Additional Director or Joint Director, as the case may be, appointed under sub-section (1) of section 49;
- (l) **“Financial institution”** means a financial institution as defined in clause (C) of section 45-I of the Reserve Bank of India Act, 1934 and includes a chit fund company, a co-operative bank, a housing finance institution, [an authorized person, a payment system operator and a non-banking financial company];
- (m) **“Housing finance institution”** shall have the meaning as assigned to it in clause (d) of section 2 of the National Housing Bank Act, 1987;
- (n) **“Intermediary”** means a stock-broker, sub-broker, share transfer agent, banker to an issue, trustee to a trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and any other intermediary associated with securities market and registered under section 12 of the Securities and Exchange Board of India Act, 1992;
- (o) **“Member”** means a Member of the Appellate Tribunal and includes the Chairperson;
- (p) “money-laundering” has the meaning assigned to it in section 3;
- (q) **“Non-banking financial company”** shall have the same meaning as assigned to it in clause (f) of section 45-I of the Reserve Bank of India Act, 1934 [and includes a person carrying on designated business or profession]
- (r) **“Notification”** means a notification published in the Official Gazette;
- [(ra) **“Offence of cross border implications”,** means –
 - (i) any conduct by a person at a place outside India which constitutes an offence at that place and which would have constituted an offence specified in Part A, Part B or Part C of the Schedule, had it been committed in India and if such person remits the proceeds of such conduct or part thereof to India; or
 - (ii) any offence specified in Part A, Part B or Part C of the Schedule which has been committed in India and the proceeds of crime, or part thereof have been transferred to a place outside India or any attempt has been made to transfer the proceeds of crime, or part thereof from India to a place outside India.

Explanation:- Nothing contained in this clause shall adversely affect any investigation, enquiry, trial or proceeding before any authority in respect of the offences specified in Part A or Part B of the Schedule to the Act before the commencement of the Prevention of Money – Laundering (Amendment) Act 2009;

- (rb) **“Payment system”** means a system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them.

Explanation- For the purpose of this clause, “payment system” includes the systems enabling credit card operations, debit card operations, smart card operations, money transfer operations or similar operations;

- (rc) **“Payment system operator”** means a person who operates a payment system and such person includes his overseas principal.

Explanation- For the purpose of this clause, “overseas principal” means, -

- (A) In the case of a person, being an individual, such individual residing outside India, who owns or controls or manages, directly or indirectly, the activities or functions of payment system in India;
- (B) In the case of a Hindu undivided family, Karta of such Hindu undivided family residing outside India who owns or controls or manages, directly or indirectly, the activities or functions of payment system in India;
- (C) In the case of a company, a firm, an association of persons, a body of individuals, an artificial juridical person, whether incorporated or not, such company, firm, association of persons, body of individuals, artificial juridical person incorporated or registered outside India or existing as such and which owns or controls or manages, directly or indirectly, the activities or functions of payment system in India;]

- (s) **“Person”** includes;-

- (i) an individual
- (ii) a Hindu undivided family,
- (iii) a company,
- (iv) firm,
- (v) an association of persons or a body of individuals whether incorporated or not,
- (vi) every artificial juridical person not falling within any of the preceding sub-clauses, and
- (vii) any agency, office or branch owned or controlled by any of the above persons mentioned in the preceding sub-clauses;

- (t) **“Prescribed”** means prescribed by rules made under this Act;

- (u) **“Proceeds of crime”** means any property derived or obtained, directly or indirectly, by any person as a result of criminal activity relating to a scheduled offence or the value of any such property;

- (v) **“Property”** means any property or assets of every description, whether corporeal or incorporeal, movable or immovable, tangible or intangible and includes deeds and instruments evidencing title to, or interest in, such property or assets, wherever located;

- (w) **“Records”** include the records maintained in the form of books or stored in a computer or such other form as may be prescribed;

- (x) **“Schedule”** means the Schedule to this Act;



- (y) **“Scheduled offence”** means -
 - (i) the offences specified under Part A of the Schedule; or
 - [(ii) the offences specified under Part B of the Schedule if the total value involved in such offences is thirty lakh rupees or more; or
 - (iii) the offences specified under Part C of the Schedule.]
 - (z) **“Special Court”** means a Court of Session designated as Special Court under sub-section (1) of section 43;
 - (za) **“Transfer”** includes sale, purchase, mortgage, pledge, gift, loan or any other form of transfer of right, title, possession or lien.
 - (zb) **“Value”** means the fair market value of any property on the date of its acquisition by any person, or if such date cannot be determined, the date on which such property is possessed by such person.
- (2) Any reference, in this Act or the Schedule, to any enactment or any provision thereof shall, in relation to an area in which such enactment or such provision is not in force, be construed as a reference to the corresponding law or the relevant provisions of the corresponding law, if any, in force in that area.

6.2.1 What is Money Laundering?

Money Laundering is the generic term used to describe the process by which criminals disguise the original ownership and control of the proceeds of criminal conduct by making such process appear to have derived from the legitimate source. The term money laundering has not been defined in the Act any where, however, **Section 2** of the Act which defines various terms and expressions used in the Act in sub section (p) refer the meaning of money laundering to **section 3** of the Act.

Section 3 of the Act says “Whosoever **directly or indirectly attempts to indulge or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money laundering**”. So we can say that activity or process by which tainted money of crime is projected as untainted property is money laundering. It is not necessary that the person should be directly involved in the process of legitimating the tainted money but also all those persons who assisted or were party to it or attempts to do will be guilty of money laundering activity.

PUNISHMENT FOR MONEY LAUNDERING:

Section 4 of the Act provide punishing of rigorous imprisonment ranging from 3 years to seven years and fine which may extend to ₹ 5 lakh for indulging in money laundering activity or process.

Where the proceeds of crime involved in money laundering relates to any offence specified under paragraph 2 of Part A of the schedule the maximum imprisonment can extend to 10 years instead of 7 years. Under paragraph 2 of Part A of the Schedule to the Act certain offences under various sections of the Narcotic Drugs Psychotropic Substances Act (NDPS), 1985 have been included for which maximum imprisonment extend to 10 years. These offences includes contravention in relation to poppy straw(sec 15 of NDPS Act,1985,contravention in relation to coco plant and coca leaves(sec 16 of NDPS),contravention in relation to prepared opium(sec 17 of NDPS), contravention in relation to opium poppy and opium etc.

In order to prevent the process of money laundering activities Director or any other officer not below the rank of Deputy Director appointed under **section 49** of the Act has power to order in writing to attach property provisionally for a period not exceeding 150 days from the date of order where he has reasons to believe that on the basis of material in his possession, that –

- (a) Any person is in possession of any proceeds of crime

- (b) Such person has been charged of having committed a scheduled offence and
- (c) Such proceeds of crime are likely to be concealed, transferred or dealt with in any manner which may result in frustrating any proceedings relating to confiscation of such proceed.

No such order of attachment can be made unless in relation to the scheduled offence a report has been forwarded to a Magistrate under section 173 of the Code of Criminal Procedure 1973 or a complaint has been filed by a person, authorized to investigate the offence mentioned in the schedule, before a magistrate or court for taking cognizance of the scheduled offence as may be.

Despite attachment of the property the person interested in the property in the enjoyment of the immovable property attached under this Act. Interested person in relation to any immovable property includes all persons claiming or entitled to claim any interest in the property.

The officer attaching the property is required to file a complaint stating the fact of attachment of such property before the Adjudicating Authority within a period of 30 days from the date of such attachment.

In order to adjudicate the case of money laundering the Central Government shall by notification appoint an Adjudicating Authority to exercise jurisdiction powers and authority conferred by or under the Act. The Adjudicating Authority consists of a Chairman and two other members.

On receipt of complaint of attachment of the property of the proceeds of money laundering if the Adjudicating Authority has reasons to believe that any person has committed an offence under section 3 of the Act or is in possession of proceeds of crime, he may serve a notice of not less than 30 days on such person calling upon him to indicate the source of his income, earnings or assets out of which or by means of which he has acquired the property attached or seized under this Act., the evidence on which he relies and other relevant information and particulars and to show causes why all or any of such properties should not be declared to be the properties involved in money laundering and confiscated by the Central Government.

Where an order of confiscation has been made by the Adjudicating Authority in respect of any property of a person, all the rights and title in such property vests absolutely in the Central Government free from all encumbrances **(sec 9)**

Where the Adjudicating Authority is of the opinion that any encumbrance on the property or lease hold interest has been created with view to defeat the provisions of this Act, it may be order declare such encumbrances or lease hold interest to be void and thereupon the said property vest in the Central Government free from such encumbrances or lease hold interest.

Despite attachment of such property and vesting of its title with the Central Government, it does not discharge any person from any liability in respect of such encumbrances which may be enforced against such person by a suit of damages.

In order to manage the confiscated property the Central Government may by order published in the official gazette appoint as many of its officers not below the rank of Joint Secretary to the Government of India to perform the function of an Administrator.

The Administrator appointed by the Central Government is required to receive and manage the property in accordance with the rules made under this Act. He is also required to take such measures as the Central Government may direct to dispose of the property vested in the Central Government.

OBLIGATIONS OF BANKING COMPANIES, FINANCIAL INSTITUTIONS AND INTERMEDIARIES

Section 12 of the Act cast a duty upon every banking company, financial institution and intermediary to –

- (a) Maintain a record of all transaction, the nature and value of which may be prescribed whether such transactions comprise of a single transaction or a series of transactions integrally connected to each other and where such series of transactions take place within a month. Such record



should be maintained for a period of ten years from the date of transaction between the clients and the banking company or financial institution or intermediary as the case may be

- (b) Furnish information of transactions referred to in clause (a) to the Director within such time as may be prescribed.
- (c) Verify and maintain the records of the identity of all its clients in such a manner as may be prescribed.

Such record should be maintained for a period of ten years from the date of cessation of transaction between the clients and the banking company or financial institution or intermediary as the case may be.

Where the Principal officer of a banking company or a financial institution or intermediary as the case may be has reasons to believe that a single transaction or series of transactions integrally connected to each other have been valued below the prescribed value so as to defeat the provisions of this section, such officer shall furnish information in respect of such transactions to the Director within the prescribed time.

Powers of Director to impose fine (Sec 13)

- (1) The Director may, either of his own motion or on an application made by any authority, officer or person, call for records referred to in sub-section (1) of section 12 and may make such inquiry or cause such inquiry to be made, as he thinks fit.
- (2) If the Director, in the course of any inquiry, finds that a banking company, financial institution or an intermediary or any of its officers has failed to comply with the provisions contained in section 12, then, without prejudice to any other action that may be taken under any other provisions of this Act, he may, by an order, levy a fine on such banking company or financial institution or intermediary which shall not be less than ten thousand rupees but may extend to one lakh rupees for each failure .
- (3) The Director shall forward a copy of the order passed under sub-section (2) to every banking company, financial institution or intermediary or person who is a party to the proceedings under that sub-section.

***Section 73(2) (clause)** of the Act empowers the Central Government to make rules for carrying out the provisions of this Act. In pursuance of this power, the Central Government vide *GSR 444(E) dated 1st July 2005* notified the "The Prevention of Money Laundering(Maintenance of Records) Rules 2005 the prescribed value of transaction and nature of transaction required to be maintained by a Banking company, Financial Institution or Financial Intermediary are specified in rule 3 of the aforesaid rules. The value of all cash transactions is ₹10 lakh or its equivalent in foreign currency. In addition to all cash transactions records of all series of cash transactions integrally connected to each other which have been valued below ₹10 lakh or its equivalent in foreign currency where such series of transactions have taken place within a month are also required to be maintained **[Rule 3(b)]**

These records are to be maintained in the manner prescribed in **Rule 4** of the aforesaid Rules which includes information on—

- (a) Nature of the transactions;
- (b) The amount of the transaction and the currency in which it was denominated;
- (c) The date on which the transaction was conducted; and
- (d) The parties to the transaction.

The procedure and manner of maintaining the information are provided in **Rule 5**.

The information and records relating to such transactions are required to be maintained for a period of ten years from the date of transactions between the client and the banking company, financial institution or intermediary.

Every Banking Company, Financial Institution, Intermediary is required to communicate the name, designation and address of the Principal Officer to the Director.

It is the duty of every banking company, financial institution and intermediary to observe the procedure and the manner of furnishing the information. .

Furnishing of information to the director

S. No	Officer concerned	Institutions	Nature of transactions	When to report	Report to whom	Due date
1	Principal officer	Banking company, a financial institution, an intermediary	Referred to in clause (A),(B) and (BA) of sub-rule (1) of rule 3	Every month	Director	By 15th day of the succeeding month
2	Principal officer	Banking company, a financial institution, an intermediary	Referred to in clause (C) of sub-rule (1) of rule 3	Date of occurrence of such transaction	Director (in writing or by fax or by electronic mail)	Not later than seven working days from date of occurrence
3	Principal officer	Banking company, a financial institution, an intermediary	Referred to in clause (D) of sub-rule (1) of rule 3	On being satisfied that the transaction is suspicious	Director (in writing or by fax or by electronic mail)	Not later than seven working days on being satisfied of suspicion

As per **Rule 9**, every banking company, financial institution is required to verify the identity of clients and obtain information on the purpose and intended nature of business relationship, and in all other cases, verify identity while carrying out –

- i. transactions of amount equal to or exceeding rupees fifty thousand, whether conducted as a single transaction or several transactions that appear to be connected, **or**
- ii. any international money transfer operations.

As per **Rule 10**, every banking company, or financial institution or intermediary is required to maintain a record of identity of its clients in both hard and soft copies.

The record of identity of the client is required to be maintained for a time period of 10 years counting from the date of ceases of the transaction between the client and the banking company or financial institution or intermediary.

Financial institutions like banks, insurance companies, stock markets, etc are most vulnerable to money laundering activities of criminals and other anti social elements and therefore the need to insulate these institutions from the effect of laundered money. This is intended to be achieved by implementation of Know Your Customers (KYC) policy, and Customer Due Diligence guidelines across the financial sector. KYC instructions have been issued by the RBI to all the Banking companies, Financial Institutions and Intermediary to verify the identity of the clients and track the suspicious movement of illegitimate funds

The objective of KYC and CDD guidelines is to enable the managers to examine and assess their customer's financial dealings from anti-money laundering perspective, so as to make a proper risk assessment for preventing the tainted money from entering the institution and report the suspicious transaction immediately.

Formulation of KYC and CDD Guidelines and procedures specifying the objective of KYC framework by regulators like the RBI, the SEBI and IRDA are designed for appropriate customer identification, and



to monitor transactions of suspicious nature. Risk Management and Monitoring Procedures have been specifically stated for having a system at ground level to exercise caution against the transaction suspected to be involving laundered money and for its identification and reporting to the FIU-IND through periodic reports.

Regulatory authorities on the basis of these guidelines and requirements under PMLA have issued instructions on KYC & CDD, to give proper effect to the said law in the financial sector. As already stated above as per the guidelines issued, financial institutions should undertake CDD measures, for establishing the identity of the customer by proper verification, particularly when initiating business relation, or carrying out occasional transaction, beyond the applicable threshold limit, or when there is a suspicion of money laundering or terrorist financing, or there is a doubt about the veracity or adequacy of previously obtained customer identification data.

Compliance with these standards of KYC and CDD by the financial institutions has been made mandatory through instructions issued by concerned regulators. These guidelines are essentially in the nature of filters having been introduced, and being operated at all the important entry points to the economy like bank, insurance, stock market. Penal provisions have been made in the Act in case the Banks and Financial Institutions fail to maintain proper record of the client and send required information to the Regulating Agency.

As the offence of money laundering is a serious offence threatening not only the financial health of the country but also its integrity and unity, the Central Government has been mandated vide **section 43** of the Act to constitute special courts in consultation with the Chief Justice of High Court for speedy trial of money laundering cases.

In order to prevent vexatious search in the garb of preventing money laundering, any authority or officer exercising powers under this Act or any rules made there under, who without reasons recorded in writing searches or cause to be searched any building or place or detains or searches or arrests any person, shall for every such offence be liable on conviction for imprisonment for a term which may extend to two years or fine which may extend to fifty thousand rupee or both.

No Civil Proceedings against Banking Companies, financial institutions etc in certain cases (Sec 14)

Section 14 of the Prevention of Money Laundering Act, 2002 gives immunity to banking companies, financial institutions and intermediaries of securities market, etc., against civil proceedings for furnishing information. Sec 14 states,

"Save as otherwise provided in section 13, the banking companies, financial institutions, intermediaries and their officers shall not be liable to any civil proceedings against them for furnishing information under clause (b) of sub-section (1) of section 12."

BURDEN OF PROOF (SEC 24)

When a person is accused of having committed the offence under section 3, the burden of proving that proceeds of crime are untainted property shall be on the accused.

APPELLATE TRIBUNAL

Appeal to Appellate Tribunal [Sec 26]

- (1) Save as otherwise provided in sub-section (3), the Director or any person aggrieved by an order made by the Adjudicating Authority under this Act, may prefer an appeal to the Appellate Tribunal.
- (2) Any banking company, financial institution or intermediary aggrieved by any order of the Director made under sub-section (2) of section 13, may prefer an appeal to the Appellate Tribunal.
- (3) Every appeal preferred under sub-section (1) or sub-section (2) shall be filed within a period of forty-five days from the date on which a copy of the order made by the Adjudicating Authority or Director is received and it shall be in such form and be accompanied by such fee as may be

prescribed: Provided that the Appellate Tribunal may, after giving an opportunity of being heard, entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

- (4) On receipt of an appeal under sub-section (1) or sub-section (2), 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 setting aside the order appealed against.
- (5) The Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned Adjudicating Authority or the Director, as the case may be.
- (6) The appeal filed before the Appellate Tribunal under sub-section (1) or sub-section (2) shall be dealt with by it as expeditiously as possible and endeavor shall be made by it to dispose of the appeal finally within six months from the date of filing of the appeal.

Procedure and powers of Appellate Tribunal (Sec 35)

- (1) The Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 (5 of 1908), but shall be guided by the principles of natural justice and, subject to the other provisions of this Act, the Appellate Tribunal shall have powers to regulate its own procedure.
- (2) The Appellate Tribunal shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908) while trying a suit, in respect of the following matters, namely:-
 - (a) summoning and enforcing the attendance of any person and examining him on oath;
 - (b) requiring the discovery and production of documents;
 - (c) receiving evidence on affidavits;
 - (d) subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872 (1 of 1872), requisitioning any public record or document or copy of such record or document from any office;
 - (e) issuing commissions for the examination of witnesses or documents;
 - (f) reviewing its decisions;
 - (g) dismissing a representation for default or deciding it ex parte;
 - (h) setting aside any order of dismissal of any representation for default or any order passed by it ex parte; and
 - (i) any other matter, which may be, prescribed by the Central Government.
- (3) An order made by the Appellate Tribunal under this Act shall be executable by the Appellate Tribunal as a decree of civil court and, for this purpose; the Appellate Tribunal shall have all the powers of a civil court.
- (4) Notwithstanding anything contained in sub-section (3), the Appellate Tribunal may transmit any order made by it to a civil court having local jurisdiction and such civil court shall execute the order as if it were a decree made by that court.
- (5) All proceedings before the Appellate Tribunal shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code (45 of 1860) and the Appellate Tribunal shall be deemed to be a civil court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 1973 (2 of 1974).



Right of appellant to take assistance of authorized representative and of Government to appoint presenting officers. (Sec 39)

- (1) A person preferring an appeal to the Appellate Tribunal under this Act may either appear in person or take the assistance of an authorised representative of his choice to present his case before the Appellate Tribunal.

Explanation.-For the purposes of this sub-section, the expression "authorised representative" shall have the same meaning as assigned to it under sub-section (2) of section 288 of the Income-tax Act, 1961 (43 of 1961).

- (2) The Central Government or the Director may authorise one or more authorised representatives or any of its officers to act as presenting officers and every person so authorised may present the case with before the Appellate Tribunal. Members, etc., to be public servants.

Civil court not to have jurisdiction (Sec 41)

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which the Director, an Adjudicating Authority or the Appellate Tribunal is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

Appeal to High Court (Sec 42)

Any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal to him on any question of law or fact arising out of such order: Provided that the High Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Explanation.- For the purposes of this section, "High Court" means-

- (i) the High Court within the jurisdiction of which the aggrieved party ordinarily resides or carries on business or personally works for gain; and
- (ii) where the Central Government is the aggrieved party, the High Court within the jurisdiction of which the respondent, or in a case where there are more than one respondent, any of the respondents, ordinarily resides or carries on business or personally works for gain.

Special Courts(Sec 43)

- (1) The Central Government, in consultation with the Chief Justice of the High Court, shall, for trial of offence punishable under section 4, by notification, designate one or more Courts of Session as Special Court or Special Courts or such area or areas or for such case or class or group of cases as may be specified in the notification.

Explanation- In this sub-section, "High Court" means the High Court of the State in which a Session Court designated as Special Court was functioning immediately before such designation.

- (2) While trying an offence under this Act, a Special Court shall also try an offence, other than an offence referred to in sub-section (1), with which the accused may, under the Code of Criminal Procedure, 1973 (2 of 1974), be charged at the same trial.

OFFENCES TO BE COGNIZABLE AND NON-BAILABLE.(Sec 45)

- [(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), no person accused of an offence punishable for a term of imprisonment of more than three years under Part A of the Schedule shall be released on bail or on his own bond unless:-

- (i) the Public Prosecutor has been given an opportunity to oppose the application for such release; and

- (ii) where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail:

Provided that a person, who, is under the age of sixteen years, or is a woman or is sick or infirm, may be released on bail, if the Special Court so directs:

Provided further that the Special Court shall not take cognizance of any offence punishable under section 4 except upon a complaint in writing made by-

- (i) the Director; or
- (ii) any officer of the Central Government or a State Government authorised in writing in this behalf by the Central Government by a general or special order made in this behalf by that Government.

[(1A) Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), or any other provision of this Act, no police officer shall investigate into an offence under this Act unless specifically authorised, by the Central Government by a general or special order, and, subject to such conditions as may be prescribed."]

[(2) The limitation on granting of bail specified in sub-section (1) is in addition to the limitations under the Code of Criminal Procedure, 1973 (2 of 1974) or any other law for the time being in force on granting of bail.]

AUTHORITIES UNDER ACT (Sec 48)

There shall be the following classes of authorities for the purposes of this Act, namely:-

- (a) Director or Additional Director or Joint Director, (b) Deputy Director, (c) Assistant Director, and (d) such other class of officers as may be appointed for the purposes of this Act.

OFFENCES BY COMPANIES (Sec 70)

- (1) Where a person committing a contravention of any of the provisions of this Act or of any rule, direction or order made there under is a company, every person who, at the time the contravention was committed, was in charge of and was responsible to the company, for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly:

Such person shall not be liable to punishment if he proves that the contravention took place without his knowledge or that he exercised all due diligence to prevent such contravention.

- (2) Notwithstanding anything contained in sub-section (1), where a contravention of any of the provisions of this Act or of any rule, direction or order made there under has been committed by a company and it is proved that the contravention has taken place with the consent or connivance of, or is attributable to any neglect on the part of any director, manager, secretary or other officer of any company, such director, manager, secretary or other officer shall also be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

Explanation - For the purposes of this section,-

- (i) "company" means anybody corporate and includes a firm or other association of individuals; and
- (ii) "director", in relation to a firm, means a partner in the firm.

Let Us Recapitulate:

- The act of money laundering has been criminalized in India through the enactment of the Prevention of Money Laundering Act, 2002.



- Section 4 of the Act provide punishing of rigorous imprisonment ranging from 3 years to seven years and fine which may extend to ₹ 5 lakh for indulging in money laundering activity or process.
- Formulation of KYC and CDD Guidelines and procedures specifying the objective of KYC framework by regulators like the RBI, the SEBI and IRDA are designed for appropriate customer identification, and to monitor transactions of suspicious nature.
- When a person is accused of having committed the offence under section 3, the burden of proving that proceeds of crime are untainted property shall be on the accused.
- Right of appellant to take assistance of authorized representative and of Government to appoint presenting officers.
- Offences by companies are dealt in Section 70 of the Act.

5.4 THE FOREIGN EXCHANGE MANAGEMENT ACT, 1999

Short title, extent, application and commencement [Section 1]

- (1) This Act may be called The Foreign Exchange Management Act, 1999.
- (2) It extends to the whole of India.
- (3) It shall also apply to all branches, offices and agencies outside India owned or controlled by a person resident in India and also to any contravention thereunder committed outside India by any person to whom this Act applies.
- (4) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint.

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

Definitions [Section 2]

In this Act, unless the context otherwise requires,

- (a) "Adjudicating Authority" means an officer authorised under sub-section (1) of section 16;
- (b) "Appellate Tribunal" means the Appellate Tribunal for Foreign Exchange established under section 18;
- (c) "authorised person" means an authorised dealer, money changer, off-shore banking unit or any other person for the time being authorised under sub-section (1) of section 10 to deal in foreign exchange or foreign securities;
- (d) "Bench" means a Bench of the Appellate Tribunal;
- (e) "capital account transaction" means a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India, and includes transactions referred to in sub-section (3) of section 6;
- (f) "Chairperson" means the Chairperson of the Appellate Tribunal;
- (g) "chartered accountant" shall have the meaning assigned to it in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949);
- (h) "currency" includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank;
- (i) "currency notes" means and includes cash in the form of coins and bank notes;
- (j) "current account transaction" means a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes,
 - (i) payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business,
 - (ii) payments due as interest on loans and as net income from investments,
 - (iii) remittances for living expenses of parents, spouse and children residing abroad, and
 - (iv) expenses in connection with foreign travel, education and medical care of parents, spouse and children;



- (k) "Director of Enforcement" means the Director of Enforcement appointed under sub-section (1) of section 36;
- (l) "export", with its grammatical variations and cognate expressions, means,-
 - (i) the taking out of India to a place outside India any goods,
 - (ii) provision of services from India to any person outside India;
- (m) "foreign currency" means any currency other than Indian currency;
- (n) "foreign exchange" means foreign currency and includes,
 - (i) deposits, credits and balances payable in any foreign currency,
 - (ii) drafts, travellers cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency,
 - (iii) drafts, travellers cheques, letters of credit or bills of exchange drawn by banks, institutions or persons outside India, but payable in Indian currency;
- (o) "foreign security" means any security, in the form of shares, stocks, bonds, debentures or any other instrument denominated or expressed in foreign currency and includes securities expressed in foreign currency, but where redemption or any form of return such as interest or dividends is payable in Indian currency;
- (p) "import", with its grammatical variations and cognate expressions, means bringing into India any goods or services;
- (q) "Indian currency" means currency which is expressed or drawn in Indian rupees but does not include special bank notes and special one rupee notes issued under section 28-A of the Reserve Bank of India Act, 1934 (2 of 1934);
- (r) "legal practitioner" shall have the meaning assigned to it in clause (i) of sub-section (1) of section 2 of the Advocates Act, 1961 (25 of 1961);
- (s) "Member" means a Member of the Appellate Tribunal and includes the Chairperson thereof;
- (t) "notify" means to notify in the Official Gazette and the expression "notification" shall be construed accordingly;
- (u) "person" includes
 - (i) an individual,
 - (ii) a Hindu undivided family,
 - (iii) a company,
 - (iv) a firm,
 - (v) an association of persons or a body of individual, whether incorporated or not,
 - (vi) every artificial juridical person, not falling within any of the preceding sub-clauses, and
 - (vii) any agency, office or branch owned or controlled by such person;
- (v) "person resident in India" means
 - (i) a person residing in India for more than one hundred and eighty-two days during the course of the preceding financial year but does not include
 - (A) a person who has gone out of India or who stays outside India, in either case
 - (a) for or on taking up employment outside India, or

- (b) for carrying on outside India a business or vocation outside India, or
 - (c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;
- (B) a person who has come to or stays in India, in either case, otherwise than
 - (a) for or on taking up employment in India, or
 - (b) for carrying on in India a business or vocation in India, or
 - (c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;
- (ii) any person or body corporate registered or incorporated in India,
- (iii) an office, branch or agency in India owned or controlled by a person resident outside India,
- (iv) an office, branch or agency outside India owned or controlled by a person resident in India;
- (w) "person resident outside India" means a person who is not resident in India;
- (x) "prescribed" means prescribed by rules made under this Act;
- (y) "repatriate to India" means bringing into India the realised foreign exchange and
 - (i) the selling of such foreign exchange to an authorised person in India in exchange for rupees; or
 - (ii) the holding of realised amount in an account with an authorized person in India to the extent notified by the Reserve Bank,and includes use of the realised amount for discharge of a debt or liability denominated in foreign exchange and the expression "repatriation" shall be construed accordingly;
- (z) "Reserve Bank" means the Reserve Bank of India constituted under sub-section (1) of section 3 of the Reserve Bank of India Act, 1934 (2 of 1934);
- (za) "security" means shares, stocks, bonds and debentures, Government securities as defined in the Public Debt Act, 1944 (18 of 1944), savings certificates to which the Government Savings Certificates Act, 1959 (46 of 1959) applies, deposit receipts in respect of deposits of securities and units of the Unit Trust of India established under sub-section (1) of section 3 of the Unit Trust of India Act, 1963 (52 of 1963) or of any mutual fund and includes certificates of title to securities, but does not include bills of exchange or promissory notes other than Government promissory notes or any other instruments which may be notified by the Reserve Bank as security for the purposes of this Act;
- (zb) "service" means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance, medical assistance, legal assistance, chit fund, real estate, transport, processing, supply of electrical or other energy, boarding or lodging or both, entertainment, amusement or the purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal service;
- (zc) "Special Director (Appeals)" means an officer appointed under section 18;
- (zd) "specify" means to specify by regulations made under this Act and the expression "specified" shall be construed accordingly;
- (ze) "transfer" includes sale, purchase, exchange, mortgage, pledge, gift, loan or any other form of transfer of right, title, possession or lien.

Dealing in foreign exchange, etc. [Section 3]



Save as otherwise provided in this Act, rules or regulations made thereunder, or with the general or special permission of the Reserve Bank, no person shall-

- (a) deal in or transfer any foreign exchange or foreign security to any person not being an authorised person;
- (b) make any payment to or for the credit of any person resident outside India in any manner;
- (c) receive otherwise through an authorised person, any payment by order or on behalf of any person resident outside India in any manner.

Explanation.-For the purpose of this clause, where any person in, or resident in, India receives any payment by order or on behalf of any person resident outside India through any other person (including an authorised person) without a corresponding inward remittance from any place outside India, then, such person shall be deemed to have received such payment otherwise than through an authorised person;

- (d) enter into any financial transaction in India as consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person.

Explanation.-For the purpose of this clause, "financial transaction" means making any payment to, or for the credit of any person, or receiving any payment for, by order or on behalf of any person, or drawing, issuing or negotiating any bill of exchange or promissory note, or transferring any security or acknowledging any debt.

Holding of foreign exchange, etc. [Section 4]

Save as otherwise provided in this Act, no person resident in India shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India.

Current account transactions [Section 5]

Any person may sell or draw foreign exchange to or from an authorised person if such sale or drawal is a current account transaction.

Provided that the Central Government may, in public interest and in consultation with the Reserve Bank, impose such reasonable restrictions for current account transactions as may be prescribed.

Capital account transactions [Section 6]

- (1) Subject to the provisions of sub-section (2), any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction.
- (2) The Reserve Bank may, in consultation with the Central Government, specify
 - (a) any class or classes of capital account transactions which are permissible;
 - (b) the limit up to which foreign exchange shall be admissible for such transactions:

Provided that the Reserve Bank shall not impose any restriction on the drawal of foreign exchange for payments due on account of amortization of loans or for depreciation of direct investments in the ordinary course of business.

- (3) Without prejudice to the generality of the provisions of sub-section (2), the Reserve Bank may, by regulations, prohibit, restrict or regulate the following
 - (a) transfer or issue of any foreign security by a person resident in India;
 - (b) transfer or issue of any security by a person resident outside India;
 - (c) transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India;
 - (d) any borrowing or lending in foreign exchange in whatever form or by whatever name

called;

- (e) any borrowing or lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India;
- (f) deposits between persons resident in India and persons resident outside India;
- (g) export, import or holding of currency or currency notes;
- (h) transfer of immovable property outside India, other than a lease not exceeding five years, by a person resident in India;
- (i) acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;
- (j) giving of a guarantee or surety in respect of any debt, obligation or other liability incurred
 - (i) by a person resident in India and owed to a person resident outside India; or
 - (ii) by a person resident outside India.
- (4) A person resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.
- (5) A person resident outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.
- (6) Without prejudice to the provisions of this section, the Reserve Bank may, by regulation, prohibit, restrict, or regulate establishment in India of a branch, office or other place of business by a person resident outside India, for carrying on any activity relating to such branch, office or other place of business.

Export of goods and services [Section 7]

- (1) Every exporter of goods shall
 - (a) furnish to the Reserve Bank or to such other authority a declaration in such form and in such manner as may be specified, containing true and correct material particulars, including the amount representing the full export value or, if the full export value of the goods is not ascertainable at the time of export, the value which the exporter, having regard to the prevailing market conditions, expects to receive on the sale of the goods in a market outside India;
 - (b) furnish to the Reserve Bank such other information as may be required by the Reserve Bank for the purpose of ensuring the realisation of the export proceeds by such exporter.
- (2) The Reserve Bank may, for the purpose of ensuring that the full export value of the goods or such reduced value of the goods as the Reserve Bank determines, having regard to the prevailing market conditions, is received without any delay, direct any exporter to comply with such requirements as it deems fit.
- (3) Every exporter of services shall furnish to the Reserve Bank or to such other authorities a declaration in such form and in such manner as may be specified, containing the true and correct material particulars in relation to payment for such services.

Realisation and repatriation of foreign exchange [Section 8]



Save as otherwise provided in this Act, where any amount of foreign exchange is due or has accrued to any person resident in India, such person shall take all reasonable steps to realise and repatriate to India such foreign exchange within such period and in such manner as may be specified by the Reserve Bank.

Exemption from realisation and repatriation in certain cases [Section 9]

The provisions of sections 4 and 8 shall not apply to the following, namely:

- (a) possession of foreign currency or foreign coins by any person up to such limit as the Reserve Bank may specify;
- (b) foreign currency account held or operated by such person or class of persons and the limit up to which the Reserve Bank may specify;
- (c) foreign exchange acquired or received before the 8th day of July, 1947 or any income arising or accruing thereon which is held outside India by any person in pursuance of a general or special permission granted by the Reserve Bank;
- (d) foreign exchange held by a person resident in India up to such limit as the Reserve Bank may specify, if such foreign exchange was acquired by way of gift or inheritance from a person referred to in clause (c), including any income arising therefrom;
- (e) foreign exchange acquired from employment, business, trade, vocation, services, honorarium, gifts, inheritance or any other legitimate means up to such limit as the Reserve Bank may specify; and
- (f) such other receipts in foreign exchange as the Reserve Bank may specify.

Authorised Person [Section 10]

- (1) The Reserve Bank may, on an application made to it in this behalf, authorise any person to be known as authorised person to deal in foreign exchange or in foreign securities, as an authorised dealer, money changer or off-shore banking unit or in any other manner as it deems fit.
- (2) An authorisation under this section shall be in writing and shall be subject to the conditions laid down therein.
- (3) An authorisation granted under sub-section (1) may be revoked by the Reserve Bank at any time if the Reserve Bank is satisfied that
 - (a) it is in public interest so to do; or
 - (b) the authorised person has failed to comply with the condition subject to which the authorisation was granted or has contravened any of the provisions of the Act or any rule, regulation, notification, direction or order made thereunder.

Provided that no such authorisation shall be revoked on any ground referred to in clause (b) unless the authorised person has been given a reasonable opportunity of making a representation in the matter.

- (4) An authorised person shall, in all his dealings in foreign exchange or foreign security, comply with such general or special directions or orders as the Reserve Bank may, from time to time, think fit to give, and, except with the previous permission of the Reserve Bank, an authorised person shall not engage in any transaction involving any foreign exchange or foreign security which is not in conformity with the terms of his authorisation under this section.
- (5) An authorised person shall, before undertaking any transaction in foreign exchange on behalf of any person, require that person to make such declaration and to give such information as will reasonably satisfy him that the transaction will not involve, and is not designed for the purpose of any contravention or evasion of the provisions of this Act or of any rule, regulation, notification, direction or order made thereunder, and where the said person refuses to comply with any such

requirement or makes only unsatisfactory compliance therewith, the authorised person shall refuse in writing to undertake the transaction and shall, if he has reason to believe that any such contravention or evasion as aforesaid is contemplated by the person, report the matter to the Reserve Bank.

- (6) Any person, other than an authorised person, who has acquired or purchased foreign exchange for any purpose mentioned in the declaration made by him to authorised person under sub-section (5) does not use it for such purpose or does not surrender it to authorised person within the specified period or uses the foreign exchange so acquired or purchased for any other purpose for which purchase or acquisition of foreign exchange is not permissible under the provisions of the Act or the rules or regulations or direction or order made thereunder shall be deemed to have committed contravention of the provisions of the Act for the purpose of this section.

Reserve Bank's powers to issue directions to authorised person [Section 11]

- (1) The Reserve Bank may, for the purpose of securing compliance with the provisions of this Act and of any rules, regulations, notifications or directions made thereunder, give to the authorised persons any direction in regard to making of payment or the doing or desist from doing any act relating to foreign exchange or foreign security.
- (2) The Reserve Bank may, for the purpose of ensuring the compliance with the provisions of this Act or of any rule, regulation, notification, direction or order made thereunder, direct any authorised person to furnish such information, in such manner, as it deems fit.
- (3) Where any authorised person contravenes any direction given by the Reserve Bank under this Act or fails to file any return as directed by the Reserve Bank, the Reserve Bank may, after giving reasonable opportunity of being heard, impose on the authorised person a penalty which may extend to ten thousand rupees and in the case of continuing contravention with an additional penalty which may extend to two thousand rupees for every day during which such contravention continues.

Power of Reserve Bank to inspect authorised person [Section 12]

- (1) The Reserve Bank may, at any time, cause an inspection to be made, by any officer of the Reserve Bank specially authorised in writing by the Reserve Bank in this behalf, of the business of any authorised person as may appear to it to be necessary or expedient for the purpose of
 - (a) verifying the correctness of any statement, information or particulars furnished to the Reserve Bank;
 - (b) obtaining any information or particulars which such authorised person has failed to furnish on being called upon to do so;
 - (c) securing compliance with the provisions of this Act or of any rules, regulations, directions or orders made thereunder.
- (2) It shall be the duty of every authorised person, and where such person is a company or a firm, every director, partner or other officer of such company or firm, as the case may be, to produce to any officer making an inspection under sub-section (1), such books, accounts and other documents in his custody or power and to furnish any statement or information relating to the affairs of such person, company or firm as the said officer may require within such time and in such manner as the said officer may direct.

Penalties [Section 13]

- (1) If any person contravenes any provision of this Act, or contravenes any rule, regulation, notification, direction or order issued in exercise of the powers under this Act, or contravenes any condition subject to which an authorisation is issued by the Reserve Bank, he shall, upon adjudication, be liable to a penalty up to thrice the sum involved in such contravention where such amount is



quantifiable, or up to two lakh rupees where the amount is not quantifiable, and where such contravention is a continuing one, further penalty which may extend to five thousand rupees for every day after the first day during which the contravention continues.

- (2) Any Adjudicating Authority adjudging any contravention under sub-section (1), may, if he thinks fit in addition to any penalty which he may impose for such contravention direct that any currency, security or any other money or property in respect of which the contravention has taken place shall be confiscated to the Central Government and further direct that the foreign exchange holdings, if any, of the persons committing the contraventions or any part thereof, shall be brought back into India or shall be retained outside India in accordance with the directions made in this behalf.

Explanation.-For the purposes of this sub-section, "property" in respect of which contravention has taken place, shall include

- (a) deposits in a bank, where the said property is converted into such deposits;
- (b) Indian currency, where the said property is converted into that currency; and
- (c) any other property which has resulted out of the conversion of that property.

Enforcement of the orders of Adjudicating Authority [Section 14]

- (1) Subject to the provisions of sub-section (2) of section 19, if any person fails to make full payment of the penalty imposed on him under section 13 within a period of ninety days from the date on which the notice for payment of such penalty is served on him, he shall be liable to civil imprisonment under this section.
- (2) No order for the arrest and detention in civil prison of a defaulter shall be made unless the Adjudicating Authority has issued and served a notice upon the defaulter calling upon him to appear before him on the date specified in the notice and to show cause why he should not be committed to the civil prison, and unless the Adjudicating Authority, for reasons in writing, is satisfied-
 - (a) that the defaulter, with the object or effect of obstructing the recovery of penalty, has after the issue of notice by the Adjudicating Authority, dishonestly transferred, concealed, or removed any part of his property, or
 - (b) that the defaulter has, or has had since the issuing of notice by the Adjudicating Authority, the means to pay the arrears or some substantial part thereof and refuses or neglects or has refused or neglected to pay the same.
- (3) Notwithstanding anything contained in sub-section (1), a warrant for the arrest of the defaulter may be issued by the Adjudicating Authority if the Adjudicating Authority is satisfied, by affidavit or otherwise, that with the object or effect of delaying the execution of the certificate the defaulter is likely to abscond or leave the local limits of the jurisdiction of the Adjudicating Authority.
- (4) Where appearance is not made pursuant to a notice issued and served under sub-section (1), the Adjudicating Authority may issue a warrant for the arrest of the defaulter.
- (5) A warrant of arrest issued by the Adjudicating Authority under sub-section (3) or sub-section (4) may also be executed by any other Adjudicating Authority within whose jurisdiction the defaulter may for the time being be found.
- (6) Every person arrested in pursuance of a warrant of arrest under this section shall be brought before the Adjudicating Authority issuing the warrant as soon as practicable and in any event within twenty-four hours of his arrest (exclusive of the time required for the journey).

Provided that if the defaulter pays the amount entered in the warrant of arrest as due and the costs of the arrest to the officer arresting him, such officer shall at once release him.

Explanation.—For the purposes of this sub-section, where the defaulter is a Hindu undivided family, the karta thereof shall be deemed to be the defaulter.

- (7) When a defaulter appears before the Adjudicating Authority pursuant to a notice to show cause or is brought before the Adjudicating Authority under this section, the Adjudicating Authority shall give the defaulter an opportunity showing cause why he should not be committed to the civil prison.

Pending the conclusion of the inquiry, the Adjudicating Authority may, in his discretion, order the defaulter to be detained in the custody of such officer as the Adjudicating Authority, may think fit or release him on his furnishing the security to the satisfaction of the Adjudicating Authority for his appearance as and when required.

- (8) Upon the conclusion of the inquiry, the Adjudicating Authority may make an order for the detention of the defaulter in the civil prison and shall in that even cause him to be arrested if he is not already under arrest.

Provided that in order to give a defaulter an opportunity of satisfying the arrears, the Adjudicating Authority may, before making the order of detention, leave the defaulter in the custody of the officer arresting him or of any other officer for a specified period not exceeding fifteen days, or release him on his furnishing security to the satisfaction of the Adjudicating Authority for his appearance at the expiration of the specified period if the arrears are not satisfied.

- (9) When the Adjudicating Authority does not make an order of detention under sub-section (9), he shall, if the defaulter is under arrest, direct his release.
- (10) Every person detained in the civil prison in execution of the certificate may be so detained?
- (a) where the certificate is for a demand of an amount exceeding rupees one crore, up to three years, and
- (b) in any other case, up to six months.

Provided that he shall be released from such detention on the amount mentioned in the warrant for his detention being paid to the officer-in-charge of the civil prison.

- (12) A defaulter released from detention under this section shall not, merely by reason of his release, be discharged from his liability for the arrears, but he shall not be liable to be arrested under the certificate in execution of which he was detained in the civil prison.
- (13) A detention order may be executed at any place in India in the manner provided for the execution of warrant of arrest under the Code of Criminal Procedure, 1973 (2 of 1974).

Power to compound contravention [Section 15]

- (1) Any contravention under section 13 may, on an application made by the person committing such contravention, be compounded within one hundred and eighty days from the date of receipt of application by the Director of Enforcement or such other officers of the Directorate of Enforcement and officers of the Reserve Bank as may be authorised in this behalf by the Central Government in such manner as may be prescribed.
- (2) Where a contravention has been compounded under sub-section (1), no proceeding or further proceeding, as the case may be, shall be initiated or continued, as the case may be, against the person committing such contravention under that section, in respect of the contravention so compounded.

Appointment of Adjudicating Authority [Section 16]

- (1) For the purpose of adjudication under section 13, the Central Government may, by an order



published in the Official Gazette, appoint as many officers of the Central Government as it may think fit, as the Adjudicating Authorities for holding an inquiry in the manner prescribed after giving the person alleged to have committed contravention under section 13, against whom a complaint has been made under sub-section (3) (hereinafter in this section referred to as the said person) a reasonable opportunity of being heard for the purpose of imposing any penalty.

Provided that where the Adjudicating Authority is of opinion that the said person is likely to abscond or is likely to evade in any manner, the payment of penalty, if levied, it may direct the said person to furnish a bond or guarantee for such amount and subject to such conditions as it may deem fit.

- (2) The Central Government shall, while appointing the Adjudicating Authorities under sub-section (1), also specify in the order published in the Official Gazette, their respective jurisdictions.
- (3) No Adjudicating Authority shall hold an enquiry under sub-section (1) except upon a complaint in writing made by any officer authorised by a general or special order by the Central Government.
- (4) The said person may appear either in person or take the assistance of a legal practitioner or a chartered accountant of his choice for presenting his case before the Adjudicating Authority.
- (5) Every Adjudicating Authority shall have the same powers of a Civil Court which are conferred on the Appellate Tribunal under sub-section (2) of section 28 and
 - (a) all proceedings before it shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code (45 of 1860);
 - (b) shall be deemed to be a Civil Court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 1973 (2 of 1974).
- (6) Every Adjudicating Authority shall deal with the complaint under sub-section (2) as expeditiously as possible and endeavour shall be made to dispose of the complaint finally within one year from the date of receipt of the complaint;

Provided that where the complaint cannot be disposed of within the said period, the Adjudicating Authority shall record periodically the reasons in writing for not disposing of the complaint within the said period.

Appeal to Special Director (Appeals) [Section 17]

- (1) The Central Government shall, by notification, appoint one or more Special Directors (Appeals) to hear appeals against the orders of the Adjudicating Authorities under this section and shall also specify in the said notification the matter and places in relation to which the Special Director (Appeals) may exercise jurisdiction.
- (2) Any person aggrieved by an order made by the Adjudicating Authority, being an Assistant Director of Enforcement or a Deputy Director of Enforcement, may prefer an appeal to the Special Director (Appeals).
- (3) Every appeal under sub-section (1) shall be filed within forty-five days from the date on which the copy of the order made by the Adjudicating Authority is received by the aggrieved person and it shall be in such form, verified in such manner and be accompanied by such fee as may be prescribed.

Provided that the Special Director (Appeals) may entertain an appeal after the expiry of the said period of forty-five days, if he is satisfied that there was sufficient cause for not filing it within that period.

- (4) On receipt of an appeal under sub-section (1), the Special Director (Appeals) may after giving the parties to the appeal an opportunity of being heard, pass such order thereon as he thinks fit, confirming, modifying or setting aside the order appealed against.

- (5) The Special Director (Appeals) shall send a copy of every order made by him to the parties to appeal and to the concerned Adjudicating Authority.
- (6) The Special Director (Appeals) shall have the same powers of a Civil Court which are conferred on the Appellate Tribunal under sub-section (2) of section 28 and
 - (a) all proceedings before him shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code (45 of 1860);
 - (b) shall be deemed to be a Civil Court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 1973 (2 of 1974).

Establishment of Appellate Tribunal [Section 18]

The Central Government shall, by notification, establish an Appellate Tribunal to be known as the Appellate Tribunal for Foreign Exchange to hear appeals against the orders of the Adjudicating Authorities and the Special Director (Appeals) under this Act.

Appeal to Appellate Tribunal [Section 19]

- (1) Save as provided in sub-section (2), the Central Government or any person aggrieved by an order made by an Adjudicating Authority, other than those referred to in sub-section (1) of section 17, or the Special Director (Appeals), may prefer an appeal to the Appellate Tribunal.

Provided that any person appealing against the order of the Adjudicating Authority or the Special Director (Appeals) levying any penalty, shall while filing the appeal, deposit the amount of such penalty with such authority as may be notified by the Central Government.

Provided further that where in any particular case, the Appellate Tribunal is of the opinion that the deposit of such penalty would cause undue hardship to such person, the Appellate Tribunal may dispense with such deposit subject to such conditions as it may deem fit to impose so as to safeguard the realisation of penalty.

- (2) Every appeal under sub-section (1) shall be filed within a period of forty-five days from the date on which a copy of the order made by the Adjudicating Authority or the Special Director (Appeals) is received by the aggrieved person or by the Central Government and it shall be in such form, verified in such manner and be accompanied by such fee as may be prescribed.

Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

- (3) On receipt of an appeal under sub-section (1), the Appellate Tribunal may, after giving the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.
- (4) The Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned Adjudicating Authority or the Special Director (Appeals), as the case may be.
- (5) The appeal filed before the Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within one hundred and eighty days from the date of receipt of the appeal.

Provided that where any appeal could not be disposed of within the said period of one hundred and eighty days, the Appellate Tribunal shall record its reasons in writing for not disposing of the appeal within the said period.

- (6) The Appellate Tribunal may, for the purpose of examining the legality, propriety or correctness of any order made by the Adjudicating Authority under section 16 in relation to any proceeding, on its own motion or otherwise, call for the records of such proceedings and make such order in the



case as it thinks fit.

Composition of Appellate Tribunal [Section 20]

- (1) The Appellate Tribunal shall consist of a Chairperson and such number of Members as the Central Government may deem fit.
- (2) Subject to the provisions of this Act,
 - (a) the jurisdiction of the Appellate Tribunal may be exercised by Benches thereof;
 - (b) a Bench may be constituted by the Chairperson with one or more Members as the Chairperson may deem fit;
 - (c) the Benches of the Appellate Tribunal shall ordinarily sit at New Delhi and at such other places as the Central Government may, in consultation with the Chairperson, notify;
 - (d) the Central Government shall notify the areas in relation to which each Bench of the Appellate Tribunal may exercise jurisdiction.
- (3) Notwithstanding anything contained in sub-section (2), the Chairperson may transfer a Member from one Bench to another Bench.
- (4) If at any stage of the hearing of any case or matter it appears to the Chairperson or a Member that the case or matter is of such a nature that it ought to be heard by a Bench consisting of two Members, the case or matter may be transferred by the Chairperson or, as the case may be, referred to him for transfer, to such Bench as the Chairperson may deem fit.

Qualifications for appointment of Chairperson, Member and Special Director (Appeals) [Section 21]

- (1) A person shall not be qualified for appointment as the Chairperson or a Member unless he
 - (a) in the case of Chairperson, is or has been, or is qualified to be, a Judge of a High Court; and
 - (b) in the case of a Member, is or has been, or is qualified to be, a District Judge.
- (2) A person shall not be qualified for appointment as a Special Director (Appeals) unless he
 - (a) has been a member of the Indian Legal Service and has held a post in Grade I of that Service; or
 - (b) has been a member of the Indian Revenue Service and has held a post equivalent to a Joint Secretary to the Government of India.

Term of office [Section 22]

The Chairperson and every other Member shall hold office as such for a term of five years from the date on which he enters upon his office.

Provided that no Chairperson or other Member shall hold office as such after he has attained,

- (a) in the case of the Chairperson, the age of sixty-five years;
- (b) in the case of any other Member, the age of sixty-two years.

Terms and conditions of service [Section 23]

The salary and allowances payable to and the other terms and conditions of service of the Chairperson, other Members and the Special Director (Appeals) shall be such as may be prescribed.

Provided that neither the salary and allowances nor the other terms conditions of service of the Chairperson or a Member shall be varied to his disadvantage after appointment.

Vacancies [Section 24]

If, for reason other than temporary absence, any vacancy occurs in the office of the Chairperson or a Member, the Central Government shall appoint another person in accordance with the provisions of this Act to fill the vacancy and the proceedings may be continued before the Appellate Tribunal from the stage at which the vacancy is filled.

Resignation and removal [Section 25]

- (1) The Chairperson or a Member may, by notice in writing under his hand addressed to the Central Government, resign his office.

Provided that the Chairperson or a Member shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor enters upon his office or until the expiry of term of office, whichever is the earliest.

- (2) The Chairperson or a Member shall not be removed from his office except by an order by the Central Government on the ground of proved misbehaviour or incapacity after an inquiry made by such person as the President may appoint for this purpose in which the Chairperson or a Member concerned has been informed of the charges against him and given a reasonable opportunity of being heard in respect of such charges.

Member to act as Chairperson in certain circumstances [Section 26]

- (1) In the event of the occurrence of any vacancy in the office of the Chairperson by reason of his death, resignation or otherwise, the senior-most Member shall act as the Chairperson until the date on which a new Chairperson, appointed in accordance with the provisions of this Act to fill such vacancy, enters upon his office.
- (2) When the Chairperson is unable to discharge his functions owing to absence, illness or any other cause, the senior-most Member shall discharge the functions of the Chairperson until the date on which the Chairperson resumes his duties.

Staff of Appellate Tribunal and Special Director (Appeals) [Section 27]

- (1) The Central Government shall provide the Appellate Tribunal and the Special Director (Appeals) with such officers and employees as it may deem fit.
- (2) The officers and employees of the Appellate Tribunal and office of the Special Director (Appeals) shall discharge their functions under the general superintendence of the Chairperson and the Special Director (Appeals), as the case may be.
- (3) The salaries and allowances and other conditions of service of the officers and employees of the Appellate Tribunal and office of the Special Director (Appeals) shall be such as may be prescribed.

Procedure and powers of Appellate Tribunal and Special Director (Appeals) [Section 28]

- (1) The Appellate Tribunal and the Special Director (Appeals) shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 (5 of 1908), but shall be guided by the principles of natural justice and, subject to the other provisions of this Act, the Appellate Tribunal and the Special Director (Appeals) shall have powers to regulate its own procedure.
- (2) The Appellate Tribunal and the Special Director (Appeals) shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a Civil Court under the Code of Civil Procedure, 1908 (5 of 1908) while trying a suit, in respect of the following matters, namely:
 - (a) summoning and enforcing the attendance of any person and examining him on oath;
 - (b) requiring the discovery and production of documents;
 - (c) receiving evidence on affidavits;



- (d) subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872 (1 of 1872), requisitioning any public record or document or copy of such record or document from any office;
 - (e) issuing commissions for the examination of witnesses or documents;
 - (f) reviewing its decisions;
 - (g) dismissing a representation of default or deciding it ex parte;
 - (h) setting aside any order of dismissal of any representation for default or any order passed by it ex parte; and
 - (i) any other matter which may be prescribed by the Central Government.
- (3) An order made by the Appellate Tribunal or the Special Director (Appeals) under this Act shall be executable by the Appellate Tribunal or the Special Director (Appeals) as a decree of Civil Court and, for this purpose, the Appellate Tribunal and the Special Director (Appeals) shall have all the powers of a Civil Court.
- (4) Notwithstanding anything contained in sub-section (3), the Appellate Tribunal or the Special Director (Appeals) may transmit any order made by it to a Civil Court having local jurisdiction and such Civil Court shall execute the order as if it were a decree made by that Court.
- (5) All proceedings before the Appellate Tribunal and the Special Director (Appeals) shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code (45 of 1860) and the Appellate Tribunal shall be deemed to be a Civil Court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 1973 (2 of 1974).

Distribution of business amongst Benches [Section 29]

Where Benches are constituted, the Chairperson may, from time to time, by notification, make provisions as to the distribution of the business of the Appellate Tribunal amongst the Benches and also provide for the matters which may be dealt with by each Bench.

Power of Chairperson to transfer cases [Section 30]

On the application of any of the parties and after notice to the parties, and after hearing such of them as he may desire to be heard, or on his own motion without such notice, the Chairperson may transfer any case pending before one Bench, for disposal, to any other Bench.

Decision to be by majority [Section 31]

If the Members of a Bench consisting of two Members differ in opinion on any point, they shall state the point or points on which they differ, and make a reference to the Chairperson who shall either hear the point or points himself or refer the case for hearing on such point or points by one or more of the other Members of the Appellate Tribunal and such point or points shall be decided according to the opinion of the majority of the Members of the Appellate Tribunal who have heard the case, including those who first heard it.

Right of appellant to take assistance of legal practitioner or chartered accountant and of Government, to appoint presenting officers [Section 32]

- (1) A person preferring an appeal to the Appellate Tribunal or the Special Director (Appeals) under this Act may either appear in person or take the assistance of a legal practitioner or a chartered accountant of his choice to present his case before the Appellate Tribunal or the Special Director (Appeals), as the case may be.
- (2) The Central Government may authorise one or more legal practitioners or chartered accountants or any of its officers to act as presenting officers and every person so authorised may present the

case with respect to any appeal before the Appellate Tribunal or the Special Director (Appeals), as the case may be.

Members, etc., to be public servants [Section 33]

The Chairperson, Members and other officers and employees of the Appellate Tribunal, the Special Director (Appeals) and the Adjudicating Authority shall be deemed to be public servants within the meaning of section 21 of the Indian Penal Code (45 of 1860).

Civil Court not to have jurisdiction [Section 34]

No Civil Court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which an Adjudicating Authority or the Appellate Tribunal or the Special Director (Appeals) is empowered by or under this Act to determine and no injunction shall be granted by any Court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

Appeal to High Court [Section 35]

Any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal to him on any question of law arising out of such order.

Provided that the High Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Explanation.—In this section “High Court” means

- (a) the High Court within the jurisdiction of which the aggrieved party ordinarily resides or carries on business or personally works for gain; and
- (b) where the Central Government is the aggrieved party, the High Court within the jurisdiction of which the respondent, or in a case where there are more than one respondent, any of the respondents, ordinarily resides or carries on business or personally work for gain.

Directorate of Enforcement [Section 36]

- (1) The Central Government shall establish a Directorate of Enforcement with a Director and such other officers or class of officers as it thinks fit, who shall be called officers of Enforcement, for the purposes of this Act.
- (2) Without prejudice to the provisions of sub-section (1), the Central Government may authorise the Director of Enforcement or an Additional Director of Enforcement or a Special Director of Enforcement or a Deputy Director of Enforcement to appoint Officers of Enforcement below the rank of an Assistant Director of Enforcement.
- (3) Subject to such conditions and limitations as the Central Government may impose, an Officer of Enforcement may exercise the powers and discharge the duties conferred or imposed on him under this Act.

Power of search, seizure, etc [Section 37]

- (1) The Director of Enforcement and other officers of Enforcement, not below the rank of an Assistant Director, shall take up for investigation the contravention referred to in section 13.
- (2) Without prejudice to the provisions of sub-section (1), the Central Government may also, by notification, authorise any officer or class of officers in the Central Government, State Government or the Reserve Bank, not below the rank of an Under Secretary to the Government of India to investigate any contravention referred to in section 13.
- (3) The officers referred to in sub-section (1) shall exercise the like powers which are conferred on



income-tax authorities under the Income-tax Act, 1961 (43 of 1961) and shall exercise such powers, subject to such limitations laid down under that Act.

Empowering other officers [Section 38]

- (1) The Central Government may, by order and subject to such conditions and limitations as it thinks fit to impose, authorise any officer of customs or any central excise officer or any police officer or any other officer of the Central Government or a State Government to exercise such of the powers and discharge such of the duties of the Director of Enforcement or any other officer of Enforcement under this Act as may be stated in the order.
- (2) The officers referred to in sub-section (1) shall exercise the like powers which are conferred on the income-tax authorities under the Income-tax Act, 1961 (43 of 1961), subject to such conditions and limitations as the Central Government may impose.

Presumption as to documents in certain cases [Section 39]

Where any document

- (i) is produced or furnished by any person or has been seized from the custody or control of any person, in either case, under this Act or under any other law; or
- (ii) has been received from any place outside India (duly authenticated by such authority or person and in such manner as may be prescribed) in the course of investigation of any contravention under this Act alleged to have been committed by any person,

and such document is tendered in any proceeding under this Act in evidence against him, or against him and any other person who is proceeded against jointly with him, the Court or the Adjudicating Authority, as the case may be, shall

- (a) presume, unless the contrary is proved, that the signature and every other part of such document which purports to be in the handwriting of any particular person or which the Court may reasonably assume to have been signed by, or to be in the handwriting of, any particular person, is in that person's handwriting, and in the case of a document executed or attested, that it was executed or attested by the person by whom it purports to have been so executed or attested;
- (b) admit the document in evidence notwithstanding that it is not duly stamped, if such document is otherwise admissible in evidence;
- (c) in a case falling under clause (i), also presume, unless the contrary is proved, the truth of the contents of such document.

Suspension of operation of this Act [Section 40]

- (1) If the Central Government is satisfied that circumstances have arisen rendering it necessary that any permission granted or restriction imposed by this Act should cease to be granted or imposed, or if it considers necessary or expedient so to do in public interest, the Central Government may, by notification, suspend or relax to such extent either indefinitely or for such period as may be notified, the operation of all or any of the provisions of this Act.
- (2) Where the operation of any provision of this Act has under sub-section (1) been suspended or relaxed indefinitely, such suspension or relaxation may, at any time while this Act remains in force, be removed by the Central Government by notification.
- (3) Every notification issued under this section shall be laid, as soon as may be after it is issued, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the notification or both Houses agree that the notification should

not be issued, the notification shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that notification.

Power of Central Government to give directions [Section 41]

For the purposes of this Act, the Central Government may, from time to time, give to the Reserve Bank such general or special directions as it thinks fit, and the Reserve Bank shall, in the discharge of its functions under this Act, comply with any such directions.

Contravention by companies [Section 42]

- (1) Where a person committing a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder is a company, every person who, at the time the contravention was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

Provided that nothing contained in this sub-section shall render any such person liable to punishment if he proves that the contravention took place without his knowledge or that he exercised all due diligence to prevent such contravention.

- (2) Notwithstanding anything contained in sub-section (1), where a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder has been committed by a company and it is proved that the contravention has taken place with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

Explanation.-For the purposes of this section

- (i) "Company" means any body corporate and includes a firm or other association of individuals; and
- (ii) "director", in relation to a firm, means a partner in the firm.

Death or insolvency in certain cases [Section 43]

Any right, obligation, liability, proceeding or appeal arising in relation to the provisions of section 13 shall not abate by reason of death or insolvency of the person liable under that section and upon such death or insolvency such rights and obligations shall devolve on the legal representative of such person or the official receiver or the official assignee, as the case may be.

Provided that a legal representative of the deceased shall be liable only to the extent of the extent of the inheritance or estate of the deceased.

Bar of legal proceedings [Section 44]

No suit, prosecution or other legal proceeding shall lie against the Central Government or the Reserve Bank or any officer of that Government or of the Reserve Bank or any other person exercising any power or discharging any functions or performing any duties under this Act, for anything in good faith done or intended to be done under this Act or any rule, regulation, notification, direction or order made thereunder.

Removal of difficulties [Section 45]

- (1) If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order, do anything not inconsistent with the provisions of this Act for the purpose of removing the difficulty.

Provided that no such order shall be made under this section after the expiry of two years from the commencement of this Act.

- (2) Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

Power to make rules [Section 46]

- (1) The Central Government may, by notification, make rules to carry out the provisions of this Act.
- (2) Without prejudice to the generality of the foregoing power, such rules may provide for,
 - (a) the imposition of reasonable restrictions on current account transactions under section 5;
 - (b) the manner in which the contravention may be compounded under subsection (l) of section 15;
 - (c) the manner of holding an inquiry by the Adjudicating Authority under sub-section (1) of section 16;
 - (d) the form of appeal and fee for filing such appeal under sections 17 and 19;
 - (e) the salary and allowances payable to and the other terms and conditions of service of the Chairperson and other Members of the Appellate Tribunal and the Special Director (Appeals) under section 23;
 - (f) the salaries and allowances and other conditions of service of the officers and employees of the Appellate Tribunal and the office of the Special Director (Appeals) under sub-section (3) of section 27;
 - (g) the additional matters in respect of which the Appellate Tribunal and the Special Director (Appeals) may exercise the powers of a Civil Court under clause (i) of sub-section (2) of section 28;
 - (h) the authority or person and the manner in which any document may be authenticated under clause (ii) of section 39; and
 - (i) any other matter which is required to be, or may be, prescribed.

Power to make regulations [Section 47]

- (1) The Reserve Bank may, by notification, make regulations to carry out the provisions of this Act and the rules made thereunder.
- (2) Without prejudice to the generality of the foregoing power, such regulations may provide for,
 - (a) the permissible classes of capital account transactions, the limits of admissibility of foreign exchange for such transactions, and the prohibition, restriction or regulation of certain capital account transactions under section 6;
 - (b) the manner and the form in which the declaration is to be furnished under clause (a) of sub-section (1) of section 7;
 - (c) the period within which and the manner of repatriation of foreign exchange under section 8;
 - (d) the limit up to which any person may possess foreign currency or foreign coins under clause (a) of section 9;
 - (e) the class of persons and the limit up to which foreign currency account may be held or operated under clause (b) of section 9;
 - (f) the limit up to which foreign exchange acquired may be exempted under clause (d) of section 9;
 - (g) the limit up to which foreign exchange acquired may be retained under clause (e) of section 9;
 - (h) any other matter which is required to be, or may be, specified.

Rules and regulations to be laid before Parliament [Section 48]

Every rule and regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised

in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or regulation, or both Houses agree that the rule or regulation should not be made, the rule or regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule or regulation.

Repeal and saving [Section 49]

- (1) The Foreign Exchange Regulation Act, 1973 (46 of 1973) is hereby repealed and the Appellate Board constituted under sub-section (1) of section 52 of the said Act (hereinafter referred to as the repealed Act) shall stand dissolved.
- (2) On the dissolution of the said Appellate Board, the person appointed as Chairman of the Appellate Board and every other person appointed as Member and holding office as such immediately before such date shall vacate their respective offices and no such Chairman or other person shall be entitled to claim any compensation for the premature termination of the term of his office or of any contract of service.
- (3) Notwithstanding anything contained in any other law for the time being in force, no Court shall take cognizance of an offence under the repealed Act and no adjudicating officer shall take notice of any contravention under section 51 of the repealed Act after the expiry of a period of two years from the date of the commencement of this Act.
- (4) Subject to the provisions of sub-section (3) all offences committed under the repealed Act shall continue to be governed by the provisions of the repealed Act as if that Act had not been repealed.
- (5) Notwithstanding such repeal,
 - (a) anything done or any action taken or purported to have been done or taken including any rule, notification, inspection, order or notice made or issued or any appointment, confirmation or declaration made or any licence, permission, authorisation or exemption granted or any document or instrument executed or any direction given under the Act hereby repealed shall, insofar as it is not inconsistent with the provisions of this Act, be deemed to have been done or taken under the corresponding provisions of this Act;
 - (b) any appeal preferred to the Appellate Board under sub-section (2) of section 52 of the repealed Act but not disposed of before the commencement of this Act shall stand transferred to and shall be disposed of by the Appellate Tribunal constituted under this Act;
 - (c) every appeal from any decision or order of the Appellate Board under sub-section (3) or sub-section (4) of section 52 of the repealed Act shall, if not filed before the commencement of this Act, be filed before the High Court within a period of sixty days of such commencement.

Provided that the High Court may entertain such appeal after the expiry of the said period of sixty days if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period.

- (6) Save as otherwise provided in sub-section (3), the mention of particular matters in sub-sections (2), (4) and (5) shall not be held to prejudice or affect the general application of section 6 of the General Clauses Act, 1897 (10 of 1897), with regard to the effect of repeal.

Study Note - 6

LAWS RELATED TO INSURANCE SECTOR



This Study Note includes

6.1 The Insurance Act, 1938

6.2 The Insurance Regulatory and Development Authority Act, 1999

6.1 THE INSURANCE ACT, 1938

Short title, extent and commencement [Section 1]

- (1) This Act may be called Insurance Act, 1938.
- (1-A) "Authority" means the Insurance Regulatory and Development Authority established under sub-section (1) of section 3 of the Insurance Regulatory and Development Authority Act, 1999.
- (2) It extends to the whole of India.
- (3) It shall come into force on such date³ as the Central Government may, by Notification in the Official Gazette, appoint in this behalf.

Definitions [Section 2]

In this Act, unless there is anything repugnant in the subject or context, -

- (1) "actuary" means an actuary possessing such [qualifications as may be specified by the regulations made by the Authority];
- [(1A) "Authority" means the Insurance Regulatory and Development Authority established under sub-section (1) of section 3 of the Insurance Regulatory and Development Authority Act, 1999;]
- (2) "policy-holder" includes a person to whom the whole of the interest of the policy-holder in the policy is assigned once and for all, but does not include an assignee thereof whose interest in the policy is defeasible or is for the time being subject to any condition;
- (3) "approved securities," means-
 - (i) Government securities and other securities charged on the revenue of the Central Government or of the Government of a State or guaranteed fully as regards principal and interest by the Central Government or the Government of any State;
 - (ii) debentures or other securities for money issued under the authority of any Central Act or Act of a State Legislature by or on behalf of a port trust or municipal corporation or city improvement trust in any Presidency-town;
 - (iii) shares of a corporation established by law and guaranteed fully by the Central Government or the Government of a State as to the repayment of the principal and the payment of the dividend;
 - (iv) securities issued or guaranteed fully as regards principal and interest by the Government of any Part B State and specified as approved securities for the purposes of this Act by the Central Government by notification in the Official Gazette; and
- (4) "Auditor" means a person qualified under the Chartered Accountants Act, 1949 (38 of 1949), to act as an auditor of companies ;

- (4A) "banking company" and "company" shall have the meanings respectively assigned in them in clauses (c) and (d) of sub-section (1) of Section 5 of the Banking Companies Act, 1949 (10 of 1949);
- (5) "certified" in relation to any copy or translation of a document required to be furnished by or on behalf of an insurer or a provident society as defined in Part III means certified by a principal officer of such insurer or provident society to be a true copy or a correct translation, as the case may be;
- (5A) "chief agent" means a person who, not being a salaried employee of an insurer, in consideration of any commission-
- (i) performs any administrative and organising functions for the insurer, and
 - (ii) procures life insurance business for the insurer by employing or causing to be employed insurance agents on behalf of the insurer;
- (5-B) "Controller of Insurance" means the officer appointed by the Central Government under section 2-B to exercise all the powers, discharge the functions and perform the duties of the Authority under this Act or the Life Insurance Corporation Act, 1956 (31 of 1956), or the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972) or the Insurance Regulatory and Development Authority Act, 1999;]
- (6) "Court" means the principal Civil Court of original jurisdiction in a district and includes the High Court in exercise of its ordinary original civil jurisdiction;
- (6A) "fire insurance business" means the business of effecting, otherwise than incidentally to some other class of insurance business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured against in fire insurance Policies;
- (6B) "general insurance business" means fire, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them;
- (7) "Government security" means a Government security as defined in the Public Debt Act, 1944 (18 of 1944);
- (7A) "Indian insurance company" means any insurer being a company-
- (a) which is formed and registered under the Companies Act, 1956 (1 of 1956);
 - (b) in which the aggregate holdings of equity shares by a foreign company, either by itself or through its subsidiary companies or its nominees, do not exceed twenty-six percent paid-up equity capital of such Indian insurance company;
 - (c) whose sole purpose is to carry on life insurance business or general insurance business or re-insurance business.
- Explanation-** For the purpose of this clause, the expression "foreign company" shall have the meaning assigned to it under clause (23A) of section 2 of the Income-tax Act, 1961 (43 of 1961);]
- (7-A) "Indian insurance Company" means any insurer being a company-
- (a) which is formed and registered under the Companies Act, 1956 (1 of 1956);
 - (b) in which the aggregate holdings of equity shares by a foreign company, either by itself or through its subsidiary companies or its nominees, do not exceed twenty six per cent. paid-up equity capital of such Indian insurance company;
 - (c) whose sole purpose is to carry on life insurance business or general insurance business or re-insurance business.



Explanation.-For the purposes of this clause, the expression “foreign company” shall have the meaning assigned to it under clause (23-A) of section 2 of the Income-tax Act, 1961 (43 of 1961);”;

- (8) “insurance company” means any insurer being a company, association or partnership which may be wound up under the Indian Companies Act, 1913(7 of 1913), or to which the Indian Partnership Act, 1932 (9 of 1932), applies;
- (8A) “insurance co-operative society” means any insurer being a co-operative society,-
- (a) which is registered on or after the commencement of the Insurance (Amendment) Act, 2002, as a co-operative society under the Co-operative Societies Act, 1912 (2 of 1912) or under any other law for the time being in force in any State relating to Co-operative Societies or under the Multi-State Co-operative Societies Act, 1984 (51 of 1984);
 - (b) having a minimum paid-up capital, (excluding the deposits required to be made under section 7), of rupees one hundred crores;
 - (c) in which no body corporate, whether incorporated or not, formed or registered outside India, either by itself or through its subsidiaries or nominees, at any time, holds more than twenty-six per cent of the capital of such Co-operative Society;
 - (d) whose sole purpose is to carry on life insurance business or general insurance business in India:
- (9) “Insurer” means-
- (a) any individual or unincorporated body of individuals or body corporate incorporated under the law of any country other than India, carrying on insurance business not being a person specified in sub-clause (c) of this clause which-
 - (i) carries on that business in India, or
 - (ii) has his or its principal place of business or is domiciled in India, or
 - (iii) with the object of obtaining insurance business, employs a representative, or maintains a place of business, in India;
 - (b) anybody corporate [not being a person specified in sub-clause (c) of this clause] carrying on the business of insurance, which is a body corporate incorporated under any law for the time being in force in India; or stands to any such body corporate in the relation of a subsidiary company within the meaning of the Indian Companies Act, 1913 (7 of 1913), as defined by sub-section (2) of section 2 of that Act, and
 - (c) any person who in India has a standing contract with underwriters who are members of the Society of Lloyd’s whereby such person is authorised within the terms of such contract to issue protection notes, cover notes, or other documents granting insurance cover to others on behalf of the underwriters.
- but does not include a principal agent’ chief agent, special agent’ or an insurance agent or a provident society as defined in Part III;
- (10) “insurance agent” means an insurance agent licensed under Sec. 42 who receives agrees to receive payment by way of commission or other remuneration in consideration of his soliciting or procuring insurance business including business relating to the continuance, renewal or revival of policies of insurance;
- (10A) “investment company” means a company whose principal business is the acquisition of shares, stocks debentures or other securities;
- (10B) “intermediary or insurance intermediary” shall have the meaning assigned to it in clause (f) of sub-section 2 of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999)

- (11) "life insurance business" means the business of effecting contracts of insurance upon human life, including any contract whereby the payment of money is assured on death (except death by accident only) or the happening of any
- (12) "Manager" and "officer" have the meanings assigned to those expressions in clauses (9) and (11), respectively of Section 2 of the Indian Companies Act, 1913 (7 of 1913);
- (13) "Managing agent" means a person, firm or company entitled to the management of the whole affairs of a company by virtue of an agreement with the company, and under the control and direction of the directors except to the extent, if any, otherwise provided for in the agreement, and includes any person, firm or company occupying such position by whatever name called.
Explanation.—If a person occupying the position of managing agent calls himself manager or managing director, he shall nevertheless be regarded as managing agent for the purposes of Sec. 32 of this Act;
- (13A) "marine insurance business" means the business of effecting contracts of insurance upon vessels of any description, including cargoes, freights and other interests which may be legally insured, in or in relation to such vessels, cargoes and freights, goods, wares, merchandise and property of whatever description insured for any transit, by land or water, or both, and whether or not including warehouse risks or similar risks in addition or as incidental to such transit, and includes any other risks customarily included among the risks insured against in marine insurance policies;
- (13B) "miscellaneous insurance business" means the business of effecting contracts of insurance which is not principally or wholly of any kind or kinds included in clause (6A), (11) and (13A);
- (14) "prescribed" means prescribed by rules made under this Act; and
- (15) "principal agent" means a person who, not being a salaried employee of an insurer, in consideration of any commission,—
 - (i) performs any administrative and organising functions for the insurer; and
 - (ii) procures general insurance business whether wholly or in part by employing or causing to be employed insurance agents on behalf of the
- (16) "private company" and "public company" have the meanings respectively assigned to them in Clauses (13) and (13-A) of Sec. 2 of the Indian Companies Act, 1913 (7 of 1913);
- (17) "special agent" means a person who, not being a salaried employee of an insurer, in consideration of any commission, procures life insurance business for the insurer whether wholly or in part by employing or causing to be employed insurance agents on behalf of the insurer, but does not include a chief agent.

Interpretation of certain words and expressions [Section 2A]

Interpretation of certain words and expressions.- Words and expressions used and not defined in this Act but defined in the Life Insurance Corporation Act, 1956 (31 of 1956), the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972), and the Insurance Regulatory and Development Authority Act, 1999 shall have the meanings respectively assigned to them in those Acts.

Appointment of Authority of Insurance [Section 2B]

- (1) If at any time, the Authority is superseded under sub-section (1) of section 19 of the Insurance Regulatory and Development Authority Act, 1999, the Central Government may, by notification in the Official Gazette, appoint a person to be the Controller of Insurance till such time the Authority is reconstituted under sub-section (3) of section 19 of that Act.
- (2) In making any appointment under this section, the Central Government shall have due regard to the following considerations, namely, whether the person to be appointed has had experience in industrial, commercial or insurance matter and whether such person has actuarial qualifications.



Prohibition of transaction of insurance business by certain persons [Section 2C]

- (1) Save as hereinafter provided, no person shall, after the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), begin to carry on any class of insurance business in India and no insurer carrying on any class of insurance business in India shall after the expiry of one year from such commencement, continue to carry on any such business unless he is-
- (a) a public company, or
 - (b) a society registered under the Co-operative Societies Act, 1912 (2 of 1912), or under any other law for the time being in force in any State relating to co-operative societies, or
 - (c) a body corporate incorporated under the law of any country outside India not being of the nature of a private company:

Provided that the Central Government may, by notification in the official Gazette, exempt from the operation of this section to such extent for such period and subject to such conditions as it may specify, any person or insurer for the purpose of carrying on the business of granting superannuation allowances and annuities of the nature specified in sub-clause (c) of clause (11) of Section 2 or for the purpose of carrying on any general insurance business:

Provided further that in the case of an insurer carrying on any general insurance business no such notification shall be issued having effect for more than three years at any one time:

Provided also that no insurer other than an Indian insurance company shall begin to carry on any class of insurance business in India under this Act on or after the commencement of the Insurance Regulatory and Development Authority Act, 1999.

- (2) Every notification issued under subsection (1) shall be laid before Parliament as soon as may be after it is issued.

Provided also that no insurer other than an Indian insurance company shall begin to carry on any class of insurance business in India under this Act on or after the commencement of the Insurance Regulatory and Development Authority Act, 1999.

- (3) Notwithstanding anything contained in sub-section (1), an insurance co-operative society may carry on any class of insurance business in India under this Act on or after the commencement of the Insurance (Amendment) Act, 2002

Insurers to be subject to this Act while liabilities remain unsatisfied [Section 2D]

Every insurer shall be subject to all the provisions of this Act in relation to any class of insurance business so long as his liabilities in 3[India] in respect of business of that class remain unsatisfied or not otherwise provided for.

This Act not to apply to certain insurers ceasing to enter into new contracts before commencement of Act [Section 2E]

The provisions of this Act shall not apply to an insurer as defined in paragraphs (i) or (iii) of sub-clause (a) of clause (9) of Section 2 in relation to any class of his insurance business whether such insurer hits ceased, before the commencement of this Act, to enter into any new contracts of that class of business.

Registration [Section 3]

- (1) No person shall, after commencement of this Act, being to carry on any class of insurance business in India and no insurer carrying on any class of insurance business in India shall, after the expiry of three months from the commencement of this Act, continue to carry on any such business, unless he has obtained from the Authority a certificate of registration for the particular class of insurance business:

Provided that in case of an insurer who was carrying on any class of insurance business in India at the commencement of this Act, failure to obtain a certificate of registration in accordance with the requirements of this sub-clause shall not operate to invalidate any contract of insurance entered into by him if before such date as may be fixed in this behalf by the Central Government by notification in the official Gazette, he has obtained that certificate:

Provided further that a person or insurer, as the case may be, carrying on any class of insurance business in India, on or before the commencement of the Insurance Regulatory and Development Authority Act, 1999, for which no registration certificate was necessary prior to such commencement, may continue to do so for a period of three months from such commencement or, if he had made an application for such registration within the said period of three months, till the disposal of such application:

Provided also that any certificate of registration, obtained immediately before the commencement of the Insurance Regulatory and Development Authority Act, 1999, shall be deemed to have been obtained from the Authority in accordance with the provisions of this Act

Provided farther that a person or insurer, as the case may be, carrying on any class of insurance business in India, on or before the commencement of the Insurance Regulatory and Development Authority Act, 1999, for which no registration certificate was necessary prior to such commencement, may continue to do so for a period of three months from such commencement or, if he had made an application for such registration within the said period of three months, till the disposal of such application.

Provided also that any certificate of registration, obtained immediately before the commencement of the Insurance Regulatory and Development Authority Act, 1999, shall be deemed to have been obtained from the Authority in accordance with the provisions of this Act

- (2) Every application for registration shall be made in such manner as may be determined by the regulations made by the Authority and shall be accompanied by-
- (a) a certified copy of the memorandum and articles of association, where the applicant is a company and incorporated under the Indian Companies Act, 1913 (7 of 1913), or under the Indian Companies Act, 1882 (6 of 1882), or under the Indian Companies Act, 1866 (10 of 1866); or under any Act repealed thereby,] or, in the case of any other insurer specified in sub-clause (a) (ii) or sub-clause (b) of clause (9) of section 2, a certified copy of the deed of partnership or of the deed of constitution of the company, as the case may be, or, in the case of an insurer having his principal place of business or domicile outside India, the document specified in Clause (a) of Section 63;
 - (b) the name, address and the occupation, if any, of the directors where insurer is a company incorporated under the Indian Companies Act, 1913 (7 of 1913), or under the Indian Companies Act, 1882 (6 of 1882), or under the Indian Companies Act, 1866 (10 of 1866), or under any Act repealed thereby, and in the case of an insurer specified in sub-clause (a) (ii) of clause (9) of section 2 the names and addresses of the proprietors and of the manager in India, and in any other case the full address of the principal office of the insurer in India, and the names of the directors and the manager at such office and the name and address of someone or more persons resident in India, authorised to accept any notice required to be served on the insurer;
 - (c) a statement of the class or classes of insurance business done or to be done, and a statement that the amount required to be deposited by section 7 or section 98 before application for registration is made has been deposited together with a certificate from the Reserve Bank of India showing the amount deposited;
 - (d) where the provisions of section 6 or section 97 apply, a declaration verified by an affidavit made by the principal officer of the insurer authorised in that behalf that the provisions of



those sections as to paid-up equity capital or working capital have been complied with;

- (e) in the case of an insurer having his principal place of business or domicile outside India, a statement verified by an affidavit made by the principal officer of the insurer setting forth the requirements (if any) not applicable to nationals of the country in which such insurer is constituted, incorporated or domiciled which are imposed by the laws or practice of that country upon Indian nationals as a condition of carrying on insurance business in that country;
- (f) a certified copy of the published prospectus, if any, and of the standard policy forms of the insurer and statements of the assured rates, advantages, terms and conditions to be offered in connection with insurance policies together with a certificate in connection with life insurance business by an actuary that such rates, advantages, terms and conditions are workable and sound:

Provided that in the case of marine accident and miscellaneous insurance business other than workmen's compensation and motor car insurance the above requirements regarding prospectus, forms and statements shall be complied with only insofar as the prospectus, forms and statements may be available; and

- (g) the receipt showing payment of fee as may be determined by the regulations which shall not exceed fifty thousand rupees for each class of business as may be specified by the regulations made by the Authority;
 - (h) such other documents as may be specified by the regulations made by the Authority.
- (2A) If, on receipt of an application for registration and after making such inquiry as he deems fit, the Authority is satisfied that—
- (a) the financial condition and the general character of management of the applicant are sound;
 - (b) the volume of business likely to be available to, and the capital structure and earning prospects of, the applicant will be adequate;
 - (c) the interest of the general public will be served if the certificate of registration is granted to the applicant in respect of the class or classes of insurance business specified in the application; and
 - (d) the applicant has complied with the provisions of Sections 2-C, 5, 31A and 32 and has fulfilled all the requirements of this section applicable to him, the Authority may register the applicant as an insurer and grant him a certificate of registration.
- (2AA) The Authority shall give preference to register the applicant and grant him a certificate of registration if such applicant agrees, in the form and manner as may be specified by the regulations made by the Authority, to carry on the life insurance business or general insurance business for providing health cover to individuals or group of individuals.
- (2B) Where the Authority refuses registration; he shall record the reasons for such decision and shall furnish a copy thereof to the applicant.
- (2C) Any person aggrieved by the decision of the Authority refusing registration may, within thirty days from the date on which a copy of the decision is received by him, appeal to the Central Government.
- (2D) The decision of the Central Government on such appeal shall be final and shall not be questioned before any Court.
- (3) Notwithstanding anything contained in sub-section (2A), in the case of any insurer having his principal place of business or domicile outside India, the Authority, shall withhold registration

or shall cancel a registration already made, if he is satisfied that in the country in which such insurer has his principal place of business or domicile Indian nationals are debarred by the law or practice of the country relating to, or applied to insurance from carrying on the business of insurance, or that any requirement imposed on such insurer under the provisions of section 62 is not satisfied.

- (4) The Authority shall cancel the registration of an insurer either wholly or in so far as it relates to a particular class of insurance business, as the case may be, -
- (a) if the insurer fails to comply with the provisions of section 7 or section 98 as to deposits, or
 - (aa) if the insurer fails, at any time, to comply the provisions of Sec. 64VA as to the excess of the value of his assets over the amount of his liabilities; or
 - (b) if the insurer is in liquidation or is adjudged an insolvent, or
 - (c) if the business or a class of the business of the insurer has been transferred to any person or has been transferred to or amalgamated with the business of any other insurer, or
 - (d) if the whole of the deposit made in respect of insurance business has been returned to the insurer under Sec. 9, or
 - (e) if, in the case of an insurer specified in sub-clause (c) of clause (9) of section 2, the standing contract referred to in that sub-clause is cancelled or is suspended and continues to be suspended for a period of six months, or
 - (ee) if the Central Government so directs under sub-section (4) of Sec. 33] and the Authority may cancel the registration of an insurer-
 - (f) if the insurer makes default in complying with, or acts in contravention of any requirement of this Act or of any rule or any regulation or order made or, any direction issued there under, or
 - (g) if the Authority has reason to believe that any claim upon the insurer arising in India under any policy of insurance remains unpaid for three months after final judgment in regular course of law, or
 - (h) if the insurer carries on any business other than insurance business or any prescribed business , or
 - (i) if the insurer makes a default in complying with any direction issued or order made, as the case may be, by the Authority under the Insurance Regulatory and Development Authority Act, 1999, or
 - (j) if the insurer makes a default in complying with, or acts in contravention of, any requirement of the Companies Act, 1956 (1 of 1956), or the Life Insurance Corporation Act, 1956 (31 of 1956), or the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972), or the Foreign Exchange Regulation Act, 1973 (46 of 1973).
- (5) When the Authority withholds or cancels any registration under sub-section (3) or clause (a), clause (aa), clause (e), clause (ee), clause (f), clause (g) or clause (h) of sub-section (4), he shall give notice in writing to the insurer of his decision, and the decision shall take effect on such date as he may specify in that behalf in the notice, such date not being less than one month nor more than two months from the date of the receipt of the notice in the ordinary course of transmission.
- (5A) When the Authority cancels any registration under clause (b), clause (c) or clause (d) of sub-section (4) the cancellation shall take effect on the date on which notice of the order of cancellation is served on the insurer.
- (5B) When a registration is cancelled the insurer shall not, after the cancellation has taken effect,



enter into any new contracts of insurance, but all rights and liabilities in respect of contracts of insurance entered into by him before such cancellation takes effect shall, subject to the provisions of sub-section (5D), continue as if the cancellation had not taken place.

- (5C) Where a registration is cancelled under clause (a), clause (aa), clause (e), clause (f), clause (g) or clause (h) or clause (i) or clause (j) of sub-section (4), the Authority may at his discretion revive the registration, if the insurer within six months from the date on which the cancellation took effect makes the deposits required by section 7 or Section 98, or complies with the provisions of Section 64VA as to the excess of the value of his assets over the amount of his liabilities or has his standing contract restored or has had an application under sub-section (4) of section 3A accepted, or satisfies the Authority that no claim upon him such as is referred to in clause (g) of sub-section (4) remains unpaid or that he has complied with any requirement of this Act or the Insurance Regulatory and Development Authority Act, 1999 or of any rule or any regulation, or order made there under or any direction issued under those Acts that he has ceased to carry on any business other than insurance business or any prescribed business, as the case may be, and complies with any directions which may be given to him by the Authority.
- (5D) Where the registration of an insurance company is cancelled under sub-section (4), the Authority may, after expiry of six months from the date on which the cancellation took effect, apply to the Court for an order to wind up the insurance company, or to wind up the affairs of the company in respect of a class of insurance business, unless the registration of the insurance company has been revived under sub-section (5C) or an application for winding up the company has been already presented to the Court. The Court may proceed as if an application under this sub-section were an application under sub-section (2) of section 53, or sub-section (1) of Sec. 58, as the case may be.
- (5E) The Authority may, by order, suspend or cancel any registration in such manner as may be determined by the regulations made by it:

Provided that no order under this sub-section shall be made unless the person concerned has been given a reasonable opportunity of being heard.

- (6) [***]
- (7) The Authority may, on payment of such fee, not exceeding five thousand rupees, as may be determined by the regulations, issue a duplicate certificate of registration to replace a certificate lost, destroyed or mutilated, or in any other case where the Authority is of opinion that the issue of duplicate certificate is necessary.”;

Renewal of registration [Section 3A]

- (1) An insurer who has been granted a certificate of registration under section 3 shall have the registration renewed annually for each year after that ending on the [31st day of March, after the commencement of the Insurance Regulatory and Development Authority Act, 1999.
- (2) An application for the renewal of a registration for any year shall be made by the insurer to the Authority before the 31st day of December of the preceding year, and shall be accompanied as provided in sub-section
- (3) by evidence of payment of the fee as determined by the regulations made by the Authority which may vary according to the total gross premium written direct in India, during the year preceding the year in which the application is required to be made under this section, by the insurer in the class of insurance business to which the registration relates but shall not—
- (i) exceed one-fourth of one per cent. of such premium income or rupees five crores, whichever is less;
 - (ii) be less, in any case, than five hundred rupees for each class of insurance business:

Provided that in the case of an insurer carrying on solely re-insurance business, the provisions of this sub-section shall apply with the modification that instead of the total gross premium written direct in India, the total premiums in respect of facultative re-insurances accepted by him in India shall be taken into account.

- (3) The fee as determined by the regulations made by the Authority for the renewal of a registration for any year shall, be paid into the Reserve Bank of India, or where there is no office of that Bank, into the Imperial Bank of India acting as the agent of that Bank, or into any Government treasury, and the receipt shall be sent along with the application for renewal of the registration.
- (4) If an insurer fails to apply for renewal of registration before the date specified in sub-section (2) the Authority may, so long as an application to the Court under sub-section (5-D) of section 3 has not been made, accept an application for renewal of the registration on receipt from the insurer of the fee payable with the application and such penalty, not exceeding the fee as determined by the regulations made by the Authority, and payable by him, as the Authority may require:

Provided that an appeal shall lie to the Central Government from an order passed by the Authority imposing a penalty on the insurer.

- (5) The Authority shall, on fulfillment by the insurer of the requirements of this section, renew the registration and grant him a certificate of renewal of registration.

Certification of soundness of terms of life insurance business [Section 3B]

If, when considering an application for registration under section 3 or at any other time, it appears to the Authority that the Assured rates, advantages, terms and conditions offered or to be offered in connection with life insurance business are in any respect not workable or sound, he may require that a statement thereof shall be submitted to an actuary appointed by the insurer for the purpose and approved by the Authority, and may by order in writing further require the insurer to make within such time as may be specified in the order such modifications in the said rates, advantages, terms, or conditions, as the case may be, as the said actuary may report to be necessary to enable him to certify that the said rates, advantages, terms and conditions are workable and sound.

Minimum limits for annuities and other benefits secured by policies of life Insurance [Section 4]

- (1) No insurer, not being a Co-operative Life Insurance Society to which Part IV of this Act applies, shall pay or undertake to pay on any policy of life insurance issued after the commencement of the Insurance (Amendment) Act, 1946 (6 of 1946), an annuity of less than one hundred rupees or a gross sum of less than one thousand rupees, exclusive of any profit or bonus provided that this shall not prevent an insurer from converting any policy into a paid-up policy of any value or payment of surrender value of any amount.
- (2) Nothing contained in this section shall apply to any policy of the description known as a group policy, where the number of persons covered by the policy is not less than fifty or such smaller number as may be approved by the Authority and a standard form of the policy has been certified in writing by the Authority to be a policy of such description or to any policy undertaking to pay a gross sum of more than five hundred rupees or an annuity of more than fifty rupee, issued-
 - (a) by an insurer to any person in his permanent employed respect of the life of that person, or
 - (b) under any scheme, approved by the Authority and complying with such conditions, if any, as he may think fit to impose, whereby premiums due from persons employed under any employer are collected by or under the supervision of the employer, or to any policy issued by a Mutual insurance Company to which Part IV applies and which the Authority may by order in writing exempt from the provisions of this section, for so long as the company complies with such conditions, if any, as may be prescribed.



Restriction on name of insurer [Section 5]

- (1) An insurer shall not be registered by a name identical with that by which an insurer in existence is already registered, or so nearly resembling that name as to be calculated to deceive except when the insurer in existence is in the course of being dissolved and signifies his consent to the Authority.
- (2) If an insurer, through inadvertence or otherwise is without such consent as aforesaid registered by a name identical with that by which an insurer already in existence whether previously registered or not is carrying on business or so nearly resembling it as to be calculated to deceive, the first mentioned insurer shall, if called upon to do so by the Authority on the application of the second mentioned insurer, change his name within a time to be fixed by the Authority:

Provided that nothing in this section shall apply to any insurer carrying on business before the 27th- day of January, 1937, under the Indian Life Assurance Companies Act, 1912 (6 of 1912):

Provided further that in the application of this section to any insurer who begins to carry on insurance business after the commencement of the Insurance (Amendment) Act, 1946 (6 of 1946), the references to an insurer in existence in sub-section (1) and this sub-section shall be construed as including references to a provident society (as defined in Part III in existence, whether or not the society is in course of being dissolved).

- (3) No insurer other than a provident society as defined in Part III, who begins to carry on insurance business after the commencement of this Act, shall adopt as its name and no such insurer carrying on business before the commencement of this Act shall continue after the expiry of six months from the commencement thereof to use as its name any combination of words which includes the word "provident".

Requirements as to capital [Section 6]

No insurer carrying on the business of life insurance, general insurance or re-insurance in India on or after the commencement of the Insurance Regulatory and Development authority Act, 1999, shall be registered unless he has,-

- (i) a paid-up equity capital of rupees one hundred crores, in case of a person carrying on the business of life insurance or general insurance; or
- (ii) a paid-up equity capital of rupees two hundred crores, in case of a person carrying on exclusively the business as a reinsurer :

Provided that in determining the paid-up equity capital specified under clause (i) or clause (ii), the deposit to be made under section 7 and any preliminary expenses incurred in the formation and registration of the company shall be excluded:

Provided further that an insurer carrying on business of life insurance, general insurance or re-insurance in India before the commencement of the Insurance Regulatory and Development Authority Act, 1999 and who is required to be registered under this Act, shall have a paid-up equity capital in accordance with clause (i) and clause (ii), as the case may be, within six months of the commencement of that Act.

Requirements as to capital structure and voting rights and maintenance of registers of beneficial owners of shares [Section 6A]

- (1) No public company limited by shares having its registered office in India, shall carry no life insurance business, unless it satisfies all the following conditions, namely:
 - (i) that the capital of the company consists only of ordinary shares each of which have a single face value;

- (ii) that, except during any period not exceeding one year allowed by the company for payment of calls on shares, the paid-up amount is the same for all shares, whether existing or new:

Provided that the conditions specified in this sub-section shall not apply to a public company which has, before the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), issued any shares other than ordinary shares each of which has a single face value or any shares paid-up amount whereof is not the same for all of them for a period of three years from such commencement.

- (2) Notwithstanding anything to the contrary contained in any law for the time being in force or in the memorandum or articles of association but subject to the other provisions contained in this section the voting right of every shareholder of any public company as aforesaid shall in all cases be strictly proportionate to the paid-up amount of the shares held by him.
- (3) No public company as aforesaid which carries on life insurance business shall, after the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), issue any shares other than ordinary shares of the nature specified in sub-section (I).
- (4) A public company as aforesaid which carries on life insurance business-
 - (a) shall maintain, in addition to the register of members to be maintained under the Indian Companies Act, 1913 (7 of 1913) a register of shares in which shall be entered the name, occupation and address of the beneficial owner of each share, and shall incorporate therein any change of beneficial owner declared to it within fourteen days from the receipt of such declaration;
 - (b) shall not register any transfer of its shares
 - (i) unless, in addition to compliance being made with the provisions of section 34 of the Indian Companies Act, 1913 (7 of 1913), the transferee furnishes a declaration in the prescribed form as to whether he proposes to hold the shares for his own benefit or as a nominee, whether jointly or severally, on behalf of others and in the latter case giving the name, occupation and address of the beneficial owner or owners, the extent of the beneficial interest of each;
 - (ii) where, after the transfer, the total paid-up holding of the transferee in the shares of the company is likely to exceed five per cent. of its paid-up capital or where the transferee is a banking or an investment company, is likely to exceed two and a half per cent of such paid-up capital, unless the previous approval of the Authority has been obtained to the transfer;
 - (iii) where, the nominal value of the shares intended to be transferred by any individual, firm, group, constituents of a group, or body corporate under the same management, jointly or severally exceeds one per cent of the paid-up equity capital of the insurer, unless the previous approval of the Authority has been obtained for the transfer.

Explanation.- For the purposes of this sub-clause, the expressions "group" and "same management" shall have the same meanings respectively assigned to them in the Monopolies and Restrictive Trade Practices Act, 1969 (54 of 1969);

- (5) Every person who has any interest in any share of a company referred to in sub-section (4) which stands in the name of another person in the register of members of the company, shall, within thirty days from the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), or from the date on which he acquires such interest, whichever is later, make a declaration in the prescribed form (which shall be countersigned by the person in whose name the share is registered) to the company declaring his interest in such share, and notwithstanding anything contained in



any other law or in any contract to the contrary, a person who fails to make a declaration as aforesaid in respect of any share shall be deemed to have no right or title whatsoever in that share:

Provided that nothing in this sub-section shall affect the right of a person who has an interest in any such share to establish in a court his right thereto, if the person, in whose name the share is registered, refuses to countersign the declaration as required by this sub-section:

Provided further that where any share, belonging to an individual who has made any such declaration as is referred to in this sub-section, is held by a company in its name in pursuance of any trust or for the purpose of safe custody or collection or realization of dividend, such individual shall, notwithstanding anything contained in the Indian Companies Act, 1913 (7 of 1913), or in the memorandum or articles of association of the company which has issued the share, be deemed to be the holder of the said share for the purpose of exercising any voting rights under this section to the exclusion of any other person.

- (6) If the total paid-up holding of any person in the shares of a company referred to in sub-section (1) on the commencement of the Insurance (Amendment) Act 1950 (47 of 1950), exceeds two and a half per cent of its paid-up capital where that person is a banking company or an investment company, or five per cent of its paid-up capital in any other case, he shall not be entitled to any vote as a shareholder of the company in respect of such excess holding of shares.
- (7) Where the total paid-up holding of any person in the shares of a company referred to sub-section (1) on the date of the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), exceeds five per cent of its paid-up capital where that person is a banking company or an investment company, or ten per cent of its paid-up capital in any other case, he shall dispose of the excess holding of shares within three years from such commencement or such further period not exceeding two years as may be allowed to him by the Central Government.
- (8) If, after the expiry of three years or of such further period as may be allowed to any person under sub-section (7), the total paid up holding of any such person has not been reduced to the limits specified in that sub-section, any shares in excess of the limits specified in that sub-section shall vest in the Administrator- General of the State in which the registered office of the company concerned is situate and the Administrator- General shall take such steps as may be necessary for taking charge of any property which has so vested in him and shall dispose of the said shares and the proceeds thereof in such manner as may be prescribed.
- (9) Subject to the other provisions contained in this section, but notwithstanding anything contained in the Indian Companies Act, 1913 (7 of 1913), or in the memorandum or articles of association of any such company as is referred to in sub-section (1), no such company shall refuse to register the transfer of any shares where the transfer is for the purpose of securing compliance with the provisions of sub-sections (7) and (8).
- (10) The Central Government may, subject to such restrictions as it may think fit to impose, exempt from the operation of sub-sections (6), (7) and (8) any insurance company, in any case where the total paid-up holding of such insurance company in the shares of any other insurance company exceeds the limits specified in the said sub-sections, if the other insurance company is or is to be made a subsidiary company of the insurance company.
- (11) The provisions of this section, except those of sub-sections (7), (8) and (9), shall, on and from the commencement of the Insurance (Amendment) Act, 1968, also apply to insurers carrying on general insurance business subject to the following notifications, namely:-
 - (i) that references in sub-sections (1), (3), (5) and (6) to the Insurance (Amendment) Act, 1950, (47 of 1950), shall be construed as reference to the Insurance (Amendment) Act, 1968; and
 - (ii) references in sub-section (10) to sub-sections (7) and (8) shall be omitted.

Explanation -For the purposes of this section, the holding of a person in the shares of a company shall be deemed to include-

- (i) the total paid-up holding in such shares held by such person in the name of others; and
- (ii) if any shares of the company are held -
 - (a) by a public limited company, of which such person is a member holding more than ten per cent. of the paid-up capital, or
 - (b) by a private limited company, of which such person is a member, or
 - (c) by a company, of which such person is a managing director, manager, managing agent or in which he has a controlling interest, or
 - (d) by a firm in which such person is a partner, or
 - (e) by such person jointly with others,

such part of the total paid-up holding of the company or firm or of the total joint holding in those shares, as is proportionate to the contribution made by such person to the paid-up capital of the company, the paid-up capital of the firm or the joint holding, as the case may be.

Manner of divesting excess shareholding by promoter in certain cases [Section 6AA]

- (1) No promoter shall at any time hold more than twenty-six per cent or such other percentage as may be prescribed, of the paid-up equity capital in an Indian insurance company:

Provided that in a case where an Indian insurance company begins the business of life insurance, general insurance or re-insurance in which the promoters hold more than twenty-six per cent of the paid-up equity capital or such other excess percentage as may be prescribed, the promoters shall divest in a phased manner the share capital in excess of the twenty-six per cent of the paid-up equity capital or such excess paid-up equity capital as may be prescribed, after a period of ten years from the date of the commencement of the said business by such Indian insurance company or within such period as may be prescribed by the Central Government.

Explanation.- For the removal of doubts, it is hereby declared that nothing contained in the proviso shall apply to the promoters being foreign company, referred to in sub-clause (b) of clause (7-A) of section 2.

- (2) The manner and procedure for divesting the excess share capital under sub-section (1) shall be specified by the regulations made by the Authority.

Provision for securing compliance with requirements relating to capital structure [Section 6B]

- (1) For the purpose of enabling any public company carrying on life insurance business to bring its capital structure into conformity with the requirements of section 6A, an officer appointed in this behalf by the Central Government may, notwithstanding anything contained in the Indian Companies Act, 1913 (7 of 1913),—

- (a) examine any scheme proposed for the purpose aforesaid by the directors of the company:

Provided that—

- (i) the scheme has been placed before a meeting of the shareholders for their opinion and has been forwarded to the officer together with the opinion of the shareholders thereon, and
 - (ii) the scheme does not involve any diminution of the liability of the shareholders in respect of unpaid-up share capital;
 - (b) invite objections and suggestions in respect of the scheme so proposed; and



- (c) after considering such objections and suggestions to the scheme so proposed, sanction it with such modifications as he may consider necessary or desirable.
- (2) Any shareholder or other person aggrieved by the decision of the officer sanctioning a scheme under sub-section (1) may, within ninety days of the date of the order sanctioning the scheme, prefer an appeal to the High Court within whose jurisdiction the registered office of the insurer is situate for the purpose of modifying or correcting any such scheme for the purpose specified in sub-section (1).
- (3) The decision of the High Court where an appeal has been preferred to it under sub-section (2), or of the officer aforesaid where no such appeal has been preferred, shall be final and binding on all the shareholders and other persons concerned.
- (4) The provisions of this section shall, on and from the commencement of the Insurance (Amendment) Act, 1968, also apply to insurers carrying on general insurance business.

Conversion of company limited by shares into company limited by guarantee

- 6C.** (1) Where a public company limited by shares carrying on insurance business has passed a special resolution for converting itself into a public company limited by guarantee, it may apply to the Central Government with a scheme for putting the special resolution into effect, including any provision for the alteration of the memorandum or articles of association insofar as it may be necessary for this purpose.
- (2) If the Central Government, after giving such notice to any person concerned as it thinks fit, is satisfied-
 - (a) that the scheme makes suitable provision with respect to the repayment, conversion or liquidation of the paid-up capital of the company,
 - (b) that the consent of the creditors to the conversion of the company limited by shares into a company limited by guarantee has been obtained, or that suitable provisions have been made for discharging, determining or securing the debts or claims of such creditors, and
 - (c) that the scheme is otherwise reasonable, it may sanction the scheme and thereupon the scheme shall become binding on the company and on all the persons concerned.
 - (3) Against the decision of the Central Government, sanctioning a scheme under sub-section (2), any person aggrieved thereby may, within ninety days of the date of the order sanctioning the scheme, prefer an appeal to the High Court within whose jurisdiction the registered office of the insurer is situate.
 - (4) The decision of the High Court where an appeal has been preferred to it under sub-section (3) or of the Central Government where no such appeal has been preferred, shall be final and binding on all the persons concerned.
 - (5) Where a scheme has been sanctioned under this section, the company shall file with the Registrar of Companies a certified copy of the scheme as sanctioned, and thereupon the provisions of the Indian Companies Act, 1913 (7 of 1913), relating to companies limited by guarantee shall become applicable to the company.

Deposits [Section 7]

- (1) Every insurer shall, in respect of the insurance business carried on by him in India, deposit and keep deposited with the Reserve Bank of India in one of the offices in India of the Bank for and on behalf of the Central Government the amount hereafter specified, either in cash or in approved securities estimated at the market value of the securities on the day of deposit, or partly in cash and partly in approved securities so estimated:-
 - (a) in the case of life insurance business, a sum equivalent to one per cent of his total gross

premium written in India in any financial year commencing after the 31st day of March, 2000, not exceeding rupees ten crores;

- (b) in the case of general insurance business, a sum equivalent to three per cent of his total gross premium written in India, in any financial year commencing after the 31st day of March, 2000, not exceeding rupees ten crores;
- (c) in the case of re-insurance business, a sum of rupees twenty crores

Provided that, where the business done or to be done is marine insurance only and relates exclusively to country craft or its cargo or both, the amount to be deposited under this sub-section shall be one hundred thousand rupees only:

Provided further that in respect of an insurer not having a share capital and carrying on only such insurance business as in the opinion of the Central Government is not carried on ordinarily by insurers under separate policies, the Central Government may, by notification under Official Gazette, order that the provisions of this sub-section shall apply to such insurer with the modification that instead of sum of rupees twenty lakhs or rupees ten lakhs, as the case may be, the deposit to be made by such insurer shall be such amount, being not less than one hundred and fifty thousand rupees, as may be specified in the said order.

- (2) Where the insurer is an insurer specified in sub-clause (c) of clause (9) of Section 2, he shall be deemed to have complied with the provisions of this section as to deposits, if in respect of insurance business carried on by him in India under a standing contract of the nature referred to in sub-clause (c) of clause (9) of section 2 a deposit of an amount one-and-a-half times that specified in sub-section (1) has been made in the Reserve Bank of India in one of the offices in India of the Bank for and on behalf of the Central Government in cash or approved securities estimated at the market value of the securities on the day of deposit by or on behalf of the underwriters who are members of the Society of Lloyd's with whom he has his standing contract.
- (3) Where the deposit to be made by an insurer not carrying on insurance business in India immediately before the commencement of the Insurance (Amendment) Act, 1968, a deposit of rupees ten lakhs shall be made before the application for registration is made, and the provision of clause (ii) of sub-section (1A) shall apply to such insurer after his registration as they apply to an insurer specified in clause (a) of sub-section (1).
- (4) An insurer shall not be registered for any class of insurance business in addition to the class or classes for which is already registered until the full deposit required under sub-section (1) has been made.
- (5) Where an insurer who intends to become a member of a group, does not carry on all the classes of insurance business carried on by the other insurers in such group, or, where out of the several insurers who desire to form themselves into a group, any insurer does not carry on all the classes of insurance business carried on by the other insurers who desire to form themselves into the group, such insurer may be registered for that class or those classes of insurance business which is or are carried on by the other insurers of the group or the proposed group, as the case may be, and where any application for registration is made by any such insurer, the Authority may, notwithstanding anything contained in sub-section (2A) of Section 3 or sub-section (4), register such insurer for one or more additional classes of insurance, if the following conditions are fulfilled, namely:-
 - (a) the Authority is satisfied that registration for the proposed one or more additional classes of insurance- business would qualify the insurer to become member of a group;
 - (b) agreements have been executed by all the insurers in the group or proposed group, as the case may be, and such agreements in the opinion of the Authority, satisfy the requirements of the Explanation to sub-section (1B); and



- (c) the insurer has, after the commencement of the Insurance (Amendment) Act, 1968, made deposit of a sum not less than the total of all the instalments of deposit which he would have been required to make after such commencement till the date of his becoming a member of the group, had he been a member of the group from such commencement.
- (6) The Authority shall cancel the registration made in pursuance of the provisions of sub-section (5), if the insurer referred to therein fails to become, within a period of three months from the date of such registration' a member of the group or proposed group, as the case may be, and, where such registration has been cancelled, the provisions of this Act shall apply to the insurer as if he had not been registered for the class or classes of insurance business in relation to which his registration has been cancelled.
- (7) Securities already deposited with the Authority of Currency in compliance with the Indian Life Assurance Companies Act, 1912 (6 of 1912), shall be transferred by him to the Reserve Bank of India and shall, to the extent of their market value as at the date of the commencement of this Act, be deemed to be deposited under this Act, as the instalment or as part of this instalment to be made under the foregoing provisions of this section before the application for registration is made whether any such application is or is not in fact made.
- (8) A deposit made in cash shall be held by the Reserve Bank of India to the credit of the insurer and shall except to the extent, if any, to which the cash has been invested in securities under sub-section (9A), be returnable to the insurer in cash in any case in which under the provisions of this Act a deposit is to be returned; and any interest accruing due and collected on securities deposited under sub-section (1) or sub-section (2) shall be paid to the insurer, subject only to deduction of the normal commission chargeable for the realization of interest.
- (9) The insurer may at any time replace any securities deposited by him under this section with the Reserve Bank of India either by cash or by other approved securities or partly by cash and partly by other approved securities, provided that such cash, or the value of such other approved securities estimated at the market rates prevailing at the time of replacement, or such cash together with such value, as the case may be, is not less than the value of the securities replaced estimated at the market rates prevailing when they were deposited.
- (9A) The Reserve Bank of India shall, if so requested by the insurer,—
- (a) sell any securities deposited by him with the Bank under this section and hold the cash realized by such sale as deposit, or
 - (b) invest in approved securities specified by the insurer the whole or any part of a deposit held by it in cash or the whole or any part of cash received by it on the sale of or on the maturing of securities deposited by the insurer, and hold the securities in which investment is so made as deposit.
- and may charge the normal commission on such sale or on such investment.
- (9B) where sub-section (9A) applies -
- (a) if the cash realized by the sale of or on the maturing of the securities (excluding in the former case the interest accrued) falls short of the market value of the securities at the date on which they were deposited with the Bank, the insurer shall make good the deficiency by a further deposit either in cash or in approved securities estimated at the market value of the securities, on the day on which they are deposited, or partly in cash and partly in approved securities so estimated, within a period of two months from the date on which the securities matured or were sold or where the securities matured or were sold before the 21st day of March, 1940, within a period of four months from the commencement of the Insurance (Amendment) Act, 1940 (20 of 1940); and unless he does so the insurer shall be deemed to have failed to comply with the requirements of this section as to deposits; and

- (b) if the cash realized by the sale of or on the maturing of the securities (excluding in the former case the interest accrued) exceeds the market value of the securities at the date on which they were deposited with the Bank, the Central Government may, if satisfied that the full amount required to be deposited under sub-section (1) is in deposit, direct the Reserve Bank to return the excess.
- (10) If any part of a deposit made under this section is used in the discharge of any liability of the insurer, the insurer shall deposit such additional sum in cash or approved securities estimated at the market value of the securities on the day of deposit, or partly in cash and partly in such securities, as will make up the amount so used. The insurer shall be deemed to have failed to comply with the requirements of sub-section (1), unless the deficiency is supplied within a period of two months from the date when the deposit or any part thereof is so used for discharge of liabilities.

Reservation of deposits [Section 8]

- (1) Any deposit made under section 7 or section 98 shall be deemed to be part of the assets of the insurer but shall not be susceptible of any assignment or charge; nor shall it be available for the discharge of any liability of the insurer other than liabilities arising out of policies of insurance issued by the insurer so long as any such liabilities remain undischarged; nor shall it be liable to attachment in execution of any decree except a decree obtained by a policy-holder of the insurer in respect of a debt due upon a policy which debt the policy-holder has failed to realise in any other way.
- (2) Where a deposit is made in respect of life insurance business the deposit made in respect thereof shall not be available for discharge of any liability of the insurer other than liabilities arising out of policies of life insurance issued by the insurer.

Refund of deposit [Section 9]

Where an insurer has ceased to carry on in India all classes of insurance business, and his liabilities in India in respect of all classes of insurance business have been satisfied or are otherwise provided for, the court may, on the application of the insurer, order the return to the insurer of the deposit made by him under this Act.

Separation of accounts and funds [Section 10]

- (1) Where the insurer carries on business of more than one of the following classes, namely, life insurance, fire insurance, marine insurance or miscellaneous insurance, he shall keep a separate account of all receipts and payments in respect of each such class of insurances business and where the insurer carries on business of miscellaneous insurance whether alone or in conjunction with business of another class, he shall, unless the Authority waives this requirement in writing, keep a separate account of all receipts and payments in respect of each of such sub-classes of miscellaneous insurance business as may be prescribed in this behalf:

Provided that no sub-class of miscellaneous insurance business shall be prescribed under this sub-section if the insurance business comprised in the sub-clause consist of insurance contracts which are terminable by the insurer at intervals not exceeding twelve months and under which, if a claim arises, the insurer's liability to pay benefit ceases within one year of the date on which the claim arose.

- (2) Where the insurer carries on the business of life insurance all receipts due in respect of such business, shall be carried to and shall form a separate fund to be called the life insurance fund the assets of which shall, after the expiry of six months from the commencement of the Insurance (Amendment) Act, 1946 (6 of 1946), be kept distinct and separate from all other assets of the insurer and the deposit made by the insurer in respect of life insurance business shall be deemed to be part of the assets of such fund; and every insurer shall, within the time limited in sub-section



(1) of section 15 in regard to the furnishing of the statements and accounts referred to in section 11, furnish to the Authority a statement showing in detail such assets as at the close of every calendar year duly certified by an auditor or by a person qualified to audit under the law of the insurer's country:

Provided that such statement shall, in the case of an insurer to whom section 11 applies, be set out as a part of the balance-sheet mentioned in clause (a) of sub-section (1) of that section:

Provided further that an insurer may show in such statement all the assets held in his life department, but at the same time showing any deductions on account of general reserves and other liabilities of that department:

Provided also that the Authority may call for a statement similarly certified of such assets as at any other date specified by him to be furnished within a period of three months from the date with reference to which the statement is called for

- (2A) No insurer carrying on life insurance business shall be entitled to be registered for any class of insurance business in addition to the class or classes for which he has been already registered unless the Authority is satisfied that the assets of the life insurance fund of the insurer are adequate to meet all his liabilities on policies of life insurance maturing for payment.
- (3) The life insurance fund shall be as absolutely the security of the life policy-holders as though it belonged to an insurer carrying on no other business than life insurance business and shall not be liable for any contracts of the insurer for which it would not have been liable had the business of the insurer been only that of life insurance and shall not be applied directly or indirectly for any purposes other than those of the life insurance business of the insurer.

Accounts and balance- sheet [Section 11]

- (1) Every insurer, in the case of an insurer specified in sub-clause (a) (ii) or sub-clause (b) of clause (9) of section 2 in respect of all insurance business transacted by him, and in the case of any other insurer in respect of the insurance business transacted by him in India, shall at the expiration of each financial year prepare with reference to that year,—
 - (a) in accordance with regulations contained in part I of the First Schedule, a balance- sheet in the form set forth in Part II of that Schedule;
 - (b) in accordance with the regulations contained in part I of the Second Schedule, a profit and loss account in the forms set forth in Part II of that Schedule, except where the insurer carries on business of one class only of the following classes, namely, life insurance, fire insurance or marine insurance and no other business;
 - (c) in respect of each class or sub-class of insurance business for which he is required under sub-section (1) of section 10 to keep a separate account of receipts and payments, a revenue account in accordance with the Regulations, and in the form or forms, set forth in the Third Schedule applicable to that class or sub-class of insurance business.
- (1A) Notwithstanding anything contained in sub-section (1), every insurer, on or after the commencement of the Insurance Regulatory and Development Authority Act, 1999, in respect of insurance business transacted by him and in respect of his shareholders' funds, shall, at the expiration of each financial year prepare with reference to that year, a balance-sheet, a profit and loss account, a separate account of receipts and payments, a revenue account in accordance with the regulations made by the Authority.
- (1B) Every insurer shall keep separate accounts relating to funds of shareholders and policy-holders.
- (2) Unless the insurer is a company, as defined in clause (2) of sub-section (1) of Section 2 of the Indian Companies Act, 1913 (7 of 1913), the accounts and statements referred to in sub-section (1) shall be signed by the insurer, or in the case of a company by the chairman, if any, and two

directors and the principal officer of the company, or in the case of a firm by two partners of the firm, and shall be accompanied by a statement containing the names, descriptions and occupations of, and the directorships held by, the persons in charge of the management of business during the period to which such accounts and statements refer and by a report on the affairs of the business during that period.

- (3) Where an insurer carrying on the business of insurance at the commencement of this Act has prepared the balance-sheet and accounts required by the Indian Life Assurance Companies Act, 1912 (6 of 1912), or has based his accounts upon the financial and not the calendar year, the provisions of this section shall, if the Central Government so directs in any case, apply until the 31st day of December, 1939, as if in sub-section (1) references to the calendar year were references to the financial year.

Audit [Section 12]

The balance-sheet, profit and loss account, revenue account and profit and loss appropriation account of every insurer, in the case of an insurer specified in sub-clause (a)(ii) or sub-clause (b) of clause (9) of section 2 in respect of all insurance business transacted by him, and in the case of any other insurer in respect of the insurance business transacted by him in India, shall, unless they are subject to audit under the Indian Companies Act, 1913 (7 of 1913), be audited annually by an auditor, and the auditor shall in the audit of all such accounts have the powers of, exercise the functions vested in, and discharge the duties and be subject to the liabilities and penalties imposed on, auditors of companies by section 145 of the Indian Companies Act, 1913.

Actuarial report and abstract [Section 13]

- (1) Every insurer carrying on life insurance business shall, in respect of the life-insurance business transacted by him in India, and also in the case of an insurer specified in sub-clause (a) (ii) or sub-clause (b) of clause (9) of section 2 in respect of all life insurance business transacted by him, every year cause an investigation to be made by an actuary into the financial condition of the life insurance business carried on by him, including a valuation of his liabilities in respect thereto and shall cause an abstract of the report of such actuary to be made in accordance with the regulations contained in Part I of the Fourth Schedule and in conformity with the requirements of Part II of that Schedule:

Provided that the Authority may, having regard to the circumstances any particular insurer, allow him to have the investigation made as at a date not later than two years from the date as at which the previous investigation was made:

Provided further that for an insurer carrying on life insurance business in India at the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), the last date as at which the first investigation after such commencement should be caused to be made by an actuary shall be-

- (a) the 31st day of December, 1950, or the date of expiration of five years from the date at which the last investigation was made by an actuary before such commencement, whichever is earlier, where the said last investigation was at a date-
 - (i) before the 31st day of December, 1946, but not more than five years before such commencement, or
 - (ii) after the 30th day of December, 1946, but before the 31st day of December, 1947, and had disclosed a deficit in the life insurance fund;
- (b) the 31st day of December, 1951, where the last investigation by an actuary before such commencement was at a date-
 - (i) after the 30th day of December, 1946, but before the 31st day of December, 1947, and did not disclose a deficit in the life insurance fund; or



- (ii) after the 30th day of December, 1947, but before the 31st day of December, 1948;
- (c) the 31st day of December, 1952, where the last investigation by an actuary before such commencement was as at any date after the 30th day of December, 1948, but before the 1st day of January, 1950:

Provided also that for an insurer carrying on life insurance business in India immediately before the commencement of the Insurance Regulatory and Development Authority Act, 1999, the last date as at which the first investigation after such commencement should be caused by an actuary, shall be the 31st day of March, 2001:

Provided also that, in the case of an insurer who has not caused an investigation to be made by an actuary as at any date prior to such commencement, the date of commencement of life insurance business in India shall, for the purpose of the preceding proviso, be deemed to be the date as at which the last investigation was made by an actuary before such commencement and such investigation shall be deemed to have disclosed no deficit in the life insurance fund:

Provided also that every insurer on or after the commencement of the Insurance Regulatory and Development Authority Act, 1999, shall cause an abstract of the report of the actuary to be made in the manner specified by the regulations made by the Authority.

- (2) The provisions of sub-section (1) regarding the making of an abstract shall apply whenever at any other time an investigation into the financial condition of the insurer is made with a view to the distribution of profits or an investigation is made of which the results are made public.
- (3) There shall be appended to every such abstract as is referred to in sub-section (1) or sub-section (2) a certificate signed by the principal officer of the insurer that full and accurate particulars of every policy under which there is a liability either actual or contingent have been furnished to the actuary for the purpose of the investigation.
- (4) There shall be appended to every such abstract a statement, in conformity with their requirements of a Part II of the Fifth Schedule and prepared in accordance with the regulations contained in Part I of that Schedule, of the life insurance business in force at the date to which the accounts of the insurer are made up for the purposes of such abstract:

Provided that, if the investigation referred to in sub-sections (1) and (2) is made annually by any insurer, the statement need not be appended every year but shall be appended at least once in every three years:

Provided further that the statement referred to in sub-section (4) shall be appended in the form and in the manner specified by the regulations made by the Authority.

- (5) Where an investigation into the financial conditions of an insurer is made as at a date other than the expiration of the year of account, the accounts for the period since the expiration of the last year of account and the balance sheet as at the date at which the investigation is made shall be prepared and audited in the manner provided by this Act.
- (6) The provisions of this section relating to the life insurance business shall apply also to any such sub-class of insurance business included in the class "Miscellaneous Insurance" as may be prescribed under sub-section (1) of section 10; and the Authority may authorize such modifications and variations of the regulations contained in Part I of the Fourth and Fifth Schedules and of the requirements of Part II of those Schedules as may be necessary to facilitate their application to any such sub-class of insurance business:

Provided that, if the Authority is satisfied that the number and amount of the transactions carried out by an insurer in any such sub-class of insurance business is so small as to render periodic investigation and valuation unnecessary, he may exempt that insurer from the operation of this sub-section in respect of that sub-class of insurance business.

Register of policies and register of claims [Section 14]

Every insurer, in the case of an insurer specified in sub-clause (a)(ii) or sub-clause (b) of clause (9) of section 2 in respect of all business transacted by him, and in the case of any other insurer in respect of the insurance business transacted by him in India, shall maintain-

- (a) a register or record of policies, in which shall be entered, in respect of every policy issued by the insurer, the name and address of the policy-holder, the date when the policy was effected and a record of any transfer, assignment or nomination of which the insurer has notice, and
- (b) a register or record of claims, in which shall be entered every claim made together with the date of the claim, the name and address of the claimant and the date on which the claim was discharged, or, in the case of a claim which is rejected, the date of rejection and the grounds there for.

Submission of returns [Section 15]

- (1) The audited accounts and statements referred to in section 11 or sub-section (5) of section 13 and the abstract and statement referred to in section 13 shall be printed, and four copies thereof shall be furnished as returns to the Authority within six months from the end of the period to which they refer:

Provided that the said period of six months shall in the case of insurers having their principal place of business or domicile outside India and in the case of insurers constituted, incorporated or domiciled in India but also carrying on business outside India be extended by three months, and provided further that the Central Government may in any case extend the time allowed by this sub-section for the furnishing of such returns by a further period not exceeding three months.

- (2) Of the four copies so furnished one shall be signed in the case of a company by the chairman and two directors and by the principle officers of the company and, if the company has a managing director or managing agent, by that director or managing agent, in the case of a firm, by two partners of the firm, and, in the case of an insurer being an individual, by the Insurer himself and one shall be signed by the auditor who made the audit or the actuary who made the valuation, as the case may be.
- (3) Where the insurer's principal place of business or domicile is outside India, he shall forward to the Authority, along with the documents referred to in section 11, the balance-sheet, profit and loss account and revenue account and the valuation reports and valuation statements, if any, which the insurer is required to file with the public authority of the country in which the insurer is constituted, incorporated or domiciled, or, where such documents are not required to be filed, a certified statement showing the total assets and liabilities of the insurer at the close of the period covered by the said documents and his total income and expenditure during that period.

Returns by insurers established outside India [Section 16]

- (1) Where, by the law of the country in which an insurer, not being an insurer specified in sub-clause (a)(ii) or sub-clause (b) of clause (9) of section 2, is constituted, incorporated or domiciled, the insurer is required to prepare and to furnish to a public authority of that country documents of substantially the same nature as the documents required to be furnished as returns in accordance with provisions of section 15, the provisions of sub-section (2) of this section shall apply to such insurer in lieu of the provisions of sections 11, 12, 13 and 15.
- (2) The insurer shall, within the time specified in sub-section (1) of Section 15, furnish to the Authority four certified copies in the English language of every balance-sheet, account, abstract, report and statement supplied to the public authority referred to in sub-section (1) of this section, and in addition thereto, four certified copies in the English language of each of the following statements, namely:-



- (a) a statement audited by an auditor or by a person duly qualified under the law of the insurer's country showing the assets held by insurer in India as at the date of any balance-sheet so furnished;
- (b) for each class or sub-class of insurance business for which he is required under sub-section (1) of section 10 to keep a separate account of receipts and payments, a revenue account for the period covered by any account so furnished, prepared in accordance with the regulations, and in the form or forms, set forth in the Third Schedule applicable to that class or subclass of insurance business and similarly audited, showing separately with respect to business transacted by the insurer in India the details required to be supplied in a revenue account furnished under this clause of this subsection;
- (c) a separate abstract of the valuation report in respect of all business transacted in India in each class or sub-class of insurance business to which section 13 refers, prepared in the manner required by that section; and
- (d) a declaration in the prescribed form stating that all amounts received by the insurer directly or indirectly whether from his head office or from any other source outside India have been shown in the revenue account except such sums as properly appertain to the capital account.

Exemption from certain provisions of the Indian Companies Act, 1913 [Section 17]

Where an insurer, being a company incorporated under the Indian Companies Act, 1913 (7 of 1913), or under the Indian Companies Act, 1882 (6 of 1882), or under the Indian Companies Acts, 1866 (10 of 1866), or under any Act repealed thereby, in any year furnishes his balance-sheet and accounts, in accordance with the provisions of section 15, he may at the same time send to the Registrar of Companies copies of such balance-sheet and accounts; and where such copies are so sent it shall not be necessary for the Company to file copies of the balance-sheet and accounts with the Registrar as required by sub-section (1) of section 134 of the first mentioned Act and such copies so sent shall be chargeable with the same fees and shall be dealt within all respects as if they were filed in accordance with that section.

This Act not to apply to preparation of account, etc., for periods prior to this Act coming into force [Section 17A]

Nothing in this Act shall apply to the preparation of accounts by an insurer and the audit and submission thereof in respect of any accounting year which has expired prior to the commencement of this Act, and notwithstanding the other provisions of this Act, such accounts shall be prepared, audited and submitted in accordance with the law in force immediately before the commencement of this Act.

Furnishing reports [Section 18]

Every insurer shall furnish to the Authority a certified copy of every report on the affairs of the concern which is submitted to the members or policy-holders of the insurer immediately after its submission to the members or policy-holders, as the case may be.

Abstract of proceedings of general meetings [Section 19]

Every insurer, being a company or body incorporated under any law for the time being in force in India, shall furnish to the Authority a certified copy of the minutes of the proceedings of every general meeting, as entered in the Minutes Book of the insurer within thirty days from the holding of the meeting to which it relates.

Custody and inspection of documents and supply of copies [Section 20]

- (1) Every return furnished to the Authority or certified copy thereof shall be kept by the Authority and shall be open to inspection; and any person may procure a copy of any such return, or of any

part thereof, on payment of a fee of six annas for every hundred words or fractional part thereof required to be copied, any five figures being deemed equivalent to one word.

- (2) A printed or certified copy of the accounts, statements and abstract furnished in accordance with the provisions of section 15 or section 16 shall, on the application of any shareholder or policy-holder made at any time within two years from the date on which the document was so furnished, be supplied to him by the insurer within fourteen days when the insurer is constituted, incorporated or domiciled in India and in any other case within one month of such application.
- (3) A copy of the memorandum and articles of association of the insurer, if a company shall on the application of any policy-holder, be supplied to him by the Insurer on payment of one rupee.

Powers of Authority regarding returns [Section 21]

- (1) If it appears to the Authority that any return furnished to him under the provisions of this Act is inaccurate or defective in any respect, he may—
 - (a) require from the insurer such further information, certified if he so directs by an auditor or actuary, as he may consider necessary to correct or supplement such return;
 - (b) call upon the insurer to submit for his examination at the principal place of business of the insurer in India any book of account, register or other document or to supply any statement which he may specify in a notice served on the insurer for the purpose;
 - (c) examine any officer of the insurer on oath in relation to the return;
 - (d) decline to accept any such return unless the inaccuracy has been corrected or the deficiency has been supplied before the expiry of one month from the date on which the requisition asking for correction of the inaccuracy or supply of the deficiency was delivered to the insurer or of such further time as the Authority may specify in the requisition and if he declines to accept any such return, the insurer shall be deemed to have failed to comply with the provisions of section 15 or section 16 or section 28 or section 28A or section 28B or section 64V relating to the furnishing of returns.
- (2) The Court may on the application of an insurer and after hearing the Authority cancel any order made by the Authority under clause (a), (b) or (c) of sub-section (1) or may direct the acceptance of any return which the Authority has declined to accept, if the insurer satisfies the Court that action of the Authority was in the circumstances unreasonable:

Provided that no application under this subsection shall be entertained unless it is made before the expiration of four months from the time when the Authority made the order or declined to accept the return.

Powers of Authority to order revaluation [Section 22]

- (1) If it appears to the Authority that an investigation or valuation to which section 13 refers or an abstract of a valuation report furnished under clause (c) of sub-section (2) of section 16 does not properly indicate the condition of the affairs of the insurer by reason of the faulty basis adopted in the valuation, he may, after giving notice to the insurer and giving him an opportunity to be heard, cause an investigation and valuation at such date as the Authority may specify to be made at the expense of the insurer by an actuary appointed by the insurer for this purpose and approved by the Authority and the insurer shall place at the disposal of the Actuary so appointed and approved all the material required by the Actuary for the purposes of the investigation and valuation within such period, not being less than three months, as the Authority may specify.
- (2) The provisions of subsections (1) and (4) of section 13, and of sub-sections (1) and (2) of section 15 or, as the case may be, of sub-section (2) of section 16, shall apply in relation to an investigation and valuation under this section:



Provided that the abstract and statement prepared as the result of such investigation and valuation shall be furnished by such date as the Authority may specify.

Evidence of documents [Section 23]

- (1) Every return furnished to the Authority which has been certified by the Authority to be a return so furnished, shall be deemed to be a return so furnished.
- (2) Every document, purporting to be certified by the Authority to be a copy of a return so furnished, shall be deemed to be a copy of that return and shall be received in evidence as if it were the original return, unless some variation between it and the original return is proved.

Summary of returns to be published [Section 24]

[Repealed by the Insurance (Amendment) Act, 1941]

Returns to be published in statutory forms [Section 25]

No insurer shall publish in India any return in a form other than that in which it has been furnished to the Authority.

Provided that nothing contained in this section shall prevent an insurer from publishing a true and accurate abstract from such returns for the purposes of publicity.

Alterations in the particulars furnished with application for registration to be reported [Section 26]

Whenever any alteration occurs or is made which affects any of the matters which are required under the provisions of sub-section (2) of section 3 to accompany an application by an insurer for registration, the insurer shall forthwith furnish to the Authority full particulars of such alteration. All such particulars shall be authenticated in the manner required by that sub-section for the authentication of the matters therein referred to, and where the alteration affects the assured rates, advantages, terms and conditions offered in connection with life insurance policies, the actuarial certificate referred to in clause (f) of the said sub-section shall accompany the particulars of the alteration.

Investment of assets [Section 27]

- (1) Every insurer shall invest and at all times keep invested assets equivalent to not less than the sum of-
 - (a) the amount of his liabilities to holders of life insurance policies in India on account of matured claims, and
 - (b) the amount required to meet the liability on policies of life insurance maturing for payment in India,
less-
 - (i) the amount of premiums which have fallen due to the insurer on such policies but have not been paid and the days of grace for payment of which have not expired, and
 - (ii) any amount due to the insurer for loans granted on and within the surrender values of policies of life insurance maturing for payment in India issued by him or by an insurer whose business he has acquired and in respect of which he has assumed liability,

in the manner following, namely, twenty-five per cent of the said sum in Government securities, a further sum equal to not less than twenty-five per cent of the said sum in Government securities or other approved securities and the balance in any of the approved investments specified in sub-section (1) of section 27A or, subject to the limitations, conditions and restrictions specified in sub-section (2) of that section, in any over investment.

(2) For the purposes of subsection (1),—

- (a) the amount of any deposit made under section 7 or section 98 by the insurer in respect of his life insurance business shall be deemed to be assets invested or kept invested Government securities;
- (b) the securities of, or guaranteed as to principal and interest by, the Government of the United Kingdom shall be regarded as approved securities other than Government securities for a period of four years from the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), in the manner and to the extent hereinafter specified, namely:—
 - (i) during the first year, to the extent of twenty-five per cent in value of the sum referred to in sub-section (1);
 - (ii) during the second year, to the extent of eighteen and three fourths per cent in value of the said sum;
 - (iii) during the third year, to the extent of twelve and a half per cent in value of the said sum; and
 - (iv) during the fourth year, to the extent of six and a quarter per cent in value of the said sum:

Provided that, if the Authority so directs in any case, the securities specified in clause (b) shall be regarded as approved securities other than Government securities for a longer period than four years, but not exceeding six years in all and the manner in which and the extent to which the securities shall be so regarded shall be as specified in the direction;

- (c) any prescribed assets shall, subject to such conditions, if any, as may be prescribed, be deemed to be assets invested or kept invested in approved investments specified in sub-section (1) of section 27A.

(3) In computing the assets referred to in subsection (1),—

- (a) any investment made with reference to any currency other than the Indian rupee which is in excess of the amount required to meet the liabilities of the insurer in India with reference to that currency, to the extent of such excess; and
- (b) any investment made in the purchase of any immoveable property outside India or on the security of any such property,

shall not be taken into account:

Provided that nothing contained in this sub-section shall affect the operation of sub-section (2):

Provided further that the Authority may, either generally or in any particular case, direct that any investment, whether made before or after the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), and whether made in or outside India, shall, subject to such conditions as may be imposed, be taken into account, in such manner as may be specified in computing the assets referred to in sub-section (1) and where any direction has been issued under this proviso copies thereof shall be laid before Parliament as soon as may be after it is issued.

- (4) Where an insurer has accepted reinsurance in respect of any policies of life insurance issued by another insurer and maturing for payment in India or has ceded reinsurance to another insurer in respect of any such policies issued by himself, the sum referred to in subsection (1) shall be increased by the amount of the liability involved in such acceptance and decreased by the amount of the liability involved in such cession.
- (5) The Government securities and other approved securities in which assets are under sub-section (1) to be invested and kept invested shall be held by the insurer free of any encumbrance, charge, hypothecation or lien.



- (6) The assets required by this section to be held invested by an insurer incorporated or domiciled outside India shall, except to the extent of any part thereof which consists of foreign assets held outside India, be held in India and all such assets shall be held in trust for the discharge of the liabilities of the nature referred to in sub-section (1) and shall be vested in trustees resident in India and approved by the Authority, and the instrument of trust under this sub-section shall be executed by the insurer with the approval of the Authority and shall define the manner in which alone the subject-matter of the trust shall be dealt with.

Explanation.—This sub-section shall apply to an insurer incorporated in India whose share capital to the extent of one-third is owned by, or the members of whose governing body to the extent of one-third consists of, members domiciled elsewhere than in India.

Further provisions regarding investments [Section 27A]

- (1) No insurer shall invest or keep invested any part of his controlled fund otherwise than in any of the following approved investments, namely:
- (a) approved securities;
 - (b) securities of, or guaranteed as to principal and interest by, the Government of the United Kingdom;
 - (c) debentures or other securities for money issued with the permission of the State Government by any municipality in a State;
 - (d) debentures or other securities for money issued by any authority constituted under any housing or building scheme approved by the Central or a State Government, or by any authority or body constituted by any Central Act or Act of a State Legislature;
 - (e) first mortgages on immoveable property situated in India under any housing or building scheme of the insurer approved by the Authority or a State Government;
 - (f) debentures secured by a first charge on any immoveable property plant or equipment of any company which has paid interest in full for the five years immediately preceding or for at least five out of the six or seven years immediately preceding on such or similar debentures issued by it;
 - (g) debentures secured by a first charge on any immovable property, plant or equipment of any company where either the book value or the market value, whichever is less, of such property, plant or equipment is more than three times the value of such debentures;
 - (h) first debentures secured by a floating charge on all its assets of any company which has paid dividends on its ordinary shares for the five years immediately preceding or for at least five out of the six or seven years immediately preceding;
 - (i) preference shares of any company which has paid dividends on its ordinary shares for the five years immediately preceding or for at least five out of the six or seven years immediately preceding;
 - (j) preference shares of any company on which dividends have been paid for the five years immediately preceding or for at least five out of the six or seven years immediately preceding and which have priority in payment over all the ordinary shares of the company in winding up;
 - (k) shares of any company which have been guaranteed by another company, such other company having paid dividends on its ordinary shares for the five years immediately preceding or for at least five out of the six or seven years immediately preceding:

Provided that the total amount of shares of all the companies under guarantee by the guaranteeing company is not in excess of fifty per cent of the paid up amount of preference and ordinary shares of the guaranteeing company;

- (l) shares of any company on which dividends of not less than four per cent including bonus have been paid for the seven years immediately preceding or for at least seven out of the eight or nine years immediately preceding;
 - (m) first mortgages on immovable property situated in India or in any other country where the insurer is carrying on insurance business
Provided that the property mortgaged is not leasehold property with an outstanding term of less than thirty years and the value of the property exceeding by one-third, or if it consists of buildings, exceeds by one-half, the mortgage money;
 - (n) immovable property situated in India or in any other country where the insurer is carrying on insurance business:
Provided that the property is free of all encumbrances;
 - (o) loans on life interests, or on policies of life insurance within their surrender values issued by him or by an insurer whose business he has acquired and in respect of which business he has assumed liability;
 - (p) life interests;
 - (q) fixed deposits with banks included for the time being in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934) or with co-operative societies registered under the Indian Co-operative Societies Act, 1912 (6 of 1912), or under any other law for the time being in force, the primary object of which is to finance other co-operative societies similarly registered;
 - (r) debentures of, or shares in co-operative societies registered under the Indian Co-operative Societies Act, 1912 (2 of 1912), or under any other law for the time being in force;
 - (s) such other investments as the Authority may, by notification in the Official Gazette, declare to be approved investments for the purposes of this section.
- (2) Notwithstanding anything contained in sub-section (1), an insurer being a company or a co-operative life insurance society as defined in clause (b) of sub-section (1) of section 95, may, subject to the provisions contained in the next succeeding sub-sections, invest or keep invested any part of his controlled fund otherwise than in an approved investment, if-
- (i) after such investment, the total amounts of all such investments of the insurer do not exceed fifteen per cent of the sum referred to in sub-section (1) of section 27,
 - (ii) the investment is made, or, in the case of any investment already made, the continuance of such investment is with the consent of all the directors present at a meeting and eligible to vote, special notice of which has been given to all the directors then in India, and all such investments, including investments in which any director is interested, are reported without delay to the Authority with full details of the investments and the extent of the director's interest in any such investment.
- (3) An insurer shall not out of his controlled fund invest or keep invested in the shares of any one banking company or investment company more than—
- (a) two and a quarter per cent of the sum referred to in sub-section (1) of section 27, or
 - (b) two per cent of the subscribed share capital and debentures of the banking company or investment company concerned, whichever is less.
- (4) An insurer shall not out of the controlled fund invest or keep invested in the shares or debentures of any one company other than a banking company or investment company more than-
- (a) two and a quarter per cent of the sum referred to in sub-section (1) of section 27, or



- (b) ten per cent. of the subscribed share capital and debentures of the company, Whichever is less:

Provided that nothing in this sub-section shall apply to any investment made with the previous consent of the Authority by an insurer, being a company with a view to forming a subsidiary company carrying on insurance business.

- (5) An insurer shall not out of his controlled fund invest or keep invest any sum in the shares or debentures of any private limited company.
- (6) Where an investment is in partly paid-up shares, the uncalled liability on such shares shall be added to the amount invested for the purpose of computing the percentages referred to in clause (a) of sub section (3) and clause (a) of subsection (4).
- (7) Notwithstanding anything contained in subsections (3) and (4), where new shares are issued to the existing shareholders by a company the existing shares of which are covered by Clause (i) or Clause (k) or Clause (l) of subsection (1) and of which an insurer is already a shareholder, the insurer may subscribe to such new shares:

Provided that the proportion of new shares subscribed by him does not exceed the proportion which the paid-up amount on the shares held by him immediately before such subscription bears to the total paid-up capital of the company at the time of such subscription

- (8) If, on an application submitted through the Authority the Authority is satisfied that special grounds exist warranting such exemption, the Authority may for such period, to such extent and in relation to such particular investments and subject to such conditions as maybe specified by it in this behalf, exempt an insurer from all or any of the provisions of sub-sections (3), (4) and (7).
- (9) An insurer shall not keep more than three per cent. of the controlled fund in fixed deposit or current deposit, or partly in fixed deposit and partly in current deposit, with any one banking company or with any one comparative society registered under the Insurance Cooperative Societies Act, 1912 (2 of 1912), or under any other law for the time being in force and doing banking business:

Provided that in applying this sub-section to the amount in deposit with banking on any day all the premiums collected by that company on behalf of the insurer during the preceding thirty days shall be excluded:

Provided further that the Authority may permit a co-operative life insurance society as defined in Clause (b) of sub-section (1) of Section 95 to keep more than three per cent. of its controlled fund in fixed deposit with any cooperative society referred to in this subsection, if the fixed deposit is secured by a first mortgage on any immoveable property.

- (10) All assets forming the controlled fund, not being Government securities or other approved securities in which assets are to be invested or held invested in accordance with Section 27, shall (except for a part thereof not exceeding one-tenth of the controlled fund in value which may, subject to such conditions and restrictions as may be prescribed, be offered as security for any loan taken for purposes of any investment), be held free of any encumbrance, charge, hypothecation or lien.
- (11) If at any time the Authority considers any one or more of the investments constituting an insurer's controlled fund to be unsuitable or undesirable, the Authority may, after giving the insurer an opportunity of being heard, direct him to realise the investment or investments, and the insurer shall comply with the direction within such time as may be specified by the Authority.
- (12) Every insurer in existence at the 'commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), whose investments or any part thereof at such commencement contravene or contravenes any of the provisions of this section, shall, within ninety days from such commencement, submit to the Authority a report specifying in all such investments, and if the Authority is satisfied that

it will not be in the interests of the insurer or any class of insurers generally to realise any such investments, it may, by order direct that the provisions of this section [other than the provisions contained in sub-section (11)] shall not apply in relation to any such investments or to any class of investments generally for such period or periods as may be specified in the order.

- (13) Without prejudice to the powers given to the Authority by subsection (11), nothing contained in this section shall be deemed to require any insurer to realise any investment made in conformity with the provisions of subsection (1) after the commencement of this Act which after the making thereof, has ceased to be an approved investment within the meaning of this section.
- (14) Nothing contained in this section shall be deemed to affect in any way the manner in which any moneys relating to the provident fund of any employee or to any security taken from any employee or over moneys of a like nature are required -to be held by or under any Central Act, or Act of a State Legislature.

Explanation.- In this section "controlled fund" means-

- (a) in the case of any insurer specified in sub-clause (a) (ii) or sub-clause (b) of Clause (9) of section 2 and carrying on life insurance business-
 - (i) all his funds, if he carries on no other class of insurance business;
 - (ii) all the funds appertaining to his life insurance business if he carries on some other class of insurance business also; and
- (b) in the case of any other insurer carrying on life insurance business,-
 - (i) all his funds in India, if he carries on no other class of insurance business;
 - (ii) all the funds in India appertaining to his life insurance business if he carries on some other class of insurance business also;

but does not include any fund or portion thereof in respect of which the Authority is satisfied that such fund or portion thereof, as the case may be, is regulated by the law of any country outside India or in respect of which the Authority is satisfied that it would not be in the interest of the insurer to apply the provisions of this section.

Further provisions regarding investments [Section 27B]

- (1) No insurer carrying on general insurance business shall, after the commencement of the Insurance (Amendment) Act, 1968 (62 of 1968), invest or keep invested any part of his asset otherwise than in any of the following approved investments, namely:
 - (a) the investment specified in clauses (a) to (e), (n), (q) and (r) of sub-section (1) of Sec. 27A;
 - (b) debentures secured by a first charge on any immoveable property, plant or equipment of any company which has paid interest in full for the three years immediately preceding or for at least three out of the four or five years immediately preceding on such or similar debentures issued by it;
 - (c) debentures secured by a first charge on any immoveable property, plant or equipment of any company where either the book value or the market value, whichever is less, of such property, plant or equipment is more than twice the value of such debentures;
 - (d) first debentures secured by a floating charge on all its assets or by a fixed charge on fixed assets and floating charge on all other assets of any company which has paid dividends on its equity shares for the three years immediately preceding or for at least three out of the four or five years immediately preceding the date of the investment;
 - (e) preference shares of any company which has paid dividends on its equity shares for the three years immediately preceding or for at least three out of the four or five years immediately preceding;



(f) preference shares of any company on which dividends have been paid for the three years immediately preceding or for at least three out of the four or five years immediately preceding and which have priority in payment over all the equity shares of the company in winding up;

(g) shares of any company which have been guaranteed by another company, such other company having paid dividends on its equity shares for the three years immediately preceding or for at least three out of the four or five years immediately preceding:

Provided that the total amount of shares of all the companies under - that guarantee by the guaranteeing company is not in excess of fifty percent. of the paid-up amount of preference and equity shares of the guaranteeing company;

(h) shares of any company on which dividends of not less than four per cent including bonus have been paid for the three years immediately preceding or for at least three out of the four or five years immediately preceding;

(i) first mortgages on immoveable proper situated in India or in any other country where the insurer is carrying on insurance business:

Provided that the property mortgaged is not lease-hold property with an outstanding term of less than fifteen years and the value of the property exceeds by one-third, or if it consists of buildings, exceeds by on-half, the mortgage money;

(j) such other investments as the Authority may, by notification in the Official Gazette, declare to be approved investments for the purposes of this section.

(2) Any prescribed assets shall, subject to such conditions, if any, as may by prescribed be deemed to be assets invested or kept invested in approved investments specified in sub-section (1).

(3) Notwithstanding anything contained in sub-section (1), an insurer may, subject to the provisions contained in the next succeeding sub-sections, invest or keep invested any part of his assets otherwise than in an approved investment specified in subsection (1), if-

(i) after such investment, the fatal amounts of all such investments of the insurer do not exceed twenty-five per cent of his assets, and

(ii) the investment is made or in the case of any investment already made, the continuance of such investment is with the consent of all the directors, other than the directors appointed under Section 34-C, present at a meeting and eligible to vote, special notice of which has been given to -all the directors then in India, and all such investments, including investments in which any director is interested, are reported without delay to the Authority with full details of investments and the extent of the director's interest in any such investment:

Provided that the making, or the continuance, of such investment is not objected to by any director appointed under Section 34-C

(4) An insurer shall not invest or keep invested any part of his assets in the shares of any one banking company or investment company more than-

(a) ten per cent of his assets, or

(b) two per cent of the subscribed share capital and Dentures of the banking company or investment company concerned,

whichever is less.

(5) An insurer shall not invest or keep invested any part of his assets in the shares or debentures of any one company other than a banking company or investment company more than

(a) ten per cent of his assets, or

- (b) ten per cent of the subscribed share capital and debentures of the company, whichever is less:

Provided that nothing in this sub-section shall apply to any investment made by an insurer in the shares of any other insurer if such other insurer is a company within the meaning of Section 3 of the Companies Act, 1956 (1 of 1956) and carries on insurance or re-insurance business in India.

- (6) An insurer shall not invest or keep invested any part of his assets in the shares or debentures of any private company.
- (7) Where an investment is in partly paid-up shares, the uncalled liability on such shares shall be added to the amount invested for the purpose of computing the percentages referred to in Clause (a) of sub-section (4) and Clause (a) of sub-section (5).
- (8) Notwithstanding anything contained in sub-sections (4) and (5) where new shares are issued to the existing shareholders by a company, the existing shares of which are covered by Clause (e) or clause (g) or Clause (h) of sub-section (1) and of which an insurer is already a share-holder, the insurer may subscribe to such new shares:

Provided that the proportion of new shares subscribed by him does not exceed the proportion which the paid-up amount on the shares held by him immediately before such subscription bears to the total paid-up capital of the company at the time of such subscription

- (9) If, on an application submitted to the Authority, he has satisfied that special grounds exist warranting such exemption, he may, for such period, to such extent and in relation to such particular investments and subject to such conditions as may be specified by him in this behalf, exempt an insurer from all or any of the provisions of sub-sections (4), (5) and (8).
- (10) An insurer shall not keep more than ten per cent. of his assets in fixed deposit or current deposit, or partly in fixed deposit and partly in current deposit, with any one banking company or with any co-operative society registered under the Co-operative Societies Act, 1912 (2 of 1912), or under any other law for the time being in force and doing banking business:

Provided that in applying this sub-section to the amount in deposit with a banking company on any day, all the premiums credited during the preceding sixty days, to the account of the insurer with such banking company and the amounts deposited, during the preceding thirty days, by such insurer with that banking company for payment of claims or out of re-insurance recoveries, shall be excluded.

- (11) All assets shall (except for a part thereof not exceeding one-tenth of the total assets in value which may, subject to such conditions and restriction as may be prescribed, be offered as security for any loan taken for purposes of any investment or for payment of claims, or which may be kept as security deposit with the banks for acceptance of policies) be held free of any encumbrance, charge, hypothecation or lien.
- (12) If at any time the Authority considers any one or more of the investments constituting an insurer's assets to be unsuitable or undesirable, he may, after giving the insurer an opportunity of being heard, direct the insurer to realize the investment or investments, and the insurer shall comply with the direction within such time as may be specified in this behalf by the Authority.
- (13) Every insurer in existence at the commencement of the insurance (Amendment) Act, 1968, whose investments or any part thereof at such commencement do or does not fulfill the requirements of this section, shall, within ninety days from such commencement, submit to the Authority a report specifying all such investments, and, if the Authority is satisfied that it will not be in the interest of the insurer or any class of insurers generally to realise any such investments, he may, by order direct that the provisions of this section, other than the provisions contained in sub-section (12), shall not apply in relation to any such investments or to any class of investments generally for such period or periods as may be specified in the order.



- (14) Without prejudice to the powers conferred on the Authority by subsection (12), nothing contained in this section shall be deemed to require any insurer to realise any investment made in conformity with the provisions of sub-section (1) after the commencement of the Insurance (Amendment) Act, 1968(62 of 1968), which, after the making thereof, has ceased to be an approved investment within the meaning of this section.
- (15) Nothing contained in this section shall be deemed to affect in any way the manner in which any moneys relating to the provident fund of any employee or to any security taken from any employee or other moneys of a like nature are required to be held by or under any Central, Provincial or State Act.
- (16) In this section, unless the context otherwise requires, "assets" means-
- (a) in the case of an insurer carrying on life insurance business in India, all his assets required to be shown under the column "Other Classes of Business" in the balance-sheet in Form A, in Part II of the First Schedule, but excluding any items against the head "Other Accounts (to be specified)";
 - (b) in the case of an insurer specified in sub-clause (a) (ii) or sub-clause (b) of Clause (9) of Sec. 2, who is not carrying on life insurance business in India, all his assets required to be shown in the balance-sheet in Form A in Part II of the First Schedule but excluding any items against the head "Other Accounts (to be specified)"; and
 - (c) in the case of any other insurer, the assets required to be shown in the statement in Form AA, in Part II of the First Schedule, but excluding office furniture,
but does not include any assets specifically held against any fund or portion thereof in respect of which the Authority is satisfied that such funds or portion thereof, as the case may be, is regulated by the law of any country outside India or in respect of which the Authority is satisfied that it would not be in the interest of the insurer to apply the provisions of this section.

Prohibition for investment of funds outside India [Section 27C]

No insurer shall directly or indirectly invest outside India, the funds of the policy-holders.

Manner and conditions of investment [Section 27D]

- (1) Without prejudice to anything contained in sections 27, 27A and 27B, the Authority may, in the interests of the policy-holders, specify by the regulations made by it, the time, manner and other conditions of investment of assets to be held by an insurer for the purposes of this Act.
- (2) The Authority may give specific directions for the time, manner and other conditions subject to which the funds of policy-holders shall be invested in the infrastructure and social sector as may be specified by regulations made by the Authority and such regulations shall apply uniformly to all the insurers carrying on the business of life insurance, general insurance, or re-insurance in India on or after the commencement of the Insurance Regulatory and Development Authority Act, 1999.
- (3) The Authority may, after taking into account the nature of business and to protect the interests of the policy-holders, issue to an insurer the directions relating to the time, manner and other conditions of investment of assets to be held by him:

Provided that no direction under this sub-section shall be issued unless the insurer concerned has been given a reasonable opportunity of being heard

Statement of investment of assets [Section 28]

- (1) Every insurer carrying on the business of life insurance shall every year, within thirty-one days from the beginning of the year submit to the Authority a return showing as at the 31st day of December

of the preceding year the assets held invested in accordance with Section 27 and all other particulars necessary to establish that the requirements of that section have been complied with, and such return shall be certified by a principal officer of the insurer.

- (2) Every such insurer shall also furnish, within fifteen days from the last day of March, June, and September, a return certified as aforesaid showing as at the end of each of the said months the assets held invested in accordance with Sec. 27.
- (2A) In respect of the Government securities and other approved securities invested and kept invested in accordance with sub-section (1) of Section 27 an insurer shall submit along with the returns referred to in sub-sections (1) and (2) a certificate, where such assets are in the custody of a banking company, from that company, and in any other case from the chairman, two directors and a principal officer, if the insurer is a company, or otherwise from a principal officer of the insurer to the effect that the securities are held free of any encumbrance, charge, hypothecation, or lien, and every such certificate after the first shall also state that since the date of the certificate immediately preceding all the securities have been so held.
- (2B) In respect of the assets forming the controlled fund within the meaning of Section 27A, and which do not form part of the Government securities and approved securities invested and kept invested in accordance with Section 27, an insurer shall submit, along with the returns referred to in sub-sections (1) and (2), a statement, where such assets are in the custody of a banking company, from that company, and, in any other case, from the chairman, two directors and a principal officer if the insurer is a company, or from a principal officer of the insurer if the insurer is not a company, specifying the assets, which are subjected to any charge and certifying that the assets, which are held free of any encumbrance, charge, hypothecation, or lien, and every such statement after the first shall also specify the charges created in respect of any of those assets since the date of the statement immediately preceding, and, if any such charges have been liquidated, the date on which they were so liquidated.
- (3) The Authority may, at his discretion require any insurer to whom sub-section (1) applies to submit before the 1st day of August in each or any year a return of the nature referred to in subsection (1), certified as required by mat sub-section and prepared as at the 30th day of June.
- (4) In the case of an insurer having his principal place of business or domicile outside India, the Authority may, on application made by the insurer, extend the periods of fifteen and thirty-one days mentioned in the foregoing sub-sections to thirty days and sixty days, respectively.
- (5) The Authority shall be entitled at any time to take such steps as he may consider necessary for the inspection or verification of the assets invested in compliance with Section 27 or for the purpose of securing the particulars necessary to establish that the requirements of that section have been complied with; the insurer shall comply with any requisition made in this behalf by the Authority, and if he fails to do so within two months from the receipt of the requisition he shall be deemed to have made default in complying with the requirements of this section.

Return of investments relating to controlled fund and changes therein [Section 28A]

- (1) Every insurer carrying on life insurance business, shall every year, within thirty-one days from the beginning of the year submit to the Authority a return in the form specified by the regulations made by the Authority showing as at the 31st day of March of the preceding year, the investments made out of the controlled fund referred to in Section 27A, and every such return shall be certified by a principal officer of the insurer.
- (2) Every insurer referred to in sub-section (1) shall also submit to the Authority a return in the form specified by the regulations made by the Authority showing all the changes that occurred in the investments aforesaid during each of the quarters ending on the last day of March, June, September and December within thirty-one days from the close of the quarter to which it relates, and every such return shall be certified by a principal officer of the insurers.



Returns of investments relating to the assets and changes therein [Section 28B]

- (1) Every insurer carrying on general insurance business, shall, every year, within thirty-one days from the beginning of the year, submit to the Authority a return in the form specified by the regulations made by the Authority form showing as at the 31st day of March of the preceding year the investments made out of his assets referred to in Section 27B, and every such return shall be certified by a principal officer of the insurer.
- (2) Every insurer referred to in sub-section (1) shall also submit to the Authority a return in the form specified by the regulations made by the Authority showing all the changes that occurred in the investment aforesaid during each of the quarters ending on the last day of March, June, September and December within thirty-one days from the close of the quarter to which it relates, and every such return shall be certified by a principal officer of the insurer.
- (3) Every insurer shall submit, along with the returns referred to in sub-sections (1) and (2), a statement, where any part of the assets are in the custody of a banking company, from that company, and in any other case, from the chairman, two directors and a principal officer, if the insurer is a company, or from a principal officer of the insurer, if the insurer, is not a company, specifying the assets, which are subject to charge and certifying that the other assets are held free of any encumbrance, charge, hypothecation or lien, and every such statement after the first shall also specify the charges created in respect of any of those assets since the date of the statement immediately preceding, and, if any such charges have been liquidated, the date on which they were so liquidated.

Prohibition of loans [Section 29]

- 29.** (1) No insurer shall grant loans or temporary advances either on hypothecation of property or on personal security or otherwise, except loans on life policies issued by him within their surrender value, to any director, manager, managing agent, actuary, auditor or officer of the insurer if a company, or where the insurer is a firm, to any partner therein, or to any other company or firm in which any such director, manager, managing agent, actuary, officer or partner holds the position of a director, manager, managing agent' actuary, officer or partner:

Provided that nothing contained in this sub-section shall apply to loans made by an insurer to a banking company:

Provided further that nothing in this section shall prohibit a company from granting such loans or advances to subsidiary company or to any other company of which the company granting the loan or advance is a subsidiary company eland where any such loan or advance is made out of any life insurance fund the matter shall be reported within thirty days of the making of such loan or advance to the Authority.

- (2) The provisions of Section 86D of the Indian Companies Act, 1913 (7 of 1913), shall not apply to a loan granted to a director of an insurer being a company, if the loan is one granted on the security of a policy on which the insurer bears the risk and the policy was issued to the director on his own life, and the loan is within the surrender value of the policy.
- (3) Subject to the provisions of sub-section (1), no insurer carrying on life insurance business shall grant—
 - (a) any loans or temporary advances either on hypothecation of property or on personal security or otherwise, except such loans as are specified in sub-section (1) of Section 27A;
 - (b) temporary advances to any chief, special or insurance agent to facilitate the carrying out of his functions as such except in cases where such advances do not exceed in the aggregate—
 - (i) in the case of a chief agent, the overriding renewal commission earned by him during the year immediately preceding,

- (ii) in the case of special agent, the renewal commission earned by him during the year immediately preceding,
- (iii) in the case of an insurance agent, the renewal commission earned by him during the year immediately preceding.

Explanation.- The temporary advance referred to in clause (b) of this sub-section shall also be admissible in the case of any special agent or insurance agent newly appointed, but such advance—

- (a) shall be repayable within two years from the date on which such special agent or insurance agent was first appointed, and
 - (b) shall not exceed, in the case of the special agent, five hundred rupees, and, in the case of the insurance agent, one hundred rupees,
and the total amount of all advances so made shall not exceed ten thousand rupees in the case of any insurer whose business in force is one crore of rupees or more and five thousand rupees in any other case.
- (4) Every loan or advance existing at the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), which contravenes the provisions of subsection (3) shall be notified by the insurer to the Authority within thirty days of such commencement and shall notwithstanding any contract to the contrary be repaid within one year from commencement.
 - (5) Where any event occurs giving rise to circumstances, the existence of which at the time of the grant of any subsisting loan or advance would have made such grant a contravention of this section, such loan or advance shall, notwithstanding anything in any contract to the contrary, be repaid within three months from the occurrence of such event.
 - (6) In case of default in complying with the provisions of sub-section (4) or subsection (5) the director, manager, auditor, actuary, officer or partner, or the chief, special or insurance agent concerned shall, without prejudice to any other penalty which he may incur, cease to hold office under, or to act for, the insurer granting the loan on the expiry of the said period of one year or three months, as the case may be.

Liability of directors, etc. for loss due to contraventions of Sections 27, 27A and 29

- 30.** If by reason of a contravention of any of the provisions of Section 27, Section 27A, Section 27B or Section 29, any loss is sustained by the insurer or by the policy-holders, every director, manager, managing agent, officer or partner who is knowingly a party to such contravention shall, without prejudice to any other penalty to which he may be liable under this Act, be jointly and severally liable to make good the amount of such loss.

Assets of insurer how to be kept [Section 31]

- (1) None of the assets in India of any insurer shall, except in the case of deposits made with the Reserve Bank of India under Section 7 or Section 98 or in so far as assets are required to be vested in trustees by sub-section (4) of Section 27, be kept otherwise than in the name of a public officer approved by the Authority, or in the corporate name of the undertaking, if a company, or in the name of the partners, if a firm, or in the name of the proprietor, if an individual.
- (2) Nothing contained in this section shall be deemed to prohibit the endorsement in favour of a banking company of any security or other document solely for the purpose of collection or for realization of interest, bonus or dividend.

Provisions relating to managers, etc [Section 31A]

- (1) Notwithstanding anything to the contrary contained in the Indian Companies Act, 1913 (7 of 1913), or in the articles of association of the insurer, if a company, or in any contract or agreement,



no insurer shall after expiry of one year from the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950),

- (a) be managed by a company or a firm, or
- (b) be directed or managed by, or employ as manager, or officer or in any capacity, any person whose remuneration or any part thereof takes the form of commission or bonus or a share in the valuation surplus in respect of the life insurance business of the insurer, or
- (c) be directed or managed by, or employ as manager or officer or in any capacity, any person whose remuneration or any part thereof takes the form of commission or bonus in respect of the general insurance business of the insurer:

Provided that nothing in this sub-section shall be deemed to prohibit-

- (i) the payment of commission to a chief agent, special agent or an insurance agent, in respect of life insurance business procured by or through him;
 - (ii) the payment of commission to a principal agent or an insurance agent in respect of general insurance business procured by or through him;
 - (iii) the payment of commission, with the approval of the Central Government and for such period as it may determine, to a person not being an officer of an insurer who was, on the 1st November, 1944, employing on behalf of an insurer, chief agents or special agents and continues so to do in respect of insurance business procured by or through him;
 - (iv) the employment of any individual in a clerical or other subordinate capacity who, as an insurance agent, receives commission in respect of insurance business procured by him;
 - (v) the employment as an officer of any individual who receives renewal commission in respect of life insurance business procured by him in his capacity as an insurance agent or as an employer of agents before such employment, or before the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), whichever is later;
 - (vi) the payment of a share in the profits of general insurance business;
 - (vii) the payment of bonus in any year on a uniform basis to all salaried employees or any class of them by way of additional remuneration.
- (2) Notwithstanding anything to the contrary contained in the Indian Companies Act, 1913 (7 of 1913), or in the articles of association of the insurer, being a company, or in any contract or agreement, no manager, managing director or any other person concerned in the management of an insurer's business shall be entitled to nominate a successor to his office, and no person so nominated, whether before or after the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), shall be entitled to hold or to continue in such office.
- (3) If in the case of any insurance company provision is made by the articles of association of the company
- or by an agreement entered into between any person and the company for empowering a director or manager or other officer of the company to assign his office to any other person, any assignment of office made in pursuance of the said provision, shall, notwithstanding anything to the contrary contained in the said provisions or in Section 86B of the Indian Companies Act, 1913 (7 of 1913), be void.
- (4) No person shall have any right, whether in contract or otherwise, to any compensation for any loss incurred by reason of the operation of any provision of this section.

Power to restrict payment of excessive remuneration [Section 31B]

- (1) The Authority may if it is satisfied that any insurer, in the case of an insurer specified in sub-clause

(a) (ii) or sub-clause (b) of Clause (9) of Section 2 in respect of all insurance business transacted by him, and in the case of any other insurer in respect of the insurance business transacted by him in India, is paying any person remuneration, whether by way of commission or otherwise on a scale disproportionate, according to the normal standards prevailing in insurance business, to the resources of the insurer, call upon the insurer to comply within six months with such directions as it may think fit to issue in the matter, and if compliance with the directions so issued requires the alteration of any of the terms of the contract entered into by the insurer with such person, no compensation shall be payable to such person by the insurer by reason only of such alteration or of the resignation of such person if the altered terms are not acceptable to him and no payment by way of renewal commission or otherwise shall be made to such person by the insurer in respect of any premiums paid after the date of such resignation except at such rate as may be approved by the Authority in this behalf.

- (2) Every insurer shall, before the close of the month following every year, submit to the Authority a statement in the form specified by the regulations made by the Authority showing the remuneration paid whether by way of commission or otherwise, to any person in cases where such remuneration exceeds such sum as may be specified by the regulations made by the Authority.
- (3) Where any person not being a chief agent, principal agent or special agent is in respect of remuneration exceeding the sum of five thousand rupees in any year, the Authority may, by notice in writing, require the insurer to submit certified copies of the agreement entered into between the insurer and any such person, and the insurer shall comply with any such requisition within the time specified in the notice.
- (4) Every direction under this section shall be issued by an order made by the Authority:

Provided that no order under this section shall be made unless the person concerned has been given an opportunity of being heard

Limitation on employment of managing agents and on the remuneration payable to them

[Section 32]

- (1) No insurer shall after the commencement of this Act, appoint a managing agent for the conduct of business.
- (2) Where any insurer engaged in the business of insurance before the commencement of this Act employs a managing agent for the conduct of his business, then notwithstanding anything to the contrary contained in the Indian Companies Act, 1913 (7 of 1913) and notwithstanding anything to the contrary contained in the articles of the insurer, if a company, or in any agreement entered into by the insurer, such managing agent shall cease to hold office on the expiry of three years from the commencement of this Act and no compensation shall be payable to him by the insurer by reason only of the premature termination of his employment as managing agent.
- (3) After the commencement of this Act, notwithstanding anything contained in the Indian Companies Act, 1913 (7 of 1913), and notwithstanding anything to the contrary contained in any agreement entered into by an insurer or in the articles of association of an insurer being a company, no insurer shall pay to a managing agent and no managing agent shall accept from an insurer as remuneration for his services as managing agent more than two thousand rupees per month in all, including salary and commission and other remuneration payable to and receivable by him, for his services as managing agent.

Prohibition of common officers and requirement as to whole time officers [Section 32A]

- (1) A managing director or other officer of an insurer specified in sub-clause (b) of clause (9) of Section 2 and carrying on life insurance business shall not be a managing director or other officer of any other insurer carrying on life insurance business or of a banking company or of an investment company:



Provided that the Authority may permit such managing director or other officer to be a managing director or other officer of any other insurer carrying on life insurance business for the purpose of amalgamating the business of the two insurers or transferring the business of one insurer to the other.

- (2) Where an insurer specified in sub-clause (b) of Clause (9) of Section 2 has a life insurance fund of more than twenty-five lakhs of rupees or insurance funds totaling more than fifty lakhs of rupees, the manager, managing director or either officer of the insurer shall be a whole time employee of the insurer:

Provided that the Authority may, for such period as it thinks fit, permit the employment of any specified person as a part-time manager, managing director or other officer of such insurer.

- (3) Nothing in this section, shall prevent—

- (a) the manager, managing director or other officer of a insurer being the manager, managing director or other officer of a subsidiary company of the insurer with the previous approval of the Authority;
- (b) the manager, managing director or other officer of an insurer, exclusively carrying on life insurance business being the manager, managing director or other officer of an insurer not carrying on life insurance business;
- (c) any officer of a branch of one insurer carrying on general insurance business from being any officer of a branch in the same town of another insurer carrying on general insurance business;
- (d) an officer in the employment of an insurer for giving professional advice;

Explanation: In this section the expression “officer” does not include a director.

Insurance business in rural or social sector [Section 32B]

Every insurer shall, after the commencement of the Insurance Regulatory and Development Authority Act, 1999, undertake such percentages of life insurance business and general insurance business in the rural or social sector, as may be specified, in the Official Gazette by the Authority, in this behalf.

Obligations of insurer in respect of rural or unorganized sector and backward classes [Section 32C]

Every insurer shall, after the commencement of the Insurance Regulatory and Development Authority act, 1999 discharge the obligations specified under section 32B to provide life insurance or general insurance policies to the persons residing in the rural sector, workers in the unorganized or informal sector or for economically vulnerable or backward classes of the society and other categories of persons as may specified by regulations made by the Authority and such insurance policies shall include insurance for crops.

Power of investigation and inspection by Authority [Section 33]

- (1) The Authority may, at any time, by order in writing, direct any person (hereafter in this section referred to as “Investigating Authority”) specified in the order to investigate the affairs of any insurer and to report to the Authority on any investigation made by such Investigating Authority:

Provided that the Investigating Authority may, wherever necessary, employ any auditor or actuary or both for the purpose of assisting him in any investigation under this section.

- (2) Notwithstanding anything to the contrary contained in Section 235 of the Companies Act, 1956 (1 of 1956), the Investigating Authority may, at any time, and shall, on being directed so to do by the Authority, cause an inspection to be made by one or more of his officers of any insurer and his books of accounts; and the Investigating Authority shall supply to the insurer a copy of his report on such inspection.

- (3) It shall be the duty of every manager, managing director or other officer of the insurer to produce before the Investigating Authority directed to make the investigation under sub-section (1), or inspection under sub-section (2), all such books of account, registers and other documents in his custody or power and to furnish him with any statements and information relating to the affairs of the insurer as the said Investigating Authority may require of him within such time as the said Investigating Authority may specify.
- (4) Any Investigating Authority, directed to make an investigation under sub-section (1), or inspection under sub-section (2) may examine on oath, any manager, managing director, or other officer of the insurer in relation to his business and may administer oaths accordingly.
- (5) The Investigating Authority shall, if he has been directed by the Authority to cause an inspection to be made, and may, in any other case, report to the Authority on any inspection made under this section.
- (6) On receipt of any report under sub-section (1) or under sub-section (5), the Authority may, after giving such opportunity to the insurer to make a representation in connection with the report as, in the opinion of the Authority, seems reasonable by order in writing,—
 - (a) require the insurer, to take such action in respect of any matter arising out of the report as the Authority may think fit; or
 - (b) cancel the registration of the insurer; or
 - (c) direct any person to apply to the Court for the winding up of the insurer, if a company, whether the registration of the insurer has been cancelled under C1 clause (b) or not.
- (7) The Authority may, after giving reasonable notice to the insurer, publish the report submitted by the Investigating Authority under sub-section (5) or such portion thereof as may appear to it to be necessary.
- (8) The Authority may by the regulations made by it specify the minimum information to be maintained by insurers in their books, the manner in which such information shall be maintained, the checks and other verifications to be adopted by insurers in that connection and all other matters incidental thereto as are, in its opinion, necessary to enable the Investigating Authority to discharge satisfactorily his functions under this section.

Explanation.—For the purposes of this section, the expression “insurer” shall include in the case of an insurer incorporated in India—

- (a) all its subsidiaries formed for the purpose of carrying on the business of insurance exclusively outside India; and
 - (b) all its branches whether situated in India or outside India.
- (9) No order made under this section other than an order made under clause (b) of sub-section (6) shall be capable of being called in question in any Court.
 - (10) All expenses of, and incidental to, any investigation made under this section shall be defrayed by the insurer, shall have priority over that debts due from the insurer and shall be recoverable as an arrear of land revenue.”.

Power to appoint staff [Section 33A]

The Authority may appoint such staff, and at such places as it or he may consider necessary, for the scrutiny of the returns, statements and information furnished by insurers under this Act and generally to ensure the efficient performance of the functions of the Authority under this Act.



Power of the Authority to issue directions [Section 34]

- (1) where the Authority is satisfied that
 - (a) in the public interest; or
 - (b) to prevent the affairs of any insurer being conducted in a manner detrimental to the interests of the policy-holders or in a manner prejudicial to the interests of the insurer; or
 - (c) generally to secure the proper management of any insurer, it is necessary to issue directions to insurers generally or to any insurer in particular, he may, from time to time, issue such directions as he deems fit, and the insurers or the insurer, as the case may be, shall be bound to comply with such directions:

Provided that no such directions shall be issued to any insurer in particular unless such insurer has been given a reasonable opportunity of being heard
- (2) The Authority may, on representation made to him or on his own motion, modify or cancel any direction issued under sub-section (1), and in so modifying or canceling any directions, may impose such conditions as he thinks fit, subject to which the modification or cancellation shall have effect.

Amendment of provisions relating to appointments of managing directors, etc., to be subject to previous approval of the Authority [Section 34A]

- (1) In the case of an insurer,—
 - (a) no amendment made, after the commencement of the Insurance (Amendment) Act, 1968 of any provision relating to the appointment, re-appointment, termination of appointment or remuneration of a managing or whole-time director, or of a manager or a chief executive officer, by whatever name called, whether that provision be contained in the insurers memorandum or articles of associations, or in an agreement entered into by him, or in any resolution passed by the insurer in general meeting or by his Board of Directors shall have effect unless approved by the Authority;
 - (b) no appointment, re-appointment or termination of appointment made after the commencement of the Insurance (Amendment) Act, 1968, of a managing or whole-time director, or a manager or a chief executive officer, by whatever name called, shall have effect unless such appointment, reappointment or termination of appointment is made with the previous approval of the Authority.

Explanation- For the purposes of this sub-section, any provision conferring any benefit or providing any amenity or perquisite, in whatever form, whether during or after the termination of the term of office of the manager or the chief executive officer, by whatever name called or a managing or whole-time director, shall be deemed to be a provision relating to his remuneration.
- (2) Nothing contained in Sections 268 and 269, the proviso to sub-section (3) of Section 309, Sections 310 and 311, the proviso to Section 387 and Section 388 (in so far as Section 388 makes the provisions of Sections 310 and 311 apply in relation to the manager of a company) of the Companies Act, 1956 (1 of 1956), shall apply to any matter in respect of which the approval of the Authority has to be obtained under sub-section (1).
- (3) No act done by a person as a managing or whole-time director or a director not liable to retire by rotation or a manager or a chief executive officer, by whatever name called, shall be deemed to be invalid on the ground that it is subsequently discovered that his appointment or re-appointment had not taken effect by reason of any of the provisions of this Act; but nothing in this subsection shall be construed as rendering valid any act done by such person after his appointment or re-appointment has been shown to the insurer not to have had effect.

Power of Authority to remove managerial persons from office [Section 34B]

- (1) Where the Authority is satisfied that in the public interest or for preventing the affairs of an insurer being conducted in a manner detrimental to the interests of the policy-holders or for securing the proper management of any insurer it is necessary so to do, he may, for reasons to be recorded in writing, by order, remove from office, with effect from such date as may be specified in the order, any director or the chief executive officer, by whatever name called, of the insurer.
- (2) No order under sub-section (1) shall be made unless the director or chief executive officer concerned has been given a reasonable opportunity of making a representation to the Authority against the proposed order:

Provided that if, in the opinion of the Authority, any delay would be detrimental to the interests of the insurer or his policy-holders, he may, at the time of giving the opportunity aforesaid or at any time thereafter, by order direct that, pending the consideration of the representation aforesaid, if any, the director or, as the case may be, chief executive officer, shall not, with effect from the date of such order,

- (a) act as such director or chief executive officer of the insurer;
 - (b) in any way, whether directly, indirectly, be concerned with, or take part in the management of the insurer.
- (3) Where any order is made in respect of a director or chief executive officer of an insurer under sub-section (1), he shall cease to be a director or as the case may be chief executive officer of the insurer and shall not, in any way, whether directly or indirectly, be concerned with, or take part in, the management of any insurer for such period not exceeding five years as may be specified in the order.
 - (4) If any person in respect of whom an order is made by the Authority under sub-section (1) or under the proviso to sub-section (2) contravenes the provisions of this section, he shall be punishable with fine which may extend to two hundred and fifty rupees for each day during which such contravention continues.
 - (5) Where an order under sub-section (1) has been made, the Authority may, by order in writing, appoint a suitable person in place of the director or chief executive officer who has been removed from his office under that sub-section, with effect from such date as may be specified in the order.
 - (6) Any person appointed as director or chief executive officer under this section shall-
 - (a) hold office during the pleasure of the Authority and subject thereto for a period not exceeding three years or such further periods not exceeding three years at a time as the Authority may specify;
 - (b) not incur any obligation or liability by reason only of his being a director or chief executive officer or for anything done or omitted to be done in good faith in the execution of the duties of his office or in relation thereto.
 - (7) Notwithstanding anything contained in any law or in any contract, memorandum or articles of association, on the removal of a person from office under this section, that person shall not be entitled to claim any compensation for the loss or termination of office.

Power of Authority to appoint additional directors [Section 34C]

- (1) If the Authority is of opinion that in the public interest or in the interests of an insurer or his policy-holders it is necessary so to do, he may, from time to time, by order in writing, appoint, with effect from such date as may be specified in the order, one or more persons to hold office as additional directors of the insurer:



Provided that the number of additional directors so appointed shall not, at any time, exceed five or one-third of the maximum strength fixed for the Board by the articles of association of the insurer, whichever is less.

- (2) Any person appointed as additional director in pursuance of this section,—
 - (a) shall hold office during the pleasure of the Authority, and subject thereto for a period not exceeding three years or such further periods not exceeding three years at a time as the Authority may specify;
 - (b) shall not incur any obligation or liability by reason only of his being a director or for anything done or omitted to be done in good faith in the execution of the duties of his office or in relation thereto; and
 - (c) shall not be required to hold qualification shares of the insurer.
- (3) For the purpose of reckoning any preparation of the total number of directors of the insurer, any additional director appointed under this section shall not be taken into account.

Sections 34B and 34C to override other laws [Section 34D]

Any appointment or removal of a director or chief executive officer in pursuance of Section 34B or Section 34C shall have effect notwithstanding anything to the contrary contained in the Companies Act, 1956 (1 of 1956), or any other law for the time being in force or in any contract or any other instrument.

Further powers [Section 34E]

The Authority may,—

- (a) caution or prohibit insurers generally or any insurer in particular against entering into any particular transaction or class of transactions, and generally give advice to any insurer;
- (b) at any time, if he is satisfied that in the public interest or in the interests of the insurer or for preventing the affairs of the insurer being conducted in a manner detrimental to the interests of the insurer or his policy-holders, it is necessary so to do, by order in writing and on such terms and conditions as may be specified therein,—
 - (i) require the insurer to call a meeting of his directors for the purpose of considering any matter relating to or arising out of the affairs of the insurer;
 - (ii) depute one or more of his officers to watch the proceedings at any meeting of the Board of Directors of the insurer or of any committee or of any other body constituted by it; require the insurer to give an opportunity to the officers so deputed to be heard at such meetings and also require such officers to send a report of such proceedings to the Authority;
 - (iii) require the Board of Directors of the insurer or any committee or any other body constituted by it to give in writing to any officer specified by the Authority in this behalf at his usual address all notices of, and other communications relating to, any meeting of the Board, committee or other body constituted by it;
 - (iv) appoint one or more of his officers to observe the manner in which the affairs of the insurer or of his offices or branches are being conducted and make a report thereon;
 - (v) require the insurer to make, within such time as may be specified in the order, such changes in the management as the Authority may consider necessary.

Power of Authority to issue directions regarding re-insurance treaties, etc [Section 34F]

- (1) Without prejudice to the generality of the powers conferred by sub-section (1) of Section 34, the Authority may, if he is of opinion that the terms or conditions of any re-insurance treaty or

other re-insurance contract entered into by an insurer are not favourable to the insurer or are detrimental to the public interest, he may, by order, require, the insurer to make, at the time when the renewal of such treaty or contract becomes next due, such modifications in the terms and conditions of such treaty or contract as he may specify in the order or not to renew such treaty or contract, and, if the insurer fails to comply with such order, he shall be deemed to have failed to comply with the provisions of this Act.

- (2) The Authority may, if he has reason to believe that an insurer is entering into or is likely to enter into re-insurance treaties or other re-insurance contracts which are not favourable to the insurer or are detrimental to the public interest, he may, by order, direct that the insurer shall not enter into such re-insurance treaty or other re-insurance contract unless a copy of such treaty or contract has been furnished to him in advance and the terms and conditions thereof have been approved by him and if the insurer fails to comply with such order he shall be deemed to have failed to comply with the requirements of this Act.

Power of Authority to order closure of foreign branches [Section 34G]

Without prejudice to the generality of the powers conferred by sub-section (1) of Section 34 the Authority may, if he has reason to believe that the working of any branch outside India of an insurer being an insurer specified in sub-clause (b) of clause (9) of Section 2, is generally resulting in a loss or that the affairs of that branch are being conducted in a manner prejudicial to the interests of the policy-holders or the public interest, he may, after giving an opportunity to the insurer of being heard, direct that the insurer shall cease, within such period not being less than one year, as may be specified in the order, to carry on insurance business in the country in which such branch is situated and if the insurer fails to comply with such order he shall be deemed to have failed to comply with the provisions of this Act.

Search and seizure [Section 34H]

- (1) Where the Chairperson of the Authority in consequence of information in his possession, has reason to believe that—
 - (a) any person who has been required under sub-section (2) of Sec. 33 to produce, or cause to be produced, any books, accounts or other documents in his custody or power has omitted or failed to produce, or cause to be produced, such books, accounts or other documents, or
 - (b) any person to whom a requisition to produce any books, accounts or other documents as aforesaid has been or might be issued will not, or would not, produce or cause to be produced, any books, accounts or other documents which will be useful for, or relevant to an investigation under sub-section (1) of Section 33 or an inspection under sub-section (1A) of that section, or
 - (c) a contravention of any provision of this Act has been committed or is likely to be committed by an insurer, or
 - (d) any claim which is due to be settled by an insurer, has been or is likely to be settled at a figure higher than a reasonable amount, or
 - (e) any claim which is due to be settled by an insurer, has been or is likely to be rejected or settled at a figure lower than a reasonable amount,
 - (f) any illegal rebate or commission has been paid or is likely to be paid by an insurer, or
 - (g) any books, accounts, receipts, vouchers, survey reports or other documents, belonging to an insurer are likely to be tampered with, falsified or manufactured, he may authorise any subordinate officer of his, not lower in rank than an officer authorized by the Authority (hereafter referred to as the authorised officer) to-
 - (i) enter and search any building or place where he has reason to suspect that such



- books, accounts or other documents, or any books or papers relating to any claim, rebate or commission or any receipts, vouchers, reports or other documents are kept;
- (ii) break open the lock of any door, box, locker, safe, almirah or other receptacle for exercising the powers conferred by Clause (i) where the keys thereof are not available;
 - (iii) seize all or any such books, accounts or other documents found as a result of such search;
 - (iv) place marks of identification on such books, accounts or other documents or make or cause to be made extracts or copies there from.
- (2) The authorised officer may requisition the services of any police officer or of any officer of the Central Government, or of both, to assist him for all or any of the purposes specified in sub-section (1) and it shall be the duty of every such officer to comply with such requisition.
- (3) The authorised officer may, where it is not practicable to seize any such book, account or other document, specified in sub-section (1), serve an order on the person who is in immediate possession or control thereof that he shall not remove, part with or otherwise deal with it except with the previous permission of such officer and such officer may take such steps as may be necessary for ensuring compliance with this sub-section.
- (4) The authorised officer may, during the course of the search or seizure, examine on oath any person who is found to be in possession or control of any books, accounts or other documents, and any statement made by such person during such examination may thereafter be used in evidence in any proceeding under this Act.
- (5) The books, accounts, papers, receipts, vouchers, reports, or other documents seized under sub-section (1) shall not be retained by the authorised officer for a period exceeding one hundred and eighty days from the date of the seizure unless the reasons for retaining the same recorded by him in writing and the approval of the Chairperson of the Authority for such retention is obtained:
- Provided** that the Chairperson of the Authority shall not authorise the retention of the books, accounts, papers, receipts, vouchers, reports, or other documents for a period exceeding thirty days after all the proceedings under this Act for which the books, accounts, papers, receipts, vouchers, or other documents are relevant are completed.
- (6) The person from whose custody any books, accounts, papers, receipts, vouchers, reports, or other documents are seized under sub-section (1) may make copies thereof, or take extracts there from, in the presence of the authorised officer or any other person empowered by him in this behalf at such place and time as the authorised officer may appoint in this behalf.
- (7) If a person legally entitled to the books, accounts, papers, receipts, vouchers, reports, or other documents seized under sub-section (1) objects for any reason to the approval given by the Chairperson of the Authority under sub-section (5), he may make an application to the Central Government stating therein the reasons for such objection and requesting for the return of the books, accounts, papers, receipts, vouchers, reports, or other documents.
- (8) On receipt of the application under sub-section (7) the Central Government may, after giving the applicant an opportunity of being heard, pass such orders as it thinks fit.
- (9) The provisions of the Code of Criminal Procedure, 1898 (5 of 1898), relating to searchers and seizures shall apply, so far as may be, to every search and seizure made under sub-section (1).
- (10) The Central Government may, by notification in the official Gazette, make rules in relation to any search or seizure under this section; in particular, and without prejudice to the generality of the foregoing power, such rules may provide for the procedure to be followed by the authorised officer,—

- (i) for obtaining ingress into such building or place to be searched where free ingress thereto is not available;
- (ii) for ensuring safe custody of any books, accounts, papers, receipts, vouchers, reports, or other documents seized under this section.

Amalgamation and transfer of insurance business [Section 35]

- (1) No life insurance business of an insurer specified in sub-clause (a) (ii) or sub-clause (b) of Clause (9) of Section 2 shall be transferred to any person or transferred to or amalgamated with the life insurance business of any other insurer except in accordance with a scheme prepared under this section and approved by the Authority.
- (2) Any scheme prepared under this section shall set out the agreement under which the transfer or amalgamation is proposed to be effected, and shall contain such further provisions as may be necessary for giving effect to the scheme.
- (3) Before an application is made to the Authority to approve any such scheme, notices of the intention to make the application together with a statement of the nature of the amalgamation or transfer, as the case may be, and of the reason there for shall, at least two months before the application is made, be sent to the Authority and certified copies four in number, of each of the following documents shall be furnished to the Authority, and other such copies shall during the two months aforesaid be kept open for the inspection of the members and policy-holders at the principal and branch offices and chief agencies of the insurers concerned, namely:-
 - (a) a draft of the agreement or deed under which it is proposed to effect the amalgamation or transfer;
 - (b) balance-sheets in respect of the insurance business of each of the insurers concerned in such amalgamation or transfer, prepared in the form set forth in Part II of the First Schedule and in accordance with the regulations contained in Part I of the Schedule;
 - (c) actuarial reports and abstracts in respect of the life insurance business of each of the insurers so concerned, prepared in conformity with the requirements of Part II of the Fourth and Fifth Schedules and in accordance with the regulations contained in Part I of the Schedule concerned ;
 - (d) a report on the proposed amalgamation or transfer, prepared by an independent actuary who has never been, professionally connected; with any of the parties concerned in the amalgamation or transfer at any time in the five years preceding the date on which he signs his report;
 - (e) any other reports on which the scheme of amalgamation or transfer was founded.

The balance- sheets, reports and abstracts referred to in Clauses (b), (c) and (d) shall all be prepared as at the date at which the amalgamation or transfer if approved by the Authority is to take effect, which date shall not be more than twelve months before the date on which the application to the Authority is made under this section:

Provided that if the Authority so directs in the case of any particular insurer there may be substituted respectively for the balance-sheet, report and abstract referred to in Clauses. (b) and (c) prepared in accordance with this sub-section certified copies of the last balance-sheet and last report and abstract prepared in accordance with Sections 11 and 13 of this Act or Sections 7 and 8 of the Indian Life Assurance Companies Act, 1912 (6 of 1912), if that balance-sheet is prepared as at a date not more than twelve months, and that report and abstract as at a date not more than five years, before the date on which the application to the Authority is made under this section.



Sanction of amalgamation and transfer by Authority [Section 36]

- (1) When any application, such as, is referred to in sub-section (3) of Section 35 is made to the Authority, the Authority shall cause, if for special reasons he so directs, notice of the application to be sent to every person resident in India who is the holder of a life policy of any insurer concerned and shall cause a statement of the nature and terms of the amalgamation or transfer, as the case may be, to be published in such manner and for such period as he may direct, and, after hearing the directors and such policy-holders as apply to be heard and other persons whom he considers entitled to be heard, may approve the arrangement, he is satisfied no sufficient objection to the arrangement has been established and shall make such consequential orders as are necessary to give effect to the arrangement, including orders as to the disposal of any deposit made under Section 7 or Section 98:

Provided that

- (a) no part of the deposit made by any party to the amalgamation or transfer shall be returned except where, after effect is given to the arrangement, the whole of the deposit to be made by the insurer carrying on the amalgamated business or the person to whom the business is transferred is completed,
 - (b) only so much shall be returned as is no longer required to complete the deposit last mentioned in Clause (a), and
 - (c) while the deposit last mentioned in Clause (a) remains uncompleted, on accession, resulting from the arrangement, to the amount already deposited by the insurer carrying on the amalgamated business or the person to whom the business is transferred shall be appropriated as payment or part-payment of any installment of deposit subsequently due from him under Section 7 or Section 98.
- (2) If the arrangement involves a reduction of the amount of the insurance and other contracts of the transferor insurer or of any or all of the insurers concerned in the amalgamation, the Authority may approve the arrangement, reducing the amount of such contracts upon such terms and subject to such conditions as he may think proper, and the reduction of contracts as approved by the Authority shall be valid and binding on all the parties concerned.

Statements required after amalgamation and transfer [Section 37]

Where an amalgamation takes place between any two or more insurers, or where any business of an insurer is transferred, whether in accordance with a scheme confirmed by the Authority or otherwise, the insurer carrying on the amalgamated business or the person to whom the business is transferred, as the case may be, shall, within three months from the date of the completion of the amalgamation or transfer, furnish in duplicate to the Authority-

- (a) a certified copy of the scheme, agreement or deed under which the amalgamation or transfer has been effected, and
- (b) a declaration signed by every party concerned or in the case of a company by the chairman and the principal officer that to the best of their belief every payment made or to be made to any person whatsoever on account of the amalgamation or transfer is therein fully set forth and that no other payments beyond those set forth have been made or are to be made either in money, policies, bonds, valuable securities or other property by or with the knowledge of any parties to the amalgamation or transfer, and
- (c) where the amalgamation or transfer has not been made in accordance with a scheme approved by the Authority under Section 36-
 - (i) balance-sheet in respect of the insurance business of each of the insurers concerned in such amalgamation or transfer, prepared in the Form set forth in Part II of the First Schedule and in accordance with the regulations contained in Part I of that Schedule, and

- (ii) certified copies of any other reports on which the scheme of amalgamation or transfer was founded.

Power of the Authority to prepare scheme of Amalgamation [Section 37A]

- (1) If the Authority is satisfied that-

- (i) in the public interest; or
- (ii) in the interests of the policy-holders; or
- (iii) in order to secure the proper management of an insurer; or
- (iv) in the interests of insurance business of the country as a whole;

it is necessary so to do, he may prepare a scheme for the amalgamation of that insurer with any other insurer (hereinafter referred to in this section as the transferee insurer):

Provided that no such scheme shall be prepared unless the other insurer has given his written consent to the proposal for such amalgamation

- (2) The scheme aforesaid may contain provisions for all or any of the following matters, namely:

- (a) the constitution, name and registered office, the capital, assets, powers, rights, interests, authorities and privileges, and the liabilities, duties and obligations of the transferee insurer;
- (b) the transfer to the transferee insurer the business, properties, assets and liabilities of the insurer on such terms and conditions as may be specified in the scheme;
- (c) any change in the Board of Directors, or the appointment of a new Board of directors of the transferee-insurer and the authority by whom, the manner in which, and the other terms and conditions on which such change or appointment shall be made, and in the case of appointment of a new Board of Director or of any director, the period for which such appointment shall be made;
- (d) the alteration of the memorandum and articles of association of the transferee insurer for the purpose of altering the capital thereof or for such other purposes as may be necessary to give effect to the amalgamation;
- (e) subject to the provisions of the scheme, the continuation by or against the transferee insurer, of any actions or proceedings pending against the insurer;
- (f) the reduction of the interest or rights which the shareholders, policy holders and other creditors have in or against the insurer before the amalgamation to such extent as the Authority considers necessary in the public interest or in the interests of the shareholders, policy-holders and other creditors or for the maintenance of the business of the insurer;
- (g) the payment in cash or otherwise to policy-holders, and other creditors in full satisfaction of their claim,-
 - (i) in respect of their interest or rights in or against the insurer before the amalgamation; or
 - (ii) where their interest or rights aforesaid in or against the insurer has or have been reduced under clause (f), in respect of such interest or rights as so reduced;
- (h) the allotment to the shareholders of the insurer for shares held by them therein before the amalgamation Whether their interest in such shares has been reduced under clause (f) or not] of shares in the transferee insurer and where any shareholders claim payment in cash and not allotment of shares, or where it is not possible to allot shares to any sharp holders the payment in cash to those shareholders in full satisfaction of their claim—



- (i) in respect of their interest in shares in the insurer before the amalgamation; or
- (ii) where such interest has been reduced under clause (f) in respect of their interest in shares as so reduced;
- (i) the continuance of their services of all the employees of the insurer (excepting such of them as not being workmen within the meaning of the Industrial Disputes Act, 1947 (14 of 1947), are specifically mentioned in the scheme) in the transferee insurer at the same remuneration and on the same terms and conditions of service, which they were getting or, as the case may be, which they were being governed, immediately before the date of the amalgamation:

Provided that the scheme shall contain a provision that the transferee insurer shall pay or grant not later than the expiry of the period of three years, from the date of the amalgamation, to the said employees the same remuneration and the same terms and conditions of service as are applicable to the other employees of corresponding rank on status of the transferee insurer subject to the qualifications and experience of the said employees being the same as or equivalent to those of such other employees of the transferee insurer:

Provided further that if in any case any doubt or difference arises as to whether the qualification and experience of any of the said employees are the same as or are equivalent to the qualifications and experience of the other employees of corresponding rank or status of the transferee insurer, the doubt or difference

- (j) notwithstanding anything contained in clause (i), where any of the employee, of the insurer not being workmen within the meaning of the Industrial Disputes Act, 1947 (14 of 1947), are specifically mentioned in the scheme under clause (i) or where any employees of the insurer have by notice in writing given to the insurer or, as the case may be, the transferee insurer at any time before the expiry of one month next following the date on which the scheme is sanctioned by the Central Government, intimated their intention of not becoming employees of the transferee insurer, the payment to such employees of compensation, if any, to which they are entitled under the Industrial Disputes Act, 1947, and such pension, gratuity, provident fund, or other retirement benefits ordinarily admissible to them under the rules or authorizations of the insurer immediately before the date of the amalgamation;
 - (k) any other terms and conditions for the amalgamation of the insurer;
 - (l) such incidental, consequential and supplemental matters as are necessary to secure that the amalgamation shall be fully and effectively carried out.
- (3) (a) A copy of the scheme prepared by the Authority shall be sent in draft to the insurer and also to the transferee insurer and any other insurer concerned in the amalgamation, for suggestions and objections, if any, within such period as the Authority may specify for this purpose.
- (b) The Authority may make such modifications, if any, in the draft scheme as he may consider necessary in the light of suggestions and objections received from the insurer and also from the transferee insurer, and any other insurer concerned in the amalgamation and from any shareholder, policyholder or other creditor of each of those insurers and the transferee insurer.
- (4) The scheme shall thereafter be placed before the Central Government for its sanction and the Central Government may sanction the scheme without any modification or with such modifications as it may consider necessary; and the scheme as sanctioned by the Central Government shall come into force on such date as the Central Government may specify in this behalf:
- Provided** that different dates may be specified for different provisions of the scheme
- (5) The sanction accorded by the Central Government under sub-section (4) shall be conclusive evidence that all the requirements of this section relating to amalgamation have been complied

with and a copy of the sanctioned scheme certified in writing by an officer of the Central Government to be a true copy thereof, shall, in all legal proceedings (whether in appeal or otherwise) be admitted as evidence to the same extent as the original scheme.

- (6) The Authority may, in like-manner, add to, amend or vary any scheme made under this section.
- (7) On and from the date of the coming into operation of the scheme or any provision thereof; the scheme or such provision shall be binding on the insurer or, as the case may be, on the transferee-insurer and any other insurer concerned in the amalgamation and also on all the shareholders, policy-holders and other creditors and employees of each of those insurers and of the transferee insurer, and on any other person having any right or liability in relation to any of those insurers or the transferee insurer.
- (8) On and from such date as may be specified by the Central Government in this behalf, their properties and assets of the insurer shall, by virtue of and to the extent provided in the scheme, stand transferred to, and vest in, and the liabilities of the insurer shall, by virtue of and to the extent provided in the scheme, stand transferred to and become the liabilities of, the transferee insurer.
- (9) If any difficulty arises in giving effect to the provisions of the scheme the Central Government may by order do anything not inconsistent with such provisions which appears to it necessary or expedient for the purpose of removing the difficulty.
- (10) Copies of every scheme made under this section and of every order made under sub-section (9) shall be laid before each House of Parliament, as soon as may be, after the scheme has been sanctioned by the Central Government or, as the case may be, the order has been made.
- (11) Nothing in this section shall be deemed to prevent the amalgamation with an insurer by a single scheme of several insurers.
- (12) The provisions of this section and of any scheme made under it shall have effect notwithstanding anything to the contrary contained in any other provisions of this Act or in any other law or any agreement, award or other instrument for the time being in force.
- (13) The provisions of section 37 shall not apply to an amalgamation given effect to under provisions of this section.

Assignment and transfer of insurance policies [Section 38]

- (1) A transfer or assignment of a policy of life insurance, whether with or without consideration, may be made only by an endorsement upon the policy itself or by a separate instrument, signed in either case by the transferor or by the assignor or his duly authorised agent and attested by at least one witness, specifically setting forth the fact of transfer or assignment.
- (2) The transfer or assignment shall be complete and effectual upon the execution of such endorsement or instrument duly attested but except where the transfer or assignment is in favour of the insurer shall not be operative as against an Insurer and shall not confer upon the transferee or assignee, or his legal representative, any right to sue for the amount of such policy or the moneys secured thereby until a notice in writing of the transfer or assignment if and either the said endorsement or instrument itself or a copy thereof certified to be correct by both transferor and transferee or their duly authorised agents have been delivered to the insurer:

Provided that where the insurer maintains one or more places of business in India, such notice shall be delivered only at the place in s[India] mentioned in the policy for the purpose or at his principal place of business in India.

- (3) The date on which the notice referred to in sub-section (2) is delivered to the insurer shall regulate the priority of all claims under a transfer or assignment as between persons interested in the policy: and where there is more than one instrument of transfer or assignment, the priority of the



claims under such instruments shall be governed by the order in which the notices referred to in sub-section (2) are delivered.

- (4) Upon the receipt of the notice referred to in sub-section (2), the insurer shall record the fact of such transfer or assignment together with the date thereof and the name of the transferee or the assignee and shall, on the request of the person by whom the notice was given, or of the transferee or assignee, on payment of a fee not exceeding one rupee, grant a written acknowledgment of the receipt of such notice; and any such acknowledgment shall be conclusive evidence against the insurer that he has duly received the notice to which such acknowledgment relates.
- (5) Subject to the terms and conditions of the transfer or assignment, the insurer shall, from the date of the receipt of the notice referred to in subsection (2), recognise the transferee or assignee named in the notice as the only person entitled to benefit under the policy, and such person shall subject to all liabilities and equities to which the transferor or assignor was subject at the date of the transfer or assignment and may institute any proceedings in relation to the policy without obtaining the consent of the transferor or assignor or making him a party to such proceedings.
- (6) Any rights and remedies of an assignee or transferee of a policy of life insurance under an assignment or transfer affected prior to the commencement of this Act shall not be affected by the provisions of this section.
- (7) Notwithstanding any law or custom having the force of law to the contrary, and assignment in favour of a person made with the condition that it shall be inoperative or that the interest shall pass to some other person on the happening of a specified event during the lifetime of the person whose life is insured, and an assignment in favour of the survivor or survivors of a number of persons shall be valid.

Nomination by policy-holder [Section 39]

- (1) The holder of a policy of life insurance on his own life, may, when effecting the policy or at any time before the policy matures for payment, nominate the person or persons to whom the money secured by the policy shall be paid in the event of his death:

Provided that, where any nominee is a minor, it shall be lawful for the policy holder to appoint in the prescribed manner any person to receive the money secured by the policy in the event of his death during the minority of the nominee.

- (2) Any such nomination in order to be effectual shall, unless it is incorporated in the text of the policy itself, be made by an endorsement on the policy communicated to the insurer and registered by him in the records relating to the policy and any such nomination may at any time before the policy matures for payment be cancelled or changed by an endorsement or a further endorsement or a will, as the case may be, but unless notice in writing of any such cancellation or change has been delivered to the insurer, the insurer shall not be liable for any payment under the policy made bona fide by him to a nominee mentioned in the text of the policy or registered in records of the insurer.
- (3) The insurer shall furnish to the policy-holder a written acknowledgment of having registered a nomination or a cancellation change thereof, and may charge a fee not exceeding one rupee for registering such cancellation or change.
- (4) A transfer or assignment of a policy made in accordance with section 38 shall automatically cancel a nomination:

Provided that the assignment of a policy to the insurer who bears the risk on the policy at the time of the assignment, in consideration of a loan granted by that insurer on the security of the policy within its surrender value, or its reassignment on repayment of the loan shall not cancel a nomination, but shall affect the rights of the nominee only to the extent of the insurer's interest in the policy.

- (5) Where the policy matures for payment during the lifetime of the person whose life is insured or where the nominee or, if there are more nominees than one, all the nominees die before the policy-holder or his heirs or legal representatives or the holder of a succession certificate, as the case may be.
- (6) Where the nominee or, if there are more nominees than one, a nominee or nominees survive the person whose life is insured, the amount secured by the policy shall be payable to such survivor or survivors.
- (7) The provisions of this section shall not apply to any policy of life insurance to which section 6 of the Married Women's Property Act, 1874 (3 of 1874), applies or has at any time applied:

Provided that where a nomination made whether before or after the commencement of the Insurance (Amendment) Act, 1946 (VII of 1946), in favour of the wife of the person who has insured his life or of his wife and children or any of them is expressed, whether or not on the face of the policy as being made under this section, the said section 6 shall be deemed not to apply or not to have applied to the policy.

Prohibition of payment by way of commission or otherwise for procuring business [Section 40]

- (1) No person shall after the expiry of six months from the commencement of this Act, pay or contract to pay any remuneration or reward whether by way of commission or otherwise for soliciting or procuring insurance business in India to any person except an insurance agent or an intermediary or insurance intermediary.
- (1A) In this section and section 40A, 41 and 43 references to an insurance agent shall be construed as including references to an individual soliciting or procuring insurance business exclusively in the territories which immediately before the 1st November, 1956 were comprised in a Part B State notified in this behalf by the Central Government in the Official Gazette and holding a valid licence as an insurance agent under the law of that Part B State.
- (2) No insurance agent shall be paid or contract to be paid by way of commission or as remuneration in any form an amount exceeding, in the case of life insurance business, forty per cent of the first year's premium payable on any policy or policies effected through him and five per cent of a renewal premium, payable on such a policy, or, in the case of business of any other class, fifteen per cent of the premium:

Provided that insurers in respect of life insurance business only may pay during the first ten years of their business to their insurance agents fifty-five per cent of the first years premium payable on any policy or policies effected through them and six per cent of the renewal premiums payable on such policies:

Provided further that nothing in this sub-section shall apply in respect of any policy of life insurance issued after the 31st day of December, 1950, or in respect of any policy of general insurance issued after the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950).

- (2A) Save as hereinafter provided, no insurance agent or intermediary or insurance intermediary shall be paid or contract to be paid by way of commission or as remuneration in any form any amount in respect of any policy not effected through him:

Provided that where a policy of life insurance has lapsed and it cannot under the terms and conditions applicable to it be revived without further medical examination of the person whose life was insured thereby, an insurer, after giving by notice in writing to the insurance agent through whom the policy was effected if such agent continues to be an agent of the insurer an opportunity to effect the revival of the policy within a time specified in the notice, being not less than one month from the date of the receipt by him of the notice, may pay to another insurance agent who effects the revival of the policy an amount calculated at a rate not exceeding half the rate of commission at which the agent through whom the policy was effected would have been



paid had the policy not lapsed, on the sum payable on revival of the policy on account of arrear premiums (excluding any interest on such arrear premiums) and also on the subsequent renewal premiums payable on the policy.

- (3) Nothing in this section shall prevent the payment under any contract existing prior to the 27th day of January, 1937, of gratuities or renewal commission to any person, whether an insurance agent within the meaning of this Act or not, or to his representatives after his decease in respect of insurance business effected through him before the said date.

Limitation of expenditure on commission [Section 40A]

- (1) No person shall pay or contract to pay to an insurance agent, and no insurance agent shall receive or contract to receive by way of commission or remuneration in any form in respect of any policy of life insurance issued in India by an insurer after the 31st day of December, 1950, and effected through an insurance agent, an amount exceeding-
- (a) where the policy grants an immediate annuity or a deferred annuity in consideration of a single premium, or where only one premium is payable on the policy, two per cent of that premium,
 - (b) where the policy grants a deferred annuity in consideration of more than one premium, seven and a half per cent of the first year's premium, and two per cent of each renewal premium payable on the policy, and
 - (c) in any other case, thirty-five per cent of the first year's premium, seven and a half per cent of the second and third year's renewal premium, and thereafter five per cent of each renewal premium payable on the policy:

Provided that in a case referred to in clause (c), an insurer, during the first ten years of his business may pay to an insurance agent and an insurance agent may receive from such an insurer, forty per cent of the first year's premium payable on the policy:

Provided further that in case referred to in clause (c) where the rate of commission payable on the first year's premium is equal to or less than twenty-one per cent thereof, and the rate on the fourth and fifth year's premiums does not exceed six per cent thereof, the Life Insurance Corporation of India may pay to an insurance agent, and the insurance agent may receive from it, commission on the sixth and subsequent year's renewal premiums payable on the policy at a rate not exceeding six per cent of each renewal premium.

- (2) No person shall pay or contract to pay to a special agent, and no special agent, shall receive or contract to receive, by way of commission or as remuneration in any form, in respect of any policy of life insurance issued in India by an insurer after the 31st day of December, 1950, and effected through a special agent, an amount exceeding—
- (a) in a case referred to in clause (a) of sub-section (1), one-half per cent of the premium,
 - (b) in a case referred to in clause (b) of sub-section (1), two per cent of the first year's premium payable on the policy and
 - (c) in a case referred to in clause (c) of sub-section (1), fifteen per cent of the first year's premium payable on the policy:

Provided that in a case referred to in clause (c), an insurer, during the first ten years of his business, may pay to a special agent, and a special agent may receive from such an insurer, seventeen and a half per cent of the first year's premium payable on the policy:

Provided further that in a case referred to in clause (c), where the rate of commission payable on the first year's premium is equal to or less than twenty-one per cent thereof, and the rate on the fourth and fifth year's premiums does not exceed six per cent thereof, the Life Insurance

Corporation of India may pay to an insurance agent, and the insurance agent may receive from it, commission on the sixth and subsequent year's renewal premiums payable on the policy at a rate not exceeding six per cent of each renewal premium.

- (3) No person shall pay or contract to pay to a special agent, and no special agent, shall receive or contract to receive, by way of commission or remuneration in any form in respect of any policy of general insurance issued in India by an insurer after the Commencement of Insurance (Amendment) Act, 1968, and effected through an insurance agent, an amount not exceeding fifteen per cent of the premium payable on the policy where the policy relates to fire or marine insurance or miscellaneous insurance.
- (4) No person shall pay or contract to pay to a principal agent, and no principal agent shall receive or contract to receive, by way of commission or remuneration in any form, in respect of any policy of general insurance issued in India by an insurer after the commencement of the Insurance (Amendment) Act, 1950, and effected through a principal agent, an amount exceeding
 - (a) in the case referred to in clause (a) of sub-section (3), twenty per cent of the premium payable on the policy, and
 - (b) in the case referred to in clause (b) of that sub-section, fifteen per cent of the policy, less any commission payable to any insurance agent in respect of the said policy:

Provided that the Authority may, in such circumstances and to such extent and for such period as may be specified, authorise the payment of commission or remuneration exceeding the limits specified in this sub-section to a principal agent of an insurer incorporated or domiciled elsewhere than in India, if such agent carries out and has continuously carried out in his own office duties on behalf of the insurer which would otherwise have been performed by the insurer.

- (5) Without prejudice to the provisions of section 102 in respect of a contravention of any of the provisions of the preceding sub-sections by an insurer, any insurance agent who contravenes the provisions of sub-section (1) or sub-section (3) shall be punishable with fine which may extend to one hundred rupees.

Limitation of expenses of management in life insurance business [Section 40B]

- (1) Every insurer transacting life insurance business in India shall furnish to the Authority, within such time as may be prescribed, statements in the prescribed form certified by an actuary on the basis of premiums currently used by him in regard to new business in respect of mortality, rate of interest, expenses and bonus loading.
- (2) After the 31st day of December, 1950, no insurer shall, in respect of life insurance business transacted by him in India, spend as expenses of management in any calendar year an amount in excess of the prescribed limits and in prescribing any such limits regard shall be had to the size and age of the insurer and the provision generally made for expenses of management in the premium rates of insurers:

Provided that where an insurer has spent as such expenses in any year an amount in excess of the amount permissible under this sub-section, he shall not be deemed to have contravened the provisions of this section, if the excess amount so spent is within such limits as may be fixed in respect of the year by the Authority after consultation with the Executive Committee of the Life Insurance Council constituted under section 64-F, by which the actual expenses incurred may exceed the expenses permissible under this sub-section.

- (3) In respect of any statement mentioned in subsection (1), the Authority may require that it shall be submitted to another actuary, appointed by the insurer for the purpose and approved by the Authority, for certification by him, whether with or without modifications.



- (4) Every insurer transacting life insurance business in India shall incorporate in the revenue account
- (a) a certificate signed by the chairman and two directors and by the principal officer of the insurer, and an auditor's certificate, certifying that all expenses of management in respect of life insurance business transacted by the insurer in India have been fully debited in the revenue account as expenses, and
 - (b) if the insurer in carrying on any other class of insurance business in addition to life insurance business an auditor's certificate certifying that all charges incurred in respect of his life insurance business and in respect of his business other than life insurance business have been fully debited in the respective revenue accounts.

Explanation.—in this section.-

- (a) "calendar year" or "year" means, in relation to an insurer who is required to furnish returns in accordance with sub-section (2) of section 16, the period covered by the revenue account furnished by such insurer under clause (b) of that sub-section;
- (b) "expenses of management" means all charges wherever incurred whether directly or indirectly, and includes-
 - (i) commission payments of all kinds,
 - (ii) any amount of expenses capitalized,
 - (iii) in the case of an insurer having his principal place of business outside India, a proper share of head office expenses which shall not be less than such percentage as may be prescribed of the total premiums (less re-insurance) received during the year in respect of life insurance business transacted by him in India,

but does not include in the case of an insurer having his principal place of business in India any share of head office expenses in respect of life insurance business transacted by him outside India.

Limitation of expenses of management in general insurance business [Section 40C]

- (1) After the 31st day of December, 1949, no insurer shall, in respect of any class of general insurance business transacted by him in India, spend in any calendar year as expenses of management including commission or remuneration for procuring business an amount in excess of the prescribed limits and in prescribing any such limits regard shall be had to the size and age of the insurer:

Provided that where an insurer has spend as such expenses in any year an amount in excess of the amount permissible under this subsection, he shall not be deemed to have contravened the provisions of this section, if the excess amount so spent is within such limits as may be fixed in respect of the year by the Authority after consultation with the Executive Committee of the General Insurance. Council constituted under section 64F, by which the actual expenses incurred may exceed the expenses permissible under this sub-section.

- (2) Every insurer as aforesaid shall incorporate in the revenue account a certificate signed by the chairman and two directors and by the principal officer of the insurer, and by an auditor certifying that all expenses of management wherever incurred, whether directly or indirectly, in respect of the business referred to in this section have been fully debited in the revenue account as expenses.

Explanation.—In this section,—

- (a) "calendar year" shall have the meaning assigned to it in section 40B;
- (b) "expenses of management" means all charges, wherever incurred whether directly or indirectly, including commission payments of all kinds and, in the case of an insurer having

his principal place of business outside India, a proper share of head office expenses, which shall not be less than such percentage as may be prescribed, of his gross premium income (that is to say, the premium income without taking into account premiums or reinsurance ceded or accepted) written direct in India during the year, but in computing the expenses of management in India the following, and only the following expenses may be excluded, namely

- (i) in the case of an insurer having his principal place of business in India, a share of head office expenses in respect of general insurance business transacted by him outside India not exceeding such percentage of his gross direct premium written outside India as may be prescribed;
 - (ii) in the case of an insurer having his principal place of business outside India, a share of the expenses of his office in India in respect of general insurance business transacted by him outside India through his office in India, not exceeding such percentage of his gross direct premium written outside India through his office in India, as may be prescribed;
 - (iii) any expenses debited to profit and loss account relating exclusively to the management of capital, and dealings with share holders and a proper share of managerial expenses calculated in such manner as may be prescribed; and
 - (iv) any expenses debited to claims in the revenue account in Form F of Part II of the Third Schedule;
- (c) "insurance business transacted in India" includes insurance business, wherever effected relating to any property situate in India or to any vessel or aircraft registered in India.

Prohibition of rebates [Section 41]

- (1) No person shall allow or offer to allow, either directly or indirectly, as an inducement to any person to take or renew or continue an insurance in respect of any kind of risk relating to lives or property in India, any rebate of the whole or part of the commission payable or any rebate of the premium shown on the policy, nor shall any person taking out or renewing or continuing a policy accept any rebate, except such rebate as may be allowed in accordance with the published prospectuses or tables of the insurer:

Provided that acceptance by an insurance agent of commission in connection with a policy of life insurance taken out by himself on his own life shall not be deemed to be acceptance of a rebate of premium within the meaning of this sub-section if at the time of such acceptance the insurance agent satisfies the prescribed conditions establishing that he is a bona fide insurance agent employed by the insurer.

- (2) Any person making default in complying with the provisions of this section shall be punishable with fine which may extend to five hundred rupees.

Licensing of insurance agents [Section 42]

- (1) The Authority or an officer authorised by it in this behalf shall, in the manner determined by the regulations made by it and on payment of the fee determined by the regulations, which shall not be more than two hundred and fifty rupees, issue to any person making an application in the manner determined by the regulations, a licence to act as an insurance agent for the purpose of soliciting or procuring insurance business:

Provided that—

- (i) in the case of an individual, he does not suffer from any of the disqualification mentioned in sub-section (4); and



- (ii) in the case of a company or firm, any of its directors or partners does not suffer from any of the said disqualifications:

Provided further that any licence issued immediately before the commencement of the Insurance Regulatory and Development Authority Act, 1999, shall be deemed to have been issued in accordance with the regulations which provide for such licence.

- (2) A licence issued under this section shall entitle the holder to act as an insurance agent for any insurer.
- (3) A licence issued under this section, after this date of the commencement of the Insurance Regulatory and Development Authority Act, 1999, shall remain in force for a period of three years only from the date of issue, but shall, if the applicant, being an individual does not, or being a company or firm any of its directors or partners does not, suffer from any of the disqualification mentioned in clauses (b), (c), (d), (e), and (f) of sub-section (4) and the application for renewal of the licence reaches the issuing authority at least thirty days before the date on which the licence ceases to remain in force, be renewed for a period of three years at any one time on payment of the fee determined by the regulations made by the Authority which shall not be more than rupees two hundred and fifty, and additional fee of an amount determined by the regulations not exceeding rupees one hundred by way of penalty, if the application for renewal of the licence does not reach the issuing authority at least thirty days before the date on which the licence ceases to remain in force.
- (3A) No application for the renewal of a licence under this section shall be entertained if the application does not reach the issuing authority before the licence ceases to remain in force:

Provided that the Authority may, if satisfied that undue hardship would be caused otherwise, accept any application in contravention of this subsection on payment by the applicant of a penalty of seven hundred and fifty rupees.

- (4) The disqualifications above referred to shall be the following:
- (a) that the person is a minor;
- (b) that he is found to be of unsound mind by a Court of competent jurisdiction;
- (c) that he has been found guilty of criminal misappropriation or criminal breach of trust or cheating or forgery or an abetment of or attempt to commit any such offence by a Court of competent jurisdiction:

Provided that where at least five years have elapsed since the completion of the sentence imposed on any person in respect of any such offence, the Authority shall ordinarily declare in respect of such person that his conviction shall cease to operate as a disqualification under this clause;

- (d) that in the course of any judicial proceeding relating to any policy of insurance of the winding up of an insurance company or in the course of an investigation of the affairs of all insurer it has then found that he has been guilty off or has knowingly participated in or connived at any fraud, dishonestly fir misrepresentation against an insurer or an insured.
- (e) that he does not possess the requisite qualifications and practical training for a period not exceeding twelve months, as may be specified by the regulations made by the Authority in this behalf;
- (f) that he has not passed such examination as may be specified by the regulations made by the Authority in this behalf:

Provided that a person who had been issued a license under sub-section (1) of this section or sub-section (I) of section 64-UM shall not be required to possess the requisite

qualifications, practical training and pass such examination as required by clauses (e) and (f);

(g) that he violates the code of conduct as may be specified by the regulations made by the Authority.”;

- (5) if it be found that an insurance agent being an individual is, or being a company or firm contains a director or partner who is suffering from any of the disqualifications mentioned in sub-section (4), then, without prejudice to any other penalty to which he may be liable, the Authority shall, and if the insurance agent has knowingly contravened any of the provisions of this Act may, cancel the licence issued to the agent under this section.
- (6) The Authority may issue a duplicate licence to replace a licence lost, destroyed or mutilated on payment of such fee not exceeding rupees fifty as may be determined by the regulations.
- (7) Any person who acts as an insurance agent without holding a licence issued under this section to act as such shall be punishable with fine which may extend to five hundred rupees., and any insurer or any person acting on behalf of an insurer, who appoints as an insurance agent any person not licensed to act as such or transacts any insurance business in India through any such person shall be punishable with fine which may extend to one thousand rupees.
- (8) Where the person contravening sub-section (7) is a company or a firm, then, without prejudice to any other proceedings which may be taken against the company, or firm, every director, manager, secretary or other officer of the company, and every partner of the firm who is knowingly a party to such contravention shall be punishable with fine which may extend to five thousand rupees.sz

Registration of principal agents, chief agents and special agents [Section 42A]

- (1) The Authority or an officer authorised by it in this behalf shall in the prescribed manner and on payment of the prescribed fee, which shall not be more than twenty- five rupees for a principal agent or a chief agent and ten rupees for a special agent, register any person who makes an application to it in the prescribed manner if,—
 - (a) in the case of an individual, he does not suffer from any of the disqualifications mentioned in sub-section (4) of Section 42, or
 - (b) in the case of a company or firm, any of its directors or partners does not suffer from any of the said disqualifications,and a certificate to Act as a principal agent, chief agent or special agent, as the case may be, for the purpose of procuring insurance business shall be issued to him.
- (2) A certificate issued under this section shall entitle the holder thereof to act as a principal agent, chief agent, or special agent, as the case may be, for any insurer.
- (3) A certificate issued under this section shall remain in force for a period of twelve months only from the date of issue, but shall, on application made on this behalf, be renewed from year to year on production of a certificate from the insurer concerned that the provisions of clauses (2) and (3) of Part A of the Sixth Schedule in the case of a principal agent, the provisions of clauses (2) and (4) of Part B of the said Schedule in the case of a chief agent, and the provisions of clauses (2) and (3) of Part C of the said Schedule in the case of a special agent, have been complied with, and on payment of the prescribed fee, which shall not be more than twenty-five rupees, in the case of a principal agent or a chief agent, and ten rupees in the case of a special agent, and an additional fee of the prescribed amount not exceeding five rupees by way of penalty, in cases where the application for renewal of the certificate does not reach the issuing authority before the date on which the certificate ceases to remain in force:



Provided that, where the applicant is an individual, he does not suffer from any of the disqualifications mentioned in clauses (b) to (d) of sub-section (4) of section 42 and where the applicant is a company or a firm, any of its directors or partners does not suffer from any of the said disqualifications.

- (4) Where it is found that the principal agent, chief agent or special agent being an individual is, or being a company or firm contains a director or partner who is suffering from any of the disqualifications mentioned in subsection (4) of section 42, without prejudice to any other penalty to which he may be liable, the Authority shall, and where a principal agent, chief agent or special agent has contravened any of the provisions of this Act may cancel the certificate issued under this section to such principal agent, chief agent or special agent.
- (5) The authority which issued any certificate under this section may issue a duplicate certificate to replace a certificate lost, destroyed or mutilated on payment of the prescribed fee, which shall not be more than two rupees.
- (6) Any person who acts as a principal agent, chief agent or special agent, without holding a certificate issued under this section to act as such, shall be punishable with fine which may extend to five hundred rupees, and any insurer or any person acting on behalf of an insurer, who appoints as a principal agent, chief agent or special agent any person not entitled to act as such or transacts any insurance business in India through any such person, shall be punishable with fine which may extend to one thousand rupees.
- (7) Where the person contravening sub-section (6) is a company or a firm, then, without prejudice to any other proceedings which may be taken against the company or firm, every director, manager, secretary or any other officer of the company, and every partner of the firm who is knowingly a party to such contravention shall be punishable with fine which may extend to five hundred rupees.
- (8) The provisions of sub-sections (6) and (7) shall not take effect until the expiry of six months from the commencement of the Insurance (Amendment) Act, 1950.
- (9) No insurer shall, on or after the commencement of the Insurance (Amendment) Act, 2002, appointment or transact any insurance business in India through any principal agent, chief agent or special agent.

Regulation of employment of principal agents [Section 42B]

- (1) No insurer shall, after the expiration of seven years from the commencement of the Insurance (Amendment) Act, 1950, appoint, or transact any insurance business in India, through a principal agent.
- (2) Every contract between an insurer and a principal agent shall be in writing and the terms contained in Part A of the Sixth Schedule shall be deemed to be incorporated in, and form part of, every such contract.
- (3) No insurer shall, after the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), appoint any person as a principal agent except in a presidency-town unless the appointment is by way of renewal of any contract subsisting at such commencement.
- (4) Within sixty days of the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), every principal agent shall file with the insurer concerned a full list of insurance agents employed by him indicating the terms of the contract between the principal agent and each of such insurance agents, and, if any principal agent fails to file such a list within the period specified, any commission payable to such principal agent on premiums received from the date of expiry of the said period of sixty days until the date of the filing of the said list shall, notwithstanding anything in any contract to the contrary, cease to be so payable.

- (5) A certified copy of every contract as is referred to in sub-section (2) shall be furnished by the insurer to the Authority within thirty days of his entering into such contract, and intimation of any change in any such contract shall be furnished by the insurer with full particulars thereof to the Authority within thirty days of the making of any such change.
- (6) If the commission due to any insurance agent in respect of any general insurance business procured by such agent is not paid by the principal agent for any reason, the insurer may pay the insurance agent the commission so due and recover the amount so paid from the principal agent concerned.
- (7) Every contract as is referred to in sub-section (2), subsisting at the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), shall, with respect to terms regarding remuneration, be deemed to have been so altered as to be in accordance with the provisions of sub-section (4) of section 40A.
- (8) If any dispute arises as to whether a person is or was a principal agent the matter shall be referred to the Authority, whose decision shall be final.
- (9) Every insurer shall maintain a register in which the name and address of every principal agent appointed by him, the date of such appointment and the date, if any, on which the appointment ceased shall be entered.

Regulation of employment of chief and special agents [Section 42C]

- (1) Every contract between an insurer carrying on life insurance business and a chief agent shall be in writing, and shall specify the area (not being less in extent than a district or the equivalent thereof) for which the chief agent is appointed, and the terms contained in Part B of the Sixth Schedule shall be deemed to be incorporated in, and form part of, every such contract.
- (2) No chief agent shall, either directly or through insurance agents or special agents employed by or through him procure life insurance business for the insurer or any area outside the area for which he has been appointed or in any area for which another chief agent has been appointed or in any area in which the head office or any branch office of the insurer is operating, and neither the head office nor any branch office of the insurer shall operate in any area for which a chief agent has been appointed:

Provided that nothing in this sub-section shall be deemed to prohibit the head office of an insurer which had been operating at the commencement of the Insurance (Amendment) Act, 1950; for a period of not less than ten years before such commencement within the municipal limits of any town where the head office is situated, and a chief agent who, in pursuance of an agreement in writing, had been operating for a similar period within such limits, from continuing to operate within the said limits:

Provided further that nothing in this sub-section shall be deemed to prohibit an insurance agent from procuring life insurance business in or from any area and submitting the proposals direct to the principal office of the insurer in India.

- (3) Within sixty days of the commencement of the Insurance (Amendment) Act, 1950, every chief agent shall file with the insurer concerned a full list of the insurance agents employed by him, indicating the terms of the contract between the chief agent and each of such insurance agents and the business secured by each of such agents, and if any chief agent fails to file such a list within the period specified, any commission payable to such chief agent on premiums received from the date of the expiry of the said period of sixty days until the date of the filing of the said list shall, notwithstanding anything in any contract to the contrary, cease to be so payable.
- (4) Every contract between an insurer carrying on life insurance business and a special agent, or between a chief agent of such insurer and a special agent, shall be in writing and the terms



contained in Part C of the Sixth Schedule shall be deemed to be incorporated in, and form part of, every such contract:

Provided that the Authority may, in the case of a contract between a co-operative life insurance society as defined in clause (b) of sub-section (1) of section 95 and a co-operative society registered under the Indian Co-operative Societies Act, 1912 (2 of 1912), or under any other law for the time being in force and acting as a special agent, alter, to such extent as he thinks fit, all or any of the said terms.

- (5) A certified copy of every contract as is referred to in sub-section (1) or sub-section (4) shall be furnished by the insurer or the chief agent to the Authority within thirty days of his entering into such contract, and intimation of any change in any such contract shall be furnished by the insurer or the chief agent with full particulars thereof to the Authority within thirty days of the making of any such change.
- (6) No such contract as is referred to in sub-section (1) or sub-section (4) shall be entered into or renewed for a period exceeding ten years at any one time and notwithstanding the terms of any contract to the contrary, no option to renew any such contract given to any of the parties shall be enforceable without the consent of the other.
- (7) Every contract between an insurer and a person acting on behalf of such insurer who, before the commencement of the Insurance (Amendment) Act, 1950, has been employing insurance agents for the purpose of life insurance business, which is subsisting on such commencement, shall terminate after the expiration of ten years from such commencement, if it does not terminate earlier:

Provided that every such contract shall be modified by the parties before the 1st day of January, 1951, to bring it into conformity with this act, and any such modification shall-

- (i) as respects remuneration, whether in respect of business already procured or in respect of business to be procured thereafter, be such as may be mutually agreed upon between the parties, subject in the case of remuneration payable on business procured before such commencement, to a maximum of an overriding commission of two and a half per cent. plus a further commission not exceeding three and three-quarter per cent. on premiums in respect of which no commission is payable to any insurance agent;
- (ii) be deemed to include all the terms specified in Part B or Part C of the Sixth Schedule, as the case may be:

Provided further that, in the event of any dispute as to the terms of any fresh contract, the matter shall be referred to arbitration

- (8) Any such contract as is referred to in sub-section (7) which was subsisting on the 1st day of January, 1949, but has terminated or has been terminated before the commencement of the Insurance (Amendment) Act, 1950, shall be subject to the maximum limits specified in clause (i) of the proviso to sub-section (7) as respects remuneration, if any, payable on business procured before the termination of the contract.
- (9) Nothing in this section shall be deemed to prevent any special agent from receiving any renewal commission on policies effected through him as an insurance agent at any time before his appointment as such special agent.
- (10) If any dispute arises as to whether a person is or was a chief agent or a special agent for the purposes of this Act, the matter shall be referred to the Authority whose decision shall be final.
- (11) Every insurer shall maintain a register in which the name and address of every chief agent appointed by him, the date on which the appointment was made and the date, if any, on which the appointment ceased shall be entered, and a separate register in which similar particulars

relating to every special agent shall be entered, and every chief agent shall maintain a register in which similar particulars relating to every special agent appointed by him shall be entered.

Issue of licence to intermediary or insurance intermediary [Section 42D]

- (1) The Authority or an officer authorised by it in this behalf shall, in the manner determined by the regulations made by the Authority and on payment of the fees determined by the regulations made by the Authority, issue to any person making an application in the manner determined by the regulations, and not suffering from any of the disqualifications herein mentioned, a license to act as an intermediary or an insurance intermediary under this Act:

Provided that,-

- (a) in the case of an individual, he does not suffer from any of the disqualifications mentioned in sub-section (4) of section 42, or
 - (b) in the case of a company, or firm, any of its directors or partners does not suffer from any of the said disqualifications.
- (2) A license issued under this section shall entitle the holder thereof to act as an intermediary or insurance intermediary.
- (3) A license issued under this section shall remain in force for a period of three years only from the date of issue, but shall, if the applicant, being an individual does not, or being a company or firm any of its directors or partners does not suffer from any of the disqualifications mentioned in clauses (b), (c), (d), (e) and (f) of sub-section (4) of section 42 and the application for renewal of license reaches the issuing authority at least thirty days before the date on which the license ceases to remain in force, be renewed for a period of three years at any one time on payment of the fee, determined by the regulations made by the Authority and additional fee for an amount determined by the regulations, not exceeding one hundred rupees by way of penalty, if the application for renewal of the license does not reach the issuing authority at least thirty days before the date on which the license ceases to remain in force.
- (4) No application for the renewal of a license under this section shall be entertained if the application does not reach the issuing authority before the license ceases to remain in force: Provided that the Authority may, if satisfied that undue hardship would be caused otherwise, accept any application in contravention of this sub-section on payment by the applicant of a penalty of seven hundred and fifty rupees.
- (5) The disqualifications above referred to shall be the following: -
- (a) that the person is a minor;
 - (b) that he is found to be of unsound mind by a Court of competent jurisdiction;
 - (c) that he has been found guilty of criminal misappropriation or criminal breach of trust or cheating or forgery or an abetment of or attempt to commit any such offence by a Court of competent jurisdiction.
- Provided that,** where at least five years have elapsed since the completion of the sentence imposed on any person in respect of any such offence, the Authority shall ordinarily declare in respect of such person that his conviction shall cease to operate as a disqualification under this clause;
- (d) that in the course of any judicial proceedings relating to any policy of insurance of the winding up of an insurance company or in the course of an investigation of the affairs of an insurer it has been found that he has been guilty of or has knowingly participated



in or connived at any fraud, dishonesty or misrepresentation against an insurer or an insured;

- (e) that he does not possess the requisite qualifications and practical training for a period not exceeding twelve months, as may be specified by the regulations made by the Authority in this behalf;
 - (f) that he has not passed such examinations as may be specified by the regulations made by the Authority in this behalf;
 - (g) that he violates the code of conduct as may be specified by the regulations made by the Authority.
- (6) If it be found that an intermediary or an insurance intermediary suffers from any of the foregoing disqualifications, without prejudice to any other penalty to which he may be liable, the Authority shall, and if the intermediary or an insurance intermediary has knowingly contravened any provision of this Act, may cancel the license issued to the intermediary or insurance intermediary under this section.
- (7) The Authority may issue a duplicate license to replace a license lost, destroyed or mutilated, on payment of such fee, as may be determined by the regulations made by the Authority.
- (8) Any person who acts as an intermediary or an insurance intermediary without holding a license issued under this section to act as such, shall be punishable with fine, and any insurer or any person who appoints as an intermediary or an insurance intermediary or any person not licensed to act as such or transacts any insurance business in India through any such person, shall be punishable with fine.
- (9) Where the person contravening sub-section (8) is a company or a firm, then, without prejudice to any other proceedings which may be taken against the company or firm, every director, manager, secretary or other officer of the company, and every partner of the firm who is knowingly a party to such contravention shall be punishable with fine.

Commission, brokerage or fee payable to intermediary or insurance intermediary [Section 42E]

- (1) No intermediary or insurance intermediary shall be paid or contract to be paid by way of commission, fee or as remuneration in any form, an amount exceeding thirty per cent of the premium payable as may be specified by the regulations made by the Authority, in respect of any policy or policies effected through him:

Provided that the Authority may specify different amounts payable by way of commission, fee or as remuneration to an intermediary or insurance intermediary or different classes of business of insurance.

- (2) Without prejudice to the provisions contained in this Act, the Authority may, by the regulations made in this behalf, specify the requirements of capital, form of business and other conditions to act as an intermediary or insurance intermediary.

Register of insurance agents [Section 43]

- (1) Every insurer and every person who acting on behalf of an insurer employs insurance agents shall maintain a register showing the name and address of every insurance agent appointed by him and the date on which his appointment began and the date, if any, on which his appointment ceased.

Prohibition of cessation of payments of commission [Section 44]

- (1) Notwithstanding anything to the contrary contained in any contract between any person and an insurance agent providing for the forfeiture or stoppage of payment of renewal commission

to such insurance agent, no such person shall, in respect of life insurance business transacted in India, refuse payment to an insurance agent of commission due to him on renewal premium under the agreement by reason only of the termination of his agreement, except for fraud:

Provided that-

- (a) such agent ceases to act for the insurer concerned after the Central Government has notified in the official Gazette that it is satisfied that the circumstances in which the said insurer is placed are such as to justify the agent's ceasing to act for him; or
- (b) such agent has served the insurer continually and exclusively in respect of life insurance business for at least five years and policies assuring a total sum of not less than fifty thousand rupees effected through him for the insurer were in force on a date one year before his ceasing to act as such agent for the insurer, and that the commission on renewal premiums due to him does not exceed four per cent in any case; or
- (c) such agent has served the insurer continually and exclusively for at least ten years and after his ceasing to act as such agent he does not directly or indirectly solicit or procure insurance business for any other person.

Explanation.—For the purpose of this sub-section, service of an insurance agent under a chief agent of the insurer, whether before or after the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), shall be deemed to be service under the insurer.

- (2) Any commission payable to an insurance agent under the provisions of clause (b) and (c) of the proviso to sub-section (1) shall, notwithstanding the death of the agent, continue to be payable to his heirs for so long as such commission would have been payable had such insurance agent been alive.

Power to call for information [Section 44A]

For the purposes of ensuring compliance with the provisions of sections 40A, 40B, 40C, 42B and 42C the Authority may by notice,—

- (a) require from an insurer, principal agent, chief agent, or special agent such information, certified if so required by an auditor or actuary, as he may consider necessary;
- (b) require an insurer, principal agent, chief agent, or special agent to submit for his examination as the principal place of business of the insurer in India, any book of account, register or other document, or to supply any statement which may be specified in the notice;
- (c) examine any officer of an insurer or a principal agent, chief agent or special agent on oath, in relation to any such information, book, register, document or statement and administer the oath accordingly;

and an insurer, principal agent, chief agent or special agent shall comply with any such requirement within such time as may be specified in the notice.

Policy not to be called in question on ground of mis-statement after two years [Section 45]

No policy of life insurance effected before the commencement of this Act shall after the expiry of two years from the date of commencement of this Act and no policy of life insurance effected after the coming into force of this Act shall, after the expiry of two years from the date on which it was effected be called in question by an insurer on the ground that statement made in the proposal or in any report of a medical officer, or referee, or friend of the insured, or in any other document leading to the issue of the policy, was inaccurate or false, unless the insurer shows that such statement was on a material matter or suppressed facts which it was material to disclose and that it was fraudulently made by the policy-holder and that the policy-holder knew at the time of making it that the statement was false or that it suppressed facts which it was material to disclose:



Provided that nothing in this section shall prevent the insurer from calling for proof of age at any time if he is entitled to do so, and no policy shall be deemed to be called in question merely because the terms of the policy are adjusted on subsequent proof that the age of the life insured was incorrectly stated in the proposal.

Application of the law in force in India to policies issued in India [Section 46]

The holder of a policy of insurance issued by an insurer in respect of insurance business transacted in India after the commencement of this Act shall have the right, notwithstanding anything to the contrary contained in the policy or in any agreement relating thereto, receive payment in India of any sum secured thereby and to sue for any relief in respect of the policy in any court of competent jurisdiction in India; and if the suit is brought in India any question of law arising in connection with any such policy shall be determined according to the law in force in India:

Provided that nothing in this section shall apply to a policy of marine insurance

Payment of money into Court [Section 47]

- (1) Where in respect of any policy of life insurance maturing for payment an insurer is of opinion that by reason of conflicting claims to or insufficiency of proof of title to the amount secured thereby or for any other adequate reason it is impossible otherwise for the insurer to obtain a satisfactory discharge for the payment of such amount, the insurer may, apply to pay the amount into the Court within the jurisdiction of which is situated the place at which such amount is payable under the terms of the policy or otherwise.
- (2) A receipt granted by the Court for any such payment shall be a satisfactory discharge to the insurer for the payment of such amount.
- (3) An application for permission to make a payment into Court under this section, shall be made by a petition verified by an affidavit signed by a principal officer of the insurer setting forth the following particulars, namely:
 - (a) the name of the insured person and his address;
 - (b) if the insured person is deceased, the date and place of his death;
 - (c) the nature of the policy and the amount secured by it;
 - (d) the name and address of each claimant so far as is known to the insurer with details of every notice of claim received;
 - (e) the reasons why in the opinion of the insurer satisfactory discharge cannot be obtained for the payment of the amount; and
 - (f) the address at which the insurer may be served with notice of any proceeding relating to disposal of the amount paid into Court.
- (4) An application under this section shall not be entertained by the Court if the application is made before the expiry of six months from the maturing of the policy by survival, or from the date of receipt of notice by the insurer of the death of the insured, as the case may be.
- (5) If it appears to the Court that a satisfactory discharge for the payment of the amount cannot otherwise be obtained by the insurer it shall allow the amount to be paid into Court and shall invest the amount in Government securities pending its disposal.
- (6) The insurer shall transmit to the Court every notice of claim received after the making of the application under sub-section (3), and any payment required by the Court as costs of the proceedings or otherwise in connection with the disposal of the amount paid into Court shall as to the cost of the application under sub-section (3) be borne by the insurer and as to any other costs be in the discretion of the Court.

- (7) The Court shall cause notice to be given to every ascertained claimant of the fact that the amount has been paid into Court, and shall cause notice at the cost of any claimant applying to withdraw the amount to be given to every other ascertained claimant.
- (8) The Court shall decide all questions relating to the disposal of claims to the amount paid into Court.

Claims on small life insurance policies [Section 47A]

- (1) In the event of any dispute relating to the settlement of a claim on a policy of life insurance assuring a sum not exceeding two thousand rupees (exclusive of any profit or bonus not being a guaranteed profit or bonus) issued by an insurer in respect of insurance business transacted in India, arising between a claimant under the policy and the insurer who issued the policy or has otherwise assumed liability in respect thereof, the dispute may at the option of the claimant be referred to the Authority for decision and the Authority may, after giving an opportunity to the parties to be heard and after making such further inquiries as he may think fit, decide the matter.
- (2) The decision of the Authority under this sub-section shall be final and shall not be called in question in any Court, and may be executed by the Court which would have been competent to decide the dispute if it had not been referred to the Authority as if it were a decree passed by that Court.
- (3) There shall be charged and collected in respect of the duties of the Authority under this section such fees whether by way of percentage or otherwise as may be prescribed.

Directors of insurers being companies [Section 48]

- (1) Where the insurer is a company incorporated under the Indian Companies Act, 1913 (7 of 1913), or under the Indian Companies Act, 1882 (6 of 1882), or under the Indian Companies Act, 1866 (10 of 1866), or under any Act repealed thereby, and carries on the business of life insurance, not less than one-fourth of the whole number of the directors of the company the number to be elected not being less than two in any case shall notwithstanding anything to the contrary in the Articles of Association of the company be elected in the prescribed manner by the holders of policies of life insurance issued by the company.
- (2) Only and all persons holding otherwise than as assignees policies of life insurance issued by the company of such minimum amount and having been in force for such minimum period as may be prescribed shall unless disqualified under sub-section (2A) be eligible for election as directors under sub-section (1), and only and all persons holding policies of life insurance issued by the company and having been in force at the time of the election for not less than six months shall be eligible to vote at such elections:

Provided that the assignment of a policy to the persons who took out the policy shall not disqualify that person for being eligible for election as a director under sub-section (1)

- (2A) A person shall be ineligible for election as a director, under subsection (1) of any company if he is a director, officer, employee, or legal or technical adviser of that company, or any other insurer, and shall cease to be a director under sub-section (1) if after election he acquires any disqualification specified in this sub-section or no longer holds the qualifications required by sub-section (2):

Provided that nothing in this sub-section shall disqualify a person who is an elected director under sub-section (1) and is not otherwise disqualified under this sub-section, from being re-elected:

Provided further that the Authority may exempt any director of a subsidiary company of the insurer from any disqualification imposed by this sub-section

- (3) The Central Government may, for such period, or to such extent and subject to such conditions as may be specified by it in this behalf, exempt from the operation of this section—



- (a) any mutual Insurance Company as defined in clause (a) of sub-section (1) of section 95 in respect of which the Authority certifies that in his opinion owing to conditions governing membership of the company or to the nature of the insurance contracts undertaken by it the application of the provisions of this section to the company is practicable, or
 - (b) any company in respect of which the Authority certifies that in opinion the company, have taken all reasonable steps to achieve compliance with the provisions of this section, has been unable to obtain the required number of directors with the required qualifications.
- (4) This section shall not take effect, in respect of any company in existence at the commencement of this Act, until the expiry of one year there from, and in respect of any company incorporated after the commencement of this Act, until the expiry of two years from the date of registration to carry on life insurance business.

Life Insurance agents not to be directors of life insurance companies [Section 48A]

No insurance agent who solicits or procures life insurance business, and no chief agent or special agent shall be eligible to be or remain a director of any insurance company carrying on life insurance business:

Provided that any director holding office at the commencement of the Insurance (Amendment) Act, 1946 (6 of 1946), shall not become ineligible to remain a director by reason of this section until the expiry of six months from the commencement of that Act.

Further provision regarding directors [Section 48B]

- (1) An insurer specified in sub-clause (b) of clause (9) of section 2 and carrying on life insurance business shall not have a common director with another such insurer.
- (2) The Authority may, for such period, to such extent and subject to such conditions as it may specify, exempt from the operation of this section—
 - (a) any insurer, who is a subsidiary company of another insurer, or
 - (b) two or more insurers, for the purpose of facilitating their amalgamation or the transfer of business of one insurer to the other.

Appointment of additional directors [Section 48C]

[Repealed by the Insurance (Amendment) Act, 1968(62 of 1968).]

Restriction on dividends and bonuses [Section 49]

- (1) No insurer, being an insurer specified in sub-clause (a) (ii) or sub-clause (b) of clause (9) of section 2, who carries on the business of life insurance or any other class or subclass of insurance business to which Sec. 13 applies, shall, for the purpose of declaring or paying any dividend to shareholders or any bonus to policy-holders or of making any payment in services of any debentures, utilize directly or indirectly any portion of the life insurance fund or of the fund of such other class or sub-class of insurance business, as the case may be, except a surplus shown in the valuation balance-sheet in such form as may be specified by the regulations made by the Authority submitted to the Authority as part of the abstract referred to in Section 15 as a result of an actuarial valuation assets and liabilities of the insurer; nor shall he increase such surplus by contributions out of any reserve fund or otherwise unless such contributions have been brought in as revenue account applicable to that class or sub-class of insurance business on or before the date of the valuation aforesaid, except when the reserve fund is made up solely of transfers from similar surpluses disclosed by valuations in respect of which returns have been submitted to the Authority under Section 15 of this Act or to the Central Government under Section 11 of the Indian Life Assurance Companies Act, 1912 (6 of 1912):

Provided that payments made out of any such surplus in service of any debentures shall not

exceed fifty per cent. of such surplus including any payment by way of interest on the debentures, and interest paid on the debentures shall not exceed ten per cent of any such surplus except where the interest paid on the debentures is offset against the interest credited to the fund or funds concerned in deciding the interest basis adopted in the valuation disclosing the aforesaid surplus:

Provided further that the share of any such surplus allocated to or reserved for the shareholders (including any amount for the payment of dividends guaranteed to them, whether by way of first charge or otherwise) shall not exceed such sums as may be specified by the Authority and such share shall in no case exceed ten percent of such surplus in case of participating policies and in other cases the whole thereof.

- (2) For the purposes of sub-section (1) the actual amount of income-tax deducted at source during the period following the date as at which the last preceding valuation was made and preceding the date as at which the valuation in question is made may be added to such surplus after deducting an estimated amount for income-tax on such surplus, such addition and deduction being shown in an abstract of the report of the actuary referred to in sub-section (1) of section 13.

Notice of options available to the assured on the lapsing of a policy [Section 50]

An insurer shall, before the expiry of three months from the date on which the premiums in respect of a policy of life insurance were payable but not paid, give notice to the policy-holder informing him of the options available to him unless these are set forth in the policy.

Supply of copies of proposals and medical reports [Section 51]

Every insurer shall, on application by a policy-holder and on payment of a fee not exceeding one rupee, supply to the policy-holder certified copies of the questions put to him and his answers thereto contained in his proposal for insurance and in the medical report supplied in connection therewith.

Prohibition of business on dividing principle [Section 52]

- (1) No insurer shall after the commencement of this Act begin, or after three years from that date continue to carry on, any business upon the dividing principle, that is to say, on the principle that the benefit secured by a policy is not fixed but depends either wholly or partly on the results of a distribution of certain sums amongst policies becoming claims within certain time-limits, or on the principle that the premiums payable by a policy-holder depend wholly or partly on the number of policies becoming claims within certain time-limits:

Provided that nothing in this section shall be deemed to prevent an insurer from allocating bonuses to holders of policies of life insurance as a result of a periodical actuarial valuation either as reversionary additions to the sums insured or as immediate cash bonuses or otherwise:

Provided further that an insurer who continues to carry on insurance business on the dividing principle after the commencement of this Act shall withhold from distribution a sum of not less than forty per cent of the premiums received during each year after the commencement of this Act in which such business is continued so as to make up the amount required for investment under Section 27.

- (2) On the expiry of the period of three years referred to in sub-section (1), or on the insurer's ceasing before such expiry but at any time after the commencement of the Insurance (Amendment) Act, 1941 (13 of 1941), to carry on business on the dividing principle, the insurer shall forthwith cause an investigation to be made by an actuary, who shall determine the amount accumulated out of the contributions received from the holders of all policies to which the dividing principle applies and the extent of the claims of those policy-holders against the realisable assets of the insurer, and shall, before the expiration of six months from the date on which he is entrusted with the investigation, make recommendations regarding the distribution, whether by cash payment or by the allocation of paid-up policies or by a combination of both methods, of such assets as he



finds to appertain to such policy-holder; and the insurer shall, before the expiry of six months from the date on which the actuary make his recommendations, distribute such assets in accordance with those recommendations.

- (3) Where at any time prior to the commencement of the Insurance (Amendment) Act, 1941 (13 of 1941), an insurer has to carry on business on the dividing principle, the insurer shall before the expiration of two months from the commencement of that Act, report to the Authority the measures taken or proposed by him for the distribution among holders of policies to which the dividing principle applies of the assets due to them; and the Authority may either sanction such measures or refuse his sanction, and, if he refuses his sanction or if the insurer does not report to him as required by this sub-section, the provisions of sub-section (2) shall apply to the insurer forthwith.

When Administrator for management of insurance business may be appointed [Section 52A]

- (1) If at any time the Authority has reason to believe that an insurer carrying on life insurance business is acting in a manner likely to be prejudicial to the interests of holders of life insurance policies, he may, after giving such opportunity to the insurer to be heard as he thinks fit, make a report thereon to the Central Government.
- (2) The Central Government, if it is of opinion after considering the report that it is necessary or proper to do so, may appoint an Administrator to manage the affairs of the insurer under the direction and control of the Authority.
- (3) The Administrator shall receive such remuneration as the Central Government may direct and the Central Government may at any time cancel the appointment and appoint some other person as Administrator.
- (4) The management of the business of the insurer shall as on and after the date of appointment of the Administrator vest in such Administrator, but except with the leave of the Authority the Administrator shall not issue any further policies.
- (5) As on and after the date of appointment of the Administrator any person vested with any such management immediately prior to that date shall be divested of that management.
- (6) The Authority may issue such directions to the Administrator as to his powers and duties as he deems desirable in the circumstances of the case, and the Administrator may apply to the Authority at any time for instructions as to the manner in which he shall conduct the management of the business of the insurer or in relation to any matter arising in the course of such management.

Powers and duties of the Administrator [Section 52B]

- (1) The Administrator shall conduct the management of the business of the insurer with the greatest economy compatible with efficiency and shall, as soon as may be possible, file with the Authority a report stating which of the following courses is in the circumstances most advantageous to the general interests of the holders of life insurance policies, namely:-
 - (a) the transfer of the business of the insurer to some other insurer:
 - (b) the carrying on of its business by the insurer (whether with the policies of the business continued for the original sum insured with the addition of bonuses that attach to the policies or for reduced amounts);
 - (c) the winding up of the insurer; and
 - (d) such other course as he deems advisable.
- (2) On the filing of the report with the Authority, the Authority may take such action as he thinks fit for promoting the interests of the holders of life insurance policies in general.

- (3) Any order passed by the Authority under sub-section (2), shall be binding on all persons concerned, and shall have effect notwithstanding anything in the memorandum or articles of association of the insurer, or a company.

Powers of Administrator respecting property liable to attachment under Section 106 [Section 52BB]

- (1) If the Administrator is satisfied that any person has rendered himself liable to be proceeded against under Section 106, he may, pending the institution of proceedings against such person under that section, by order in writing, prohibit him or any other person from transferring or otherwise disposing of any property which, in the opinion of the Administrator, would be liable to attachment in proceedings under that section.
- (2) Any person aggrieved by an order made by the Administrator under sub-section (1) may, within fourteen days from the date on which the order is served on him, appeal against such order to the Central Government, and the Central Government may pass such order thereon as it thinks fit.
- (3) An order made by the Administrator under sub-section (1) shall, subject to any order made by the Central Government on appeal, be in force for a period of three months from the date of the order unless, before the expiry of the said period, an application is made under sub-section (1) of Sec. 106 to the Court competent to exercise jurisdiction under that sub-section, and when such an application is made, the order shall, subject to any order made by that Court, continue in force as if it were an order of attachment made by that Court in proceedings under that section.
- (4) An order made by the Administrator under this section shall,—
 - (a) in the case of an order affecting a corporation or firm, be served in the manner provided for the service of summons in rule 2 of Order XXIX or rule 3 of Order XXX, as the case may be, in the First Schedule to the Code of Civil Procedure, 1908 (5 of 1908), and
 - (b) in the case of an order affecting a person not being a corporation or firm, be served on such person -
 - (i) personally, by delivering or tendering to him the order, or
 - (ii) by post, or
 - (iii) where the person cannot be found, by leaving a copy of the order with some adult male member of his family or by affixing such copy to some conspicuous part of the premises in which he is known to have last resided or carried on business or personally worked for gain.

and every such order shall also be published in the official Gazette.
- (5) If any question arises whether a person was duly served with an order under sub-section (4), the publication of the order in the official Gazette shall be conclusive proof that the order was so served, and a failure to comply with the provisions of Clause (a) or Clause (b) of sub-section (4) shall not affect the validity of the order.
- (6) Notwithstanding anything contained in this sections any property in respect of which an order has been made by the Administrator may, with the previous permission of the Administrator and subject to such terms and conditions as he may impose, be transferred or otherwise disposed of.
- (7) Notwithstanding anything contained in any other law for the time being in force, the transfer or other disposition of any property in contravention of any order made by the Administrator under this section or of any terms and conditions imposed by him shall be void.
- (8) For the purpose of enabling him to form an opinion as to whether any property would be liable to attachment in proceedings under Sec. 106 or for the purpose of enabling him to institute proceedings under that section, the Administrator may require any person to furnish information



on such points or matters as, in the opinion of the Administrator, may be relevant for the purpose, and any person so required shall be deemed to be legally bound to furnish such information within the meaning of Sec. 176 of the Indian Penal Code (45 of 1860).

- (9) The Administrator shall have all the powers of a civil court under the Code of Civil Procedure, 1908 (5 of 1908), while trying a suit in respect of the following matters, namely:
- (a) summoning and enforcing the attendance of witnesses and examining them on oath;
 - (b) requiring the production of documents; and
 - (c) receiving evidence on affidavits,

and any proceeding before the Administrator under this section shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228 of the Indian Penal Code (45 of 1860).

- (10) Save as provided in this section or in Section 106, and notwithstanding anything contained in any other law for the time being in force,—
- (a) no suit or other legal proceeding shall lie in any Court to set aside or modify any order of the Administrator or the Central Government made under this section, and
 - (b) no Court shall pass any decree, grant any injunction or make any other order which shall have the effect of nullifying or affecting in any way any such order.

Cancellation of contracts and agreements [Section 52C]

The Administrator may, at any time during the continuance of his appointment with respect to an insurer and after giving an opportunity to the persons concerned to be heard, cancel or vary (either unconditionally or subject to such conditions as he thinks fit to impose) any contract or agreement (other than a policy) between the insurer and any other person which the Administrator is satisfied is prejudicial to the interest of holders of life insurance policies.

Termination of appointment of Administrator [Section 52D]

If at any time, on a report made by the Authority in this behalf, it appears to the Central Government that the purpose of the order appointing the Administrator has been fulfilled or that for any reason it is undesirable that the order of appointment should remain in force, the Central Government may cancel the order and thereupon the Administrator shall be divested of the management of the insurance business which shall, unless otherwise directed by the Central Government, again vest in the person in whom it was vested immediately prior to the date of appointment of the Administrator.

Finality of decision appointing Administrator [Section 52E]

Any order or decision of the Central Government made in pursuance of Section 52-A or Section 52-D shall be final and shall not be called in question in any Court.

Penalty for withholding documents of property from Administrator [Section 52F]

If any director or officer of the insurer or any other person fails to deliver to the Administrator any books of account, registers, or any other documents in his custody relating to the business of the insurer the management of which has vested in the Administrator, or retains any property of such insurer, he shall be punishable with imprisonment which may extend to six months, or with fine which may extend to one thousand rupees, or with both.

Protection of action taken under Sections 52-A to 52-D [Section 52G]

No suit, prosecution or other legal proceeding shall lie against an Administrator for anything which is in good faith done or intended to be done in pursuance of Section 52-A, Section 52-B, Section 52-BB or Section 52-C.

- (2) No suit or other legal proceeding shall lie against the Central Government or the Authority for any

damage caused- or likely to be caused by anything which is in good faith done or intended to be done under Section 52-A, Section 52-B, or Section 52-D.

Power of Central Government to acquire undertakings of insurers in certain cases [Section 52H]

- (1) If, upon receipt of a report from the Authority, the Central Government is satisfied that an insurer,
- (a) has persistently failed to comply with—
 - (i) any direction given to him under Section 34, Section 34-F or Section 34G, or
 - (ii) any order made under Sec. 34-E; or
 - (b) is being managed in a manner detrimental to the public interest or to the interests of his policy-holders, or share-holders,
and that
 - I. in the public interest, or
 - II. in the interest of the policy-holders or share-holders of such insurer,

it is necessary to acquire the undertaking of such insurer, the Central Government may, by notified order, acquire the undertaking of such insurer (hereafter in this section and in Sections 52-I, 52-J and 52-N and in the Eighth Schedule referred to as the acquired insurer) with effect from such date as may be specified in the order (hereinafter in this section and in Sections 52-1 and 52J and in the Eighth Schedule referred to as the appointed day):

Provided that no undertaking of an insurer shall be so acquired unless such insurer has been given a reasonable opportunity of showing cause against the proposed action

Explanation.—For the purposes of this section and of Sections 52-1 to 52N—

- (a) “notified order” means an order published in the official Gazette;
 - (b) “undertaking”, in relation to an insurer incorporated outside India, means the undertaking of the insurer in India,
- (2) Subject to the other provisions contained in this section and in Sections 52-I to 52M, on the appointed day, all the assets and liabilities of the undertaking of the acquired insurer shall stand transferred to, and vest in, the Central Government.
- (3) The assets and liabilities of the undertaking of the acquired insurer shall be deemed to include all rights, powers, authorities and privileges and all property, whether movable or immovable, including, in particular, cash balances, reserve funds, investments, deposits and all other interests and rights in, or arising out of, such property’ as may be in the possession of or held by, the acquired insurer immediately before the appointed day and all books, accounts and documents relating thereto, and shall also be deemed to include all debts, liabilities and obligations of whatever kind, then existing of the acquired insurer.
- (4) Notwithstanding anything contained in sub-section (2), the Central Government may, if it is satisfied that all the assets and liabilities of the undertaking of the acquired insurer should, instead of vesting in the Central Government, or continuing to so vest, vest in a corporation or company, whether established under the scheme made under Sec. 52-I or not (hereafter in this section and in Section 52-1 to 52-N and in the Eighth Schedule referred to as the acquired insurer), by order, direct that the assets and liabilities of the said undertaking, shall vest in the acquiring insurer, either on the publication of the notified order or on such other date as may be specified in this behalf in the direction.
- (5) Where the undertaking of the acquired insurer vests in an acquiring insurer under sub-section (4),



the acquiring insurer shall, on and from the date of such vesting, be deemed to have become the transferee of the acquired insurer and all the rights and liabilities in relation to the acquired insurer shall, on and from the date of such vesting, be deemed to have been the rights and liabilities of such acquiring insurer.

- (6) Unless otherwise expressly provided by or under this section or Sections 52-I to 52M, all contracts, deeds, bonds, agreements, powers of attorney, grants of legal representation and other instruments of whatever nature subsisting, having effect immediately before the appointed day and to which the acquired insurer is a party or which are in favour of the acquired insurer shall be of as full force and effect against or in favour, of the Central Government or, as the case may be, the acquiring insurer, and may be enforced or acted upon as fully and effectually as of in the place of the acquired insurer the Central Government or the acquiring insurer had been a party thereto or as if they had been issued in favour of the Central Government or the acquiring insurer, as the case may be.
- (7) If, on the appointed day, any suit, appeal or other proceeding, of whatever nature, is pending by or against the acquired insurer the same shall not abate, be discontinued or be, in any way, prejudicially affected by reason of the transfer of the undertaking of the acquired insurer or of anything contained in this section or in Sections 52-I to 52M, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the Central Government or the acquiring insurer, as the case may be.

Power of Central Government to make scheme [Section 52-I]

- (1) The Central Government may make a scheme for carrying out the purposes of Sections 52 H and 52J to 52-M (both inclusive) in relation to the acquired insurer.
- (2) In particular, and without prejudice to the generality of the foregoing power, the said scheme may provide for all or any of the following matters, namely:
 - (a) transfer of the undertaking, including the property, assets and liabilities of the acquired insurer to an acquiring insurer, and the capital, constitution, name and officer of the acquiring insurer;
 - (b) the constitution of the first Board of management (by whatever name called) of the acquiring insurer and all such matters in connection therewith or incidental thereto as the Central Government may consider to be necessary or expedient;
 - (c) the continuance of the services of all the employees of the acquired insurer (excepting such of them as not being workmen within the meaning of the Industrial Disputes Act' 1947 are specifically mentioned in the scheme) in the Central Government or in the acquiring insurer, as the case may be, on the same terms and conditions, so far as may be, as are specified in Clauses (i) and (j) of sub-section (2) of Sec. 37A so far as they may apply;
 - (d) the continuance of the rights of any person who, on the appointed day, is entitled to, or is in receipt of, a pension or other superannuation or compassionate allowance or benefit from the acquired insurer or any provident, pension or other fund or any authority administering such fund to be paid by, and to receive from the Central Government or the acquiring insurer, as the case may be, or any provident, pension or other fund or any authority administering such fund, the same pension, allowance or benefit so long as he observes the conditions on which the pension, allowance or benefit was granted, and if any question arises whether he has so observed such conditions, the question shall be determined by the Central Government and the decision of the Central Government thereon shall be final;
 - (e) the manner of payment to the acquired insurer in full satisfaction of his claim in relation to the compensation payable in accordance with the provisions of Section 52J;

- (f) the provision, if any, completing the effectual transfer to the Central Government or the acquiring insurer of any asset or liability which forms part of the undertaking of the acquired insurer in any country outside India;
 - (g) such incidental, consequential and supplemental matters as may be necessary to secure that the transfer of the undertaking, property, assets and liabilities of the acquired insurer to the Central Government or the acquiring insurer, as the case may be, is effectual and complete.
- (3) The Central Government may, by notification in the official Gazette, add to, amend or vary any scheme made under this section.
 - (4) Every scheme made under this section shall be published in the official Gazette.
 - (5) Copies of every scheme made under this section shall be laid before each House of Parliament as soon as may be after it is made.
 - (6) The provisions of Sections 52H and 52J to 52M and of any scheme made under this section shall have effect notwithstanding anything to the contrary contained in any other provision of this Act or in any other law or any agreement, award or other instrument for the time being in force.

Compensation to be given to the acquired insurer [Section 52J]

- (1) The acquired insurer shall be given by the Central Government or the acquiring insurer, as the case may be, such compensation in respect of the transfer of the undertaking of the acquired insurer as is determined in accordance with the principles contained in the Eighth Schedule.
- (2) The amount of compensation to be given in accordance with the principles contained in the Eighth Schedule shall be determined, in the first instance, by the Central Government or the acquiring insurer, as the case may be, in consultation with the Authority, and shall be offered by it to the acquired insurer, in full satisfaction thereof.
- (3) If the amount of compensation offered in terms of sub-section (2) is not acceptable to the acquired insurer, he may, before such date as may be notified by the Central Government in the official Gazette, request the Central Government in writing to have the matter referred to the Tribunal constituted under Section 52K.
- (4) If before the date notified under sub-section (3) the Central Government does not receive request as provided in that sub-section, the amount of compensation offered under sub-section (2), or where a reference has been made to the Tribunal, the amount determined by it, shall be the compensation payable under sub-section (1) and shall be final and binding on all the parties concerned.
- (5) Where the Central Government does not receive request as provided in sub-section (3), the compensation payable in pursuance of the provisions of this section shall become due for payment on the expiry of one year from the appointed day, and where a reference has been made to the Tribunal under subsection (3), the amount determined by the Tribunal as compensation shall become due for payment on the expiry of one year from the appointed day or on the date of decision of the Tribunal, whichever is earlier.
- (6) If between the appointed day and the date on which the compensation becomes due in pursuance of sub-section (5), any facts come to light which call for revision of the amount of the compensation, the necessary modification of the amount of the compensation shall be made and the amount of the compensation so determined shall be the compensation payable in pursuance of sub-section (1).
- (7) There shall also be paid simple interest at the rate of three per cent per annum on the amount of the compensation for the period from the appointed day to the date on which payment of the compensation becomes due.



Constitution of the Tribunal [Section 52K]

- (1) The Central Government may, for the purposes of Sections 52-H to 52J, constitute a tribunal which shall consist of a Chairman and two other members.
- (2) The Chairman shall be a person who is, or has been, a Judge of a High Court or of the Supreme Court and of the two other members, one shall be a person who, in the opinion of the Central Government, has had experience of matters connected with general insurance and the other shall be a person who is a chartered accountant within the meaning of the Chartered Accountants Act, 1949 (38 of 1949).
- (3) If, for any reason, a vacancy occurs in the office of the Chairman or any other member of the Tribunal, the Central Government may fill the vacancy by appointing another person thereto in accordance with the provisions of subsection (2), and any proceeding may be continued before the Tribunal so constituted from the stage at which the vacancy occurred.
- (4) The Tribunal may, for the purpose of determining any compensation payable under Sec. 52J, choose one or more persons having special knowledge or experience of any relevant matter to assist it in the determination of such compensation.

Tribunal to have powers of Civil Court [Section 52L]

- (1) The Tribunal shall have the powers of a Civil Court, while trying a suit, under the Code of Civil Procedure, 1908 (5 of 1908), in respect of the following matters, namely:-
 - (a) summoning and enforcing the attendance of any person and examining him on oath;
 - (b) requiring the discovery and production of documents;
 - (c) receiving evidence on affidavits;
 - (d) issuing commission for the examination of witnesses or documents.
- (2) Notwithstanding anything contained in sub-section (1) or in any other law for the time being in force, the Tribunal shall not compel the Central Government or the Authority-
 - (a) to produce any books of account, or other documents which the Central Government or the Authority claims to be of a confidential nature;
 - (b) to make any such books or documents a part of the record of the proceedings before the Tribunal;
 - (c) to give inspection of any such books or documents to any party before it and to any other person.
- (3) Any proceeding before the Tribunal shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228 of the Indian Penal Code, and the Tribunal shall be deemed to be a civil Court for the purposes of Section 195 and Chapter XXXV of the Code of Criminal Procedure, 1898 (5 of 1898).

Procedure of the Tribunal [Section 52M]

- (1) The Tribunal shall have power to regulate its own procedure.
- (2) The Tribunal may hold the whole or any part of its inquiry in camera.
- (3) Any clerical or arithmetical error in any order of the Tribunal or any error arising therein from any accidental slip or omission may, at any time, be corrected by the Tribunal either of its own motion or on the application of any of the parties.

Special provisions for the dissolution of acquired insurers [Section 52N]

Where any acquired insurer, being a company, has in accordance with the provisions of this Act,

collected and distributed any monies paid to him by the Central Government or the acquiring insurer, as the case may be, by way of compensation or otherwise, and has also complied with any directions given to him by the Central Government or the acquiring insurer, as the case may be, by way of compensation or otherwise, and has also complied with any directions given to him by the Central Government or the acquiring insurer, as the case may be, for the purpose of securing that the ownership of any property or any right is effectively transferred to the Central Government or the acquiring insurer, as the case may be, the Central Government may, on application being made to it in this behalf by such insurer, grant a certificate to be the insurer that there is no reason for the continued existence of the insurer, and upon the publication of such certificate, the insurer shall be dissolved.

Winding up by the Court [Section 53]

- (1) The Court may order the winding up in accordance with the Indian Companies Act, 1913 (7 of 1913), of any insurance company and the provisions of that Act shall, subject to the provisions of this Act apply accordingly.
- (2) In addition to the grounds on which such an order may be based, the Court may order the winding up of an insurance company
 - (a) if with the sanction of the Court previously obtained a petition in this behalf is presented by shareholders not less in number than one-tenth of the whole body of shareholders and holding not less than one tenth of the whole share capital or by not less than fifty policy-holders holding policies of life insurance that have been in force for not less than three years and are of the total value of not less than fifty thousand rupees; or
 - (b) if the Authority, who is hereby authorised to do so, applies in this behalf to the Court on any of the following grounds, namely
 - (i) that the company has failed to deposit or to keep deposited with the Reserve Bank of India the amounts required by Section 7 or Section 98;
 - (ii) that the company having failed to comply with any requirement of this Act has continued such failure Nor having contravened any provision of this Act has continued such contravention for a period of three months after notice of such failure Nor contravention has been conveyed to the company by the Authority.
 - (iii) that it appears from Many returns or statements furnished under the provisions of this Act or from the results of any investigation made there under that the company is, or is deemed to be, insolvent, or
 - (iv) that the continuance of the company is prejudicial to the interest if the policy-holders or to the public interest generally

Unpaid-up share capital [Section 53A]

Notwithstanding anything contained in any other law, in ascertaining for any purpose of this Act the solvency or otherwise of an insurer no account shall be taken of any assets of the insurer consisting of unpaid-up share capital.

Voluntary winding up [Section 54]

Notwithstanding anything contained in the Indian Companies Act, 1913 (7 of 1913), an insurance company shall not be wound up voluntarily except for the purpose of effecting an amalgamation or a re-construction of the company, or on the ground that by reason of its liabilities it cannot continue its business.

Valuation of liabilities [Section 55]

- (1) In the winding up of an insurance company or in the insolvency of any other insurer the value of the assets and the liabilities of the insurer shall be ascertained in such manner and upon such



basis as the liquidator or receiver in insolvency thinks fit, subject, so far as applicable, to the rule contained in the Seventh Schedule and to any directions which may be given by the Court.

- (2) For the purposes of any reduction by the Court of the amount of the contracts of any insurance company the value of the assets and liabilities of the company and all claims in respect of policies issued by it shall be ascertained in such manner and upon such basis as the Court thinks proper having regard to the rule aforesaid.
- (3) The rule in the Seventh Schedule shall be of the same force and may be repealed, altered or amended as if it were a rule made in pursuance of section 246 of the Indian Companies Act, 1913 (7 of 1913) and rules may be made under that section for the purpose of carrying into effect the provisions of this Act with respect to the winding up of insurance companies.

Application of surplus assets of life insurance fund in liquidation or insolvency [Section 56]

- (1) In the winding up of an insurance company and in the insolvency of any other insurer the value of the assets and the liabilities of the insurer in respect of life insurance business shall be ascertained separately from the value of any other assets or any other liabilities of the insurer and no such assets shall be applied to the discharge of any liabilities other than those in respect of life insurance business except in so far as those assets exceed the liabilities in respect of life-insurance business.
- (2) In the winding up of an insurance company carrying on the business of life insurance or in the insolvency of any other insurer carrying on such business where any proportion of the profits of the insurer was before the commencement of the winding up or insolvency allocated to policy-holders, if, when the assets and liabilities of the insurer have been ascertained, there is found to be a surplus of assets over liabilities (hereinafter referred to as a prima facie surplus) there shall be added to the liabilities of the insurer in respect of the life-insurance business an amount equal to such proportion of the prima facie surplus as is equivalent to such proportion of the profits allocated to shareholders and policy-holders as was allocated to policy-holders during the ten years immediately preceding the commencement of the winding up and the assets of the insurer shall be deemed to exceed his liabilities only in so far as those assets exceed those liabilities after such addition:

Provided that-

- (a) if in any case there has been no such allocation or if it appears to the Court that by reason of special circumstances it would be inequitable that the amount to be added to the liabilities of the insurer in respect of the life insurance business should be an amount equal to such proportion as aforesaid, the amount to be so added shall be such amount as the Court may direct, and
- (b) for the purpose of the application of this sub-section to any case where before the commencement of the winding up or insolvency a proportion of such profits as aforesaid of a branch only of the life insurance business in question has been allocated to policy-holders, the value of the assets and liabilities of the insurer in respect of that branch shall be separately ascertained in like manner as the value of his assets and liabilities in respect to the life insurance business was ascertained, and the surplus so found, if any, of assets over liabilities shall, for the purpose of determining the amount to be added to :the liabilities of the insurer in respect of the life insurance business be deemed to be the prima facie surplus..

Winding up of secondary companies [Section 57]

- (l) Where the insurance business or any part of the insurance business of an insurance company has been transferred to another insurance company under an arrangement in pursuance of which the first mentioned company (in this section referred to as the secondary company) or the creditors thereof has or have claims against the company to which such transfer was made (in this section referred to as the principal company) then, if the principal company is being wound

up by or under the supervision of the Court, the Court shall (subject as hereinafter mentioned) order the secondary company to be wound up in conjunction with the principal company and may, by the same or any subsequent order appoint the same person to be liquidator for the two companies and make provision for such other matters as may seem to the Court necessary with a view to the companies being wound up as if they were one company.

- (2) The commencement of the winding up of the principal company shall, save as otherwise ordered by the Court, be the commencement of the winding up of the secondary company.
- (3) In adjusting the rights and liabilities of the members of the several companies among themselves the Court shall have regard to the constitution of the companies and to the arrangements entered into between the companies in the same manner as the Court has regard to the rights and liabilities of different classes of contributories in the case of the winding-up of a single company or as near thereto as circumstances admit.
- (4) Where any company alleged to be secondary is not in process of being wound up at the same time as the principal company to which it is alleged to be secondary, the Court shall not direct the secondary company to be wound up, unless, after hearing all objections (if any) that may be urged by or on behalf of the company against its being wound up, the Court is of opinion that the company is secondary to the principal company and that the winding up of the company in conjunction with the principal company is just and equitable.
- (5) An application may be made in relation to the winding up of any secondary company in conjunction with the principal company by any creditor of, or person interested in, the principal or secondary company.
- (6) Where a company stands in the relation of a principal company to one insurance company and in the relation of a secondary company to some other insurance company or where there are several insurance companies standing in the relation of secondary companies to one principal company, the court may deal with any number of such companies together or in separate groups as it thinks most expedient upon the principles laid down in this section.

Schemes for partial winding-up of insurance companies [Section 58]

- (1) If at any time it appears expedient that the affairs of an insurance company in respect of any class of business comprised in the undertaking of the Company should be wound up but that any other class of business comprised in the undertaking should continue to be carried on by the company or be transferred to another insurer, a scheme for such purposes may be prepared and submitted for confirmation of the Court in accordance with the provisions of this Act.
- (2) Any scheme prepared under this section shall provide for the allocation and distribution of the assets and liabilities of the company between any classes of business affected (including the allocation of any surplus assets which may arise on the proposed winding-up) for any future rights of every class of policy-holders in respect of their policies and for the manner of winding-up any of the affairs of the company which are proposed to be wound up and may contain provisions for altering the memorandum of the company with respect to its objects and such further provisions as may be expedient for giving effect to the scheme.
- (3) The provisions of this Act relating to the valuation of liabilities of insurers in liquidation and insolvency and to the application of surplus assets of the life insurance fund in liquidation or insolvency shall apply to the winding up of any part of the affairs of a company in accordance with the scheme under this section in like manner as they apply in the winding up of an insurance company, and any scheme under this section may apply with the necessary modifications any of the provisions of the Indian Companies Act, 1913 (7 of 1913), relating to the winding up of companies.
- (4) An order of the Court confirming a scheme under this section whereby the memorandum of a company is altered with respect to its objects shall as respects the alteration have effect as if it



where an order confirmed under Sec. 12 of the Indian Companies Act, 1913 (7 of 1913), and the provisions of Sections 15 and 16 of that Act shall apply accordingly.

Return of deposits [Section 59]

In the winding up of an insurance company (otherwise than in a case to which Section 58 applies) and in the insolvency of any other insurer the liquidator or assignee as the case may be shall apply to the Court for an order for the return of the redeposit made by the company or the insurer, as the case may be, under Section 7 or Section 98 and the Court shall on such application order a return of the deposit subject to such terms and conditions as it shall direct.

Notice of policy values [Section 60]

In the winding up of an insurance company for the purposes of a cash distribution of the assets and in the insolvency of any other insurer the liquidator or assignee, as the case may be, in the case of all persons appearing by the books of the company or other insurer to be entitled to or interested in the policies granted by the company or other insurer shall ascertain the value of the liability of the company or other insurer to each such person and shall give notice of such value to those persons in such manner as the Court may direct and any person to whom notice is so given shall be bound by the value so ascertained unless he gives notice of his intention to dispute such value in such manner and within such time as may be specified by a rule or order of the Court.

Power of Court to reduce contracts of insurance [Section 61]

- (1) where an insurance company is in liquidation or any other insurer is insolvent, the Court may make an order reducing the amount of the insurance contracts of the company or other insurer upon such terms and subject to such conditions as the Court thinks Just.
- (2) Where a company carrying on the business of life insurance has been proved to be insolvent, the Court may if it thinks fit in place of making a winding up order reduce the amount of the insurance contracts of the company upon such terms and subject to such conditions as the Court thinks fit.
- (3) Application for an order under this section may be made either by the liquidator or by or on behalf of the company or by a policy-holder, or by the Authority and the Authority and any person whom the Court thinks likely to be affected shall be entitled to be heard on any such application.

Power of Central Government to impose reciprocal disabilities on non-Indian companies [Section 62]

Where by the law or practice of any country outside India in which an insurer carrying on insurance business in India is constituted, incorporated or domiciled, insurance companies incorporated in India are required as a condition of carrying on insurance business in that country to comply with any special requirement whether as to the keeping of deposits or assets in that country or otherwise which is not imposed upon insurers of that country under this Act, the Central Government shall, if satisfied of the existence of such special requirement, by notification in the official Gazette, direct that the same requirement or requirements, as similar thereto as may be, shall be imposed upon insurers of that country as a condition of carrying on the business of insurance in India.

Particulars to be filled by insurers established outside India [Section 63]

Every insurer, having his principal place of business or domicile outside Indian, who establishes a place of business within India or appoints a representative in India with the object of obtaining insurance business shall within three months from the establishment of such place of business or the appointment of such representative file with the Authority.

- (a) a certified copy of the charter, statutes, deed of settlement or memorandum and articles or other instrument constituting or defining the constitution of the insurer, and, if the instrument is not written in the English language, a certified translation thereof.

- (b) a list of the directors, if the insurer is a company,
- (c) the name and address of some one or more persons resident in India authorised to accept on behalf of the insurer service of process and any notice required to be served on the insurer together with a copy of the power of attorney granted to him.
- (d) the full address of the principal office of the insurer in India.
- (e) a statement of the classes of insurance business to be carried on by the insurer, and
- (f) a statement verified by an affidavit setting forth the special requirements, if any, of the nature specified in Section 62 imposed in the country of origin of the insurer on Indian nationals,

and, in the event of any alteration being made in the address of the principal office or in the classes of business to be carried on, or in any instrument here referred to, or in the name of any of the persons here referred to, or in the matters specified in Clause(f) above, the company shall forthwith furnish to the Authority particulars of such alteration.

Books to be kept by insurers established outside India [Section 64]

Every insurer having his principal place of business or domicile outside India shall keep at his principal office in India such books of account, registers and documents as will enable the accounts, statements and abstracts which he is required under this Act to furnish to the Authority in respect of the insurance business transacted by him, in India to be compiled and if necessary, checked by the Authority and shall furnish to the Authority on or before the last day of January in every calendar year a certificate from an auditor to the effect that the said books of account, register and documents are being kept as required at the principal office of the insurer in India.

Incorporation of the Insurance Association of India [Section 64A]

- (1) All insurers carrying on insurance business in India at the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), all insurers who may after such commencement begin to carry on insurance business in India, and, if the Central Government, by notification in the official Gazette, so declares all provident societies carrying on insurance business in India on the date of such notification and all provident societies which may begin to carry on insurance business in India after such date are hereby constituted a body corporate by the name of the Insurance Association of India.
- (2) All insurers and provident societies incorporated or domiciled in India shall be known as members of the Insurance Association of India, and all insurers and provident societies incorporated or domiciled elsewhere than in India shall be known as associate members of that Association.
- (3) The Insurance Association of India shall have perpetual succession and a common seal and shall have power to acquire, hold and dispose of all property both moveable, and immoveable and shall by the said name sue and be sued.

Entry of names of members in the register [Section 64B]

- (1) The Authority shall take or cause to be taken through such agency as he thinks fit such steps as may be necessary to have the names of all insurers and provident societies, who or which are entitled to have their names entered in the register of members and associate members of the Insurance Association of India maintained for this purpose entered therein.
- (2) Where any insurer or provident society has ceased to carry on business as such the Authority shall cause such steps to be taken as may be necessary to have the name of such insurer or provident society, as the case may be, removed from the register.

Councils of the Insurance Association of India [Section 64C]

There shall be two Councils of the Insurance Association of India, namely:



- (a) the Life Insurance Council consisting of all the members and associate members of the Association, who carry on life insurance business in India, and
- (b) the General Insurance Council consisting of all the members and associate members of the Association who carry on general insurance business in India.

Authority of members of Association to act through agents [Section 64D]

It shall be lawful for any member of the Life Insurance Council or the General Insurance Council to authorise any individual, whether an officer of the insurer or not, to act as the representative of such member at any meeting of the Council concerns or to stand as a candidate for any election held by that Council.

Authorities of the Life Insurance Council and the General Insurance Council [Section 64E]

The authorities of the Life Insurance Council and the General Insurance Council shall be the Executive Committees constituted in the manner provided in this Part.

Executive Committees of the Life Insurance Council and the General Insurance Council [Section 64F]

- (1) The Executive Committee of the Life Insurance Council shall consist of the following persons, namely:
 - (a) two officials nominated by the Authority, one as the Chairman and the other as a member;
 - (b) eight representatives of members of the Insurance Association of India carrying on life insurance business elected in their individual capacity by the said members in such manner, from such groups of members and from such areas as may be specified by the Authority.
 - (c) one official not connected with any insurance business, nominated by the Authority and
 - (d) five persons connected with life insurance business, nominated by the Authority for the purpose of representing such groups of insurers carrying on life insurance business or such areas as have not been able to secure adequate representation on the Executive Committee of the Life Insurance Council or for any other purpose.
- (2) The Executive Committee of the General Insurance Council shall consist of the following persons, namely:
 - (a) two officials nominated by the Authority, one as the Chairman and the other as a member;
 - (b) eight representatives of members of the Insurance Association of India carrying on general insurance business elected in their individual capacity by the said members in such manner, from such groups of members and from such areas as may be specified by the Authority
 - (c) one non-official not connected with any insurance business, nominated by the Authority and
 - (d) five persons connected with general insurance business, nominated by the Authority for the purpose of representing such groups of insurers carrying on general insurance business or such areas as have not been able to secure adequate representation on the Executive Committee of the General Insurance Council or for any other purpose.
- (3) If any body of persons specified in sub-sections (1) and (2) fails to elect any of the members of the Executive Committees of the Life Insurance Council or the General Insurance Council, the Authority may nominate any person to fill the vacancy, and any person so nominated shall be deemed to be a member of the Executive Committee of the Life Insurance Council or the General Insurance Council, as the case may be, as if he had been duly elected thereto.
- (4) No official nominated by the Authority shall be entitled, whether as chairman or as a member, to vote in respect of any matter coming up before any meeting of the Executive Committee

of the Life Insurance Council or the Executive Committee of the General Insurance Council, as the case may be, and subject thereto each of the said Executive Committees may, with the approval of the Authority, make bye-laws for the transaction of any business at any meeting of the said Committee, and any such bye-law may provide that any member of the Committee who is interested in any matter for the time being before that Committee may not be present at or take part in any meeting thereof.

- (5) The life insurance Council or the General Insurance Council may form such other committees consisting of such persons as it may think fit to discharge such functions as may be delegated thereto:

Provided that any action taken by any of the said Council under this subsection shall be with the previous consent of the Authority and nothing in this sub-section shall derogate from any of the powers vested in the Executive Committees.

- (6) The Secretary of the Executive Committee of the Life Insurance Council and of the Executive Committee of the General Insurance Council shall in each case be an official nominated by the Authority.

Resignation and filling up of casual vacancies [Section 64G]

- (1) Any member of the Executive Committee of the Life Insurance Council or of the General Insurance Council may resign his membership of the Committee by notice in writing addressed to the Chairman of the Committee to that effect.
- (2) Casual vacancies in the Executive Committee of the Life Insurance Council or of the General Insurance Council, whether caused by resignation, death or otherwise, shall be filled by nomination by the Authority, and any person so nominated to fill the vacancy shall hold office until the dissolution of the Committee to which he has been nominated.
- (3) No act of the Executive Committee of the Life Insurance Council or of the General Insurance Council shall be called in question on the ground merely of the existence of any vacancy in, or defect in the constitution of, the Committee concerned.

Duration and dissolution of Executive Committees [Section 64H]

- (1) The duration of the Executive Committee of the Life Insurance Council or the General Insurance Council shall be three years from the date of its first meeting on the expiry of which it shall stand dissolved and a new Executive Committee constituted.
- (2) Notwithstanding the dissolution of the Executive Committee of the Life Insurance Council or the General Insurance Council, the out-going members thereof shall continue to hold office and discharge such administrative and other duties as may be prescribed until such time as a new Executive Committee of the Life Insurance Council or the General Insurance Council, as the case may be, shall have been constituted.

Power of Executive Committee of Life Insurance Council to hold examinations for Insurance agents [Section 64-I]

The Life Insurance Council may, with the approval of the Authority authorise its Executive Committee to hold examinations for individuals wishing to qualify themselves as insurance agents for the purpose of procuring life insurance business, and if the Authority, by notification in the official Gazette, so declares, then, notwithstanding anything contained in Sec. 42, only individuals who have passed any such examination shall be eligible to apply for a licence under Section 42:

Provided that nothing in this sub-section shall affect the right of any individual, who has been licensed to act as an insurance agent under Section 42 before the date of such notification, to act as such, or to have his licence renewed from time to time



Functions of Executive Committee of Life Insurance Council [Section 64J]

- (1) The functions of the Executive Committee of the Life Insurance Council shall be
 - (a) to aid, advise and assist insurers carrying on life insurance business in the matter of setting up standards of conduct and sound practice and in the matter of rendering efficient service to holders of life insurance policies;
 - (b) to render advice to the Authority in the matter of controlling the expenses of insurers in respect of their life insurance business in India;
 - (c) to bring to the notice of the Authority the case of any insurer acting in a manner prejudicial to the interests of holders of life insurance policies;
 - (d) to act in any matter incidental or ancillary to any of the matters specified in Clauses (a) to (c) as, with the approval of the Authority, may be notified by the Life Insurance Council in the Gazette of India.
- (2) For the purpose of enabling it effectively to discharge its functions, the Executive Committee of the Life Insurance Council may collect such sums of money, whether by way of fees or otherwise, as may be prescribed from all members and associate members of the Insurance Association of India who carry on life insurance-business.

Executive Committee of Life Insurance Council may advise in controlling expenses [Section 64K]

- (1) It shall be the duty of the Executive Committee of the Life Insurance Council to meet at least once before the 31st day of March every year to advise the Authority in fixing under the proviso to sub-section (2) of Section 40-B the limits by which the actual expenses incurred by an insurer carrying on life insurance business in respect of such business in the preceding year may exceed the limits prescribed under that sub-section, and in fixing any such limits the Authority shall have due regard to the conditions obtaining in life insurance business generally during that year and he may fix different limits for different groups of insurers.
- (2) Where an insurer is guilty of contravening the provisions of Section 40B with respect to the expenses of management, the Authority may, after giving the insurer an opportunity of being heard, administer a warning to the insurer.
- (3) Where within a period of seven years two warnings have been given to an insurer under sub-section (2) and they have been disregarded by him, the Authority may cause an investigation and valuation, as at such date as the Authority may specify, to be made at the expense of the insurer by an actuary appointed by the insurer for this purpose and approved by the Authority, and the insurer shall place at the disposal of the said actuary all the materials required by him for the purpose of such investigation and valuation, within such period, not being less than three months, as the Authority may specify.
- (4) The provisions of sub-sections (1) and (4) of Section 13 and sub-sections (1) and (2) of Section 15, or, as the case may be, of sub-section (2) of Sec. 16 shall apply in relation to an investigation and valuation under this section:

Provided that the abstract and statement prepared as the result of such investigation and valuation shall be furnished by such date as the Authority may specify.
- (5) There shall be appended to every such abstract a statement signed by the actuary giving such information as may be prescribed.
- (6) On receipt of the abstract and statement furnished in accordance with sub-section (4), the Authority may take such action as may be prescribed.

Functions of the Executive Committee of General Insurance Council [Section 64L]

- (1) The functions of the Executive Committee of the General Insurance Council shall be -
 - (a) to aid and advise insurers, carrying on general insurance business, in the matter of setting up standards of conduct and sound practice and in the matter of rendering efficient service to holders of policies of general insurance;
 - (b) to render advice to the Authority in the matter of controlling the expenses of such insurers carrying on business in India in the matter of commission and other expenses;
 - (c) to bring to the notice of the Authority the case of any such insurer acting in a manner prejudicial the interests of holders of general insurance policies;
 - (d) to act in any matter incidental or ancillary to any of the matters specified in Clauses (a) to (c)as with the approval of the Authority may be notified by the General Insurance Council in the Gazette of India.
- (2) For the purpose of enabling it effectively to discharge its functions, the Executive Committee of the General Insurance Council may collect such fees as may be prescribed from all insurers carrying on general insurance business:

Provided that if the General Insurance Council thinks fit, it may by a resolution passed by it, waive the collection of the prescribed fees for any year and where any such resolution has been approved by the Authority, the Executive Committee of the General Insurance Council shall not collect any fees in relation to that year.

Executive Committee of the General Insurance Council may advise in controlling expenses [Section 64M]

- (1) It shall be the duty of the Executive Committee of the General Insurance Council to meet at least once before the 31st day of March every year to advise the Authority in fixing under the proviso to subsection (1) of Section 40-C the limits by which the actual expenses of management incurred by an insurer carrying on general insurance business in respect of such business in the preceding year may exceed the limits prescribed under that sub-section, and in the fixing any such limits the Authority shall have due regard to the conditions obtaining in general insurance business in the preceding year, and he may fix different limits for different groups of insurers.
- (2) Where an insurer is guilty of contravening the provisions of Section 40C with respect to the expenses of management the Authority may, after giving the insurer an opportunity of being heard, administer a warning to the insurer.
- (3) Where in any case two warnings given to an insurer under sub-section (2) have been disregarded by him, the Authority may take such action against the insurer as may be prescribed.

Powers of Executive Committees to act together in certain cases [Section 64N]

The Central Government may prescribe the circumstances in which, the manner in which, and the conditions subject to which, the Executive committee of the Life Insurance Council and the Executive Committee of the General Insurance Council may hold joint meetings for the purpose of doing with any matter of common interest to both Committee, and it shall be lawful for the two Committees at any such joint meeting to delegate any matter under consideration for the determination of a sub committee appointed for this purpose from amongst the members of the two Committees.

General powers of Life Insurance Council and General Insurance Council [Section 64R]

- (1) For the efficient performance of its duties, the Life Insurance Council or the General Insurance Council, as the case may be, may



- (a) appoint such officers and servants as may be necessary and fix the conditions of their service;
 - (b) determine the manner in which any prescribed fee may be collected;
 - (c) keep and maintain up to date a copy of the list of all insurers who are members or associate members of the Insurance Association of India;
 - (d) with the previous approval of the Authority, make regulations for
 - (i) the holding of elections other than the first elections;
 - (ii) the summoning and holding of meetings, the conduct of business thereat and the number of persons necessary to form a quorum;
 - (iii) the submission by insurers to the Executive Committee of the Life Insurance Council, or the General Insurance Council of such statements or information as may be required of them and the submission of copies thereof by the insurers to the Authority;
 - (iv) the levy and collection of any fees;
 - (v) the regulation of any other matter which may be necessary for the purpose of enabling it to carry out its duties under this Act.
- (2) The Life Insurance Council or the General Insurance Council may authorise the Executive Committee concerned to exercise any of the powers conferred on the Life Insurance Council or the General Insurance Council, as the case may be, under Clause (a), Clause (b) or Clause (c) of sub-section (1).

Power of Central Government to remove difficulties [Section 64S]

The Central Government may exercise such powers as may be necessary for bringing the Life Insurance Council, the General Insurance Council or the Executive Committee of any of the said Councils, as the case may be, into effective existence for the purposes of this Part, and any such powers shall include

- (a) the power to hold, in such manner as may be directed by the Central Government, the first elections to the Executive Committees of the Life Insurance Council and the General Insurance Council;
- (b) where a notification under sub-section (1) of Section 64A has been issued declaring provident societies to be members of the Insurance Association of India, the powers to associate provident societies effectively in the exercise of all powers and the discharge of all functions of the Life Insurance Council and the Executive Committee thereof;
- (c) the power to make the provisions of Section 40B applicable to the provident societies specified in Clause (b) in the same manner as they apply to insurers.

Power to exempt [Section 64T]

The Central Government may, subject to such conditions and restrictions as it may think fit to impose, exempt any insurer specified in sub-clause (c) of Clause (9) of Section 2 from the operation of all or any of the provisions of this Part.

Establishment of Tariff Advisory Committee [Section 64U]

- (1) With effect from the commencement of the Insurance (Amendment) Act, 1968, there shall be established a Committee, to be called the Tariff Advisory Committee (hereafter in this Part-referred to as the Advisory Committee) to control and regulate the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business.
- (2) The Advisory Committee shall be a body corporate having perpetual succession and a common seal, with power, subject to the provisions of this Act, to acquire, hold and dispose of property,

both moveable and immoveable, and to contract, and may, by the said name, sue and be sued.

Composition of the Advisory Committee [Section 64UA]

- (1) The Advisory Committee shall consist of the following members, namely:—
 - (a) the Chairperson of the Authority ex officio, who shall be the Chairman;
 - (b) a senior officer of the office of the Authority nominated by the Authority, who shall be the Vice-Chairman;
 - (c) not more than ten representatives of Indian insurers, elected (In their individual capacities) by such insurers in such manner, from such areas and from among such insurers or groups of insurers as may be prescribed;
 - (d) not more than four representatives of insurers incorporated or domiciled elsewhere than in India but registered in India elected (in their individual capacities) by such insurers in such manner, and from among such insurers or groups of insurers as may be prescribed.
- (2) The Secretary to the Advisory Committee shall be an officer of the office of the Authority, nominated by the Authority.

Power to make rules in respect of matters in this part [Section 64UB]

- (1) The Authority may, by notification in the official Gazette, make regulations to carry out the purposes of this Part.
- (2) In particular, and without prejudice to the generality of the foregoing power, such regulations may provide for all or any of the following matters, namely:-
 - (a) the functions to be discharged by the Advisory Committee;
 - (b) the term of office of the members of the Advisory Committee, the procedure for their election and the manner of filling casual vacancies in the Advisory Committee;
 - (c) the traveling and other allowances payable to the members of the Advisory Committee;
 - (d) the procedure for holding the meeting of the Advisory Committee and for transaction of business thereat.
- (3) The Advisory Committee may, by notification in the Official Gazette with the previous approval of the Authority, make regulations for all or any of the following matters, namely,—
 - (a) the constitution, powers and duties of Regional Committees and of sub-committees constituted by the Advisory committee or any Regional Committee;
 - (b) the method of election of candidates for Regional Committees and of sub-committees, their eligibility, term of office and method of filling casual vacancies;
 - (c) the procedure for convening meetings and transaction of business by Regional committees and sub-committees;
 - (d) the appointment of officers and other employees of the Advisory Committee and of Regional Committees or sub-committees constituted by or under the Advisory Committee or any Regional Committee and the terms and conditions of their service including travelling and other allowances;
 - (e) such other matters pertaining to procedure as are not inconsistent with the provisions of this Act or of rules made there under,

and may, from time to time, with the previous approval of the Authority, add to, amend or vary any such regulations.



- (4) The regulations made by the Tariff Committee of the General Insurance Council under Section 64-O as they were in force immediately before the commencement of the Insurance (Amendment) Act, 1968, shall, after such commencement, continue to be in force until rules are made by the Central Government under sub-section (1) and immediately after such rules have come into effect, the regulations aforesaid shall cease to be valid.
- (5) The Chairperson of the Authority shall be in direct charge of the establishment of the Advisory Committee and the Secretary of the Advisory Committee shall work under his direction and control.

Power of the Advisory Committee to regulate rates, advantages, etc [Section 64UC]

- (1) The Advisory Committee may, from time to time and to the extent it deems expedient, control and regulate the rates, advantages, terms and conditions that may be offered by insurers in respect of any risk or any class or category of risks, the rates, advantages, terms and conditions of which, in its opinion, it is proper to control and regulate, and any such rate, advantages, terms and conditions shall be binding on all insurers:

Provided that the Authority may, permit any insurer to offer, during such period (being not more than two years but which may be extended by periods of not more than two years at a time) and subject to such conditions as may be specified by him, rates, advantages, terms or conditions different from those fixed by the Advisory Committee in respect of any particular category of risks, if he is satisfied that such insurer generally issues policies only to a restricted class of the public or under a restricted category of risks.

- (2) In fixing, amending or modifying any rates, advantages, terms or conditions, relating to any risk, the Advisory Committee shall try to ensure, as far as possible, that there is no unfair discrimination between risk of essentially the same hazard, and also that consideration is given to past and prospective loss experience:

Provided that the Advisory Committee may, at its discretion, make suitable allowances for the degree of credibility to be assigned to the past experience including allowances for random fluctuations and may also, at its discretion, make suitable allowances for future fluctuations and unforeseen future contingencies including hazards of conflagration or catastrophe or both.

- (3) Every decision of the Advisory Committee shall be valid only after and to the extent it is ratified by the Authority, and every such decision shall take effect from the date on which it is so ratified by the Authority, or if the Authority so orders in any case, from such earlier date as he may specify in the order.
- (4) The decisions of the Advisory Committee in pursuance of the provisions of this section shall be final.
- (5) Where an insurer is guilty of breach of any rate, advantage, term or condition fixed by the Advisory Committee, he shall be deemed to have contravened the provisions of this Act.

Provided that instead of proceeding against the insurer for such contravention, the Authority may, if the insurer removes the contravention by recovering the deficiency in the premium, or where it is not practicable to do so, modifies suitably or cancels the contract of insurance, compound the offence on payment to the Advisory Committee of such fine, not exceeding rupees one thousand, as he may decide in consultation with the Advisory Committee.

Transitional provisions [Section 64UD]

- (1) Notwithstanding anything contained in this Part, until the names of the members of the Advisory Committee elected for the first time after the commencement of the Insurance (Amendment) Act, 1968, are notified, the Tariff Committee of the General Insurance Council appointed under regulations made under sub-section (2) of Section 64-O as it was in force immediately

before the commencement of the Insurance (Amendment) Act, 1968, and in existence on such commencement (hereafter in this Part referred to as the Tariff Committee) shall continue to function and shall be deemed to be the Advisory Committee duly elected under this Part and the Authority of Insurance shall become the Chairman of that Committee with effect from the commencement of the Insurance (Amendment) Act, 1968, and function as such, and any chairman of the Tariff Committee holding office immediately before such commencement shall cease to be the Chairman thereof from the date of such commencement but shall continue to be an ordinary member of the Advisory Committee.

Provided that the Chairperson of the Authority shall become the Chairman of the Advisory committee with effect from the commencement of the Insurance Regulatory and Development Authority Act, 1999 and function as such, and any chairman of the Tariff Committee holding office immediately before such commencement shall cease to be the Chairman.

- (2) Notwithstanding anything contained in this Part, the constitution of the Regional Councils established under Section 64-P, as in force immediately before the commencement of the Insurance (Amendment) Act, 1968 (hereafter referred to as the Regional Councils), and of the Sectional Committees formed there under, existing immediately before such commencement, shall continue to be in full force and be of full effect until the regulations made by the Advisory Committee for the first time under Section 64UB come into effect and as soon as such regulations have come into effect such constitutions shall cease to have effect.
- (3) Notwithstanding anything contained in this Part, until the Secretary to the Advisory Committee is nominated under sub-section (2) of Section 64UA, the Secretary to the Tariff Committee holding office immediately before the commencement of the Insurance (Amendment) Act, 1968, shall function as the Secretary and shall be deemed to have been duly nominated under this Part.
- (4) All rates, advantages, terms and conditions fixed by the Tariff Committee or the Regional Councils prior to the commencement of the Insurance (Amendment) Act, 1968, and in force immediately before such commencement shall continue, except to such extent as they may be altered, replaced or abolished by the Advisory Committee, to be valid and fully in force as if they were rates, advantages, terms and conditions fixed by the Advisory Committee. -

Power of the Advisory Committee to require Information, etc [Section 64UE]

- (1) The Advisory Committee may require, by notice in writing, any insurer to supply to it such information or statements, periodical or ad hoc, as it may consider necessary to enable it to discharge its functions under this Part and every insurer shall comply with such requirements within such period as may be specified by the Advisory Committee in this behalf, failing which the insurer shall be deemed to have contravened the provisions of this Act.
- (2) Any information supplied under this section shall be certified by a principal officer of the insurer or where the Advisory Committee has agreed in advance, by such other officer or officers of the insurer as the principal officer of the insurer may nominate for the purpose and if the notice so requires, also by an auditor.
- (3) The Authority may, at any time, in writing, depute any subordinate of his, to make a personal inspection of the books of account, ledgers, policy registers and other books or documents of any insurer to verify the accuracy of any return or statement furnished by him under sub section (1), or to verify that full particulars have been supplied by him in respect of all policies issued by him and the insurer shall provide all facilities for such inspection, and make available to such person all the books of account, ledgers, policy registers and other books or documents of the insurer which might be needed by him for such verification and the person deputed may himself extract from out of the books and records of the insurer such information as may be needed to fill up or complete the returns required to be submitted to the Advisory Committee under this section.



- (4) The Advisory Committee may, at any time, on the application of an insurer, make arrangements for the inspection of an organization which is concerned with the inspection of risks, adjustment of losses or fire-fighting appliances, and may, whenever necessary, advise insurers about the adequacy of the arrangements for the inspection of risks and adjustment of losses or the suitability of such appliances:

Provided that no such inspection shall be made without the written permission of the concerned organization

Assets and liabilities of the General Insurance Council to vest in the Advisory Committee [Section 64UF]

- (1) On the commencement of the Insurance (Amendment) Act, 1968, all the assets and liabilities of the General Insurance Council appertaining to its Tariff Committee and to its Regional Councils and their Sectional Committees existing on that day shall be transferred to, and vest in, the Advisory Committee.
- (2) The assets appertaining to the Tariff Committee, the Regional Councils, and their Sectional Committees shall be deemed to include all rights and powers and all property, whether moveable or immovable, including, in particular, cash balances, reserve funds, investments, deposits and all other interests and rights in, or arising out of, such property as may be in the possession of the Tariff Committee, Regional Councils and their Sectional Committees and all books of account or documents thereof; and liabilities shall be deemed to include all debts, liabilities and obligations of whatever kind existing and appertaining to the work of the Tariff Committee, the Regional Councils and their Sectional Committees.
- (3) Where the General Insurance Council has established a provident or superannuation fund or any other fund for the benefit of the employees of its Tariff Committee or Regional Councils and constituted a trust in respect thereof (hereafter in this section referred to an existing trust), the monies standing to the credit of any such fund at the commencement of the Insurance (Amendment) Act, 1968, shall, subject to the provisions of subsection (4), stand transferred to, and vest in, on such commencement, the Advisory Committee.
- (4) Where any employee of the Tariff Committee, or the Regional Councils, or the General Insurance Council does not become an employee of the Advisory Committee, the monies and other assets appertaining to any fund referred to in subsection (3) shall be apportioned between the trustees of the fund and the Advisory Committee in the prescribed manner; and in case of any dispute regarding such apportionment, the decision of the Central Government thereon shall be final.
- (5) The Advisory Committee shall, as soon as may be after the commencement of the Insurance (Amendment) Act, 1968, constitute in respect of the monies and other assets which are transferred to, and vested in it, under sub section (3), one or more trusts having, as far as practicable, objects similar to the objects of the existing trusts.
- (6) Where all the monies and other assets belonging to an existing trust are transferred to, and vested in, the Advisory Committee under sub-section (3), the trustees of such trust shall, on the commencement of the Insurance (Amendment) Act, 1968, be discharged from the trust except as respects things done or omitted to be done by them before such commencement.

Contracts, etc., to be effective by or against the Advisory Committee [Section 64UG]

- (1) Unless otherwise expressly provided by or under this Act, all contracts, agreements and other instruments of whatever nature subsisting or having effect immediately before the commencement of the Insurance (Amendment) Act, 1968, and to which Tariff Committee, or any Regional Council is a party or which is in favour of that Committee or that Council, shall be of as full force and effect against or in favour of the Advisory Committee and may be enforced or acted upon as fully and effectually as if, instead of the Tariff Committee, or the Regional Council, the Advisory Committee had been a party thereto or as if they had been entered into or issued in favour of the Advisory Committee.

- (2) If, at the commencement of the Insurance (Amendment) Act, 1968, any suit, appeal or other legal proceeding of whatever nature is pending by or against the Tariff Committee, or any Regional Council then it shall not abate, be discontinued or in any way be prejudicially affected by reason of the transfer to the Advisory Committee of the assets and liabilities of the Tariff Committee, and the Regional Councils or of anything done under this Act, but the suit, appeal or other proceeding may be continued, prosecuted or enforced by or against the Advisory Committee.

Employees, etc., to continue [Section 64UH]

- (1) Every whole-time employee of the Tariff Committee, or the Regional Councils who was employed by that Committee or those Councils wholly or mainly in connection with its or their statutory duties immediately before the commencement of the Insurance (Amendment) Act, 1968, shall, on and from such commencement, become an employee of the Advisory Committee and shall hold his office in it by the same tenure, at the same remuneration, and upon the same terms and conditions and with the same rates and privileges as to pension, gratuity and other matters as he would have held on such commencement if this Part had not been enacted, and shall continue to do so until his employment under the Advisory Committee is terminated or until his remuneration, terms and conditions, are duly altered by the Advisory Committee:

Provided that nothing contained in this sub-section shall apply to any employee who has given notice to the Central Government in writing either prior to or within two months from the commencement of the Insurance (Amendment) Act, 1968, intimating his intention of not becoming an employee of the Advisory Committee.

- (2) Where the Central Government is satisfied that for the purpose of securing uniformity in the scales of pay, remuneration and other terms and conditions of service applicable to employees of the Tariff Committee or the Regional Councils, it is necessary so to do, or that a reduction in the remuneration payable or revision of the other terms and conditions of service applicable to employees or any class of them is called for, the Central Government may, notwithstanding anything contained in sub-section (1), or in the Industrial Disputes Act, 1947 (14 of 1947), or in any other law for the time being in force or in any award settlement, or agreement for the time being in force, alter (whether by way of reduction or otherwise) the remuneration and other terms and conditions of service to such extent and in such manner as it thinks fit; and if the alteration is not acceptable to any employee, the Advisory Committee may terminate his employment by giving him compensation equivalent to three months' remuneration, unless the contract of service with such employees provides for a shorter notice of termination.

Explanation. - The compensation payable to an employee under this subsection shall be in addition to and shall not affect any pension, gratuity, provident fund money or any other benefit to which the employee may be entitled under his contract of service.

- (3) If any question arises as to whether any person was a whole-time employee of the Tariff Committee, or the Regional Council, on the commencement of the Insurance (Amendment) Act, 1968, or as to whether any employee was employed wholly or mainly in connection with the statutory duties of the Tariff Committee, or any Regional Council immediately before such commencement, the question shall be referred to the Central Government whose decision thereon shall be final.
- (4) Notwithstanding anything contained in the Industrial Disputes Act, 1947 (14 of 1947), or in any other law for the time being in force, the transfer of the services of any employee of the Tariff Committee, or the Regional Councils, to the Advisory Committee shall not entitle any such employee to any compensation under that Act or other law, and no such claim shall be entertained by any Court, tribunal or other authority.



Duty of person having custody or control of property to deliver such property to the Advisory Committee [Section 64U]

- (1) Where any property of the Tariff Committee, or the Regional Councils (appertaining to its or their statutory duties) has been transferred to, and vested in, the Advisory Committee, then,
 - (a) every person in whose possession, custody or control any such property may be, shall deliver the property to the Advisory Committee forthwith;
 - (b) any person, who, on the commencement of the Insurance (Amendment) Act, 1968, has in his possession, custody or control any books, documents and other papers relating to the Tariff Committee, or the Regional Councils, shall be liable to account for the said books, documents and papers to the Advisory Committee and shall deliver them to such person as the Committee may direct.
- (2) Without prejudice to the provisions contained in this section, it shall be lawful for the Advisory Committee to take all necessary steps for securing possession of all properties which have been transferred to and vested in it, under this Act.

Power of the Advisory Committee to constitute Regional Committees [Section 64UJ]

- (1) The Advisory Committee may constitute such Regional Committees as and when it deems fit for one or more of the prescribed regions.
- (2) Each Regional Committee shall consist of not more than seven persons of which not more than five shall be elected by such groups of insurers carrying on general insurance business in the region as may be prescribed and not more than two shall be nominated by the Authority.
- (3) For the purpose of enabling it effectively to discharge its duties, and Regional Committee may constitute such sub-committees as it may think fit, whether consisting of members of the Regional Committee or not.
- (4) It shall be the duty of every Regional committee to advise the Advisory Committee on any question connected with the fixation of rates, advantages, terms and conditions for risks in its region which may be referred to it by the Advisory Committee for advice, and in addition, every Regional Committee shall perform such other functions as may be delegated to it by the Advisory Committee by regulations made by it with the previous approval of the Central Government.
- (5) Where, in the exercise of any functions delegated to it under this section any Regional Committee or any sub-committee thereof restrains an insurance agent from procuring or causing to be procured general insurance business in any area, such agent may prefer an appeal to the Authority against such order within thirty days from the date of service of that order on him and the Authority may after giving such agent an opportunity of being heard, pass such orders thereon as it may think fit and the orders made by the Authority on such appeal shall be final.
- (6) Notwithstanding anything contained in this section every Regional Council and every Sectional or other Committee of the Regional Council, in existence immediately before the commencement of the Insurance (Amendment) Act, 1968, shall, until it is abolished by the Advisory Committee, be deemed to be a Regional Committee or sub-committee as the case may be, established in accordance with the provisions of this section and shall function as such and shall have all the powers and responsibilities which it had immediately before such commencement, and if the term of any such Council or Committee expires before Regional Committees constituted under sub-section (1) and subcommittees constituted under sub-section (3) come into existence, such terms shall be deemed to have been validly extended up to the time when such Regional Committees and sub-committees are established.

Levy of fees by the Advisory Committee [Section 64UK]

- (1) Every insurer shall annually before the prescribed date make payment to the Advisory Committee in the prescribed manner of such fees, not exceeding for any year, in the case of an insurer doing only re-insurance business in India, one per cent of his total premiums in respect of facultative re-insurance accepted by him in India in the preceding year and in the case of any other insurer, one per cent of the total gross premium written direct by him in India in the preceding year, as may be specified by the Advisory Committee for the purpose of this part.
- (2) The Advisory Committee may collect, in addition to the fees mentioned in sub-section (1), reasonable fees and charges from any person to cover the cost of any specific services rendered by it.
- (3) If an insurer fails to make payment within the prescribed date of any fee required to be paid under sub-section (1) he shall be deemed to have failed to comply with the provisions of this Act.
- (4) The Authority may, so long as an application to the Court under sub section (5-D) of Section 3 has not been made, revive the registration which might have been cancelled for failure to make payment of the fee required to be made under sub section (1), if the insurer makes payment of such fee together with such penalty not exceeding the actual amount of fee payable as the Authority may require.

Power to remove difficulties [Section 64UL]

If any difficulty arises in giving effect to the provisions of this Part, the Central Government may, by order, make such provisions or give such directions not inconsistent with the provisions of this Act as may appear to it to be necessary or expedient for the removal of the difficulty:

Provided that no such power shall be exercised after the expiry of a period of four years from the commencement of this Part

Licensing of surveyors and loss assessors [Section 64UM]

- (1) (A) Save as otherwise provided in this section, no person shall act as a surveyor or loss assessor in respect of general insurance business after the expiry of a period of one year from the commencement of the Insurance (Amendment) Act, 1968, unless he holds a valid licence issued to him by the Authority.

(B) Every person who intends to act as a surveyor or loss assessor after the expiry of a period of one year from the commencement of the Insurance (Amendment) Act, 1968, but before the commencement of the Insurance Regulatory and Development Authority Act, 1999, shall make an application to the Authority within such time, in such form, in such manner and on payment of such fee, not exceeding rupees two hundred and fifty, as may be prescribed.

(BA) Every person who intends to act as a surveyor or loss assessor after the expiry of a period of one year from the commencement of the Insurance Regulatory and Development Authority Act, 1999 shall make an application to the Authority within such time, in such manner and on payment of such fee as may be determined by the regulations made by the Authority;

Provided that any licence issued immediately before the commencement of the Insurance Regulatory and Development Authority Act, 1999 shall be deemed to have been issued in accordance with the regulations providing for such licence.

(C) Every licence issued under this section shall remain in force, unless cancelled earlier, for a period of five years from the date of issue thereof, and may be renewed for a period of five years at a time, on payment of such fee, not exceeding rupees two hundred, as may be determined by the regulations.

(D) No licence to act as a surveyor or loss assessor shall be issued unless



- (i) the applicant, where he is an individual, satisfies the Authority that he –
 - (a) has been in practice as a surveyor or loss assessor on the date of commencement of the Insurance Regulatory and Development Authority Act, 1999 or
 - (b) holds a degree of a recognised University in any branch of engineering, or
 - (c) is a fellow or associate member of the Institute of Chartered Accountants of India or the Institute of cost and Works Accountants of India, or
 - (d) Possesses actuarial qualifications or holds a degree or diploma of any recognized University or institute in relation to insurance, or
 - (e) holds a diploma in insurance granted or recognised by the Government, or
 - (f) possesses such other technical qualifications as may be specified by the regulations made by the Authority, and
 - (g) does not suffer from any of the disqualifications mentioned in sub section (4) of Section 42;
- (ii) the applicant, where he is a company or firm, satisfies the Authority that all his directors or partners, as the case may be, possess one or more of the qualifications specified in Clause (i) and none of such directors or partners suffer from any of the disqualifications mentioned in sub section (4) of Section 42.

(E) Every application for the renewal of the licence shall be made at least thirty days before the expiry of the period of validity thereof.

(F) The Authority may, if he is satisfied that any licence issued or renewed under this section has been lost or destroyed, issue a duplicate licence on payment of a fee of rupees five and the duplicate licence so issued shall remain in force for the remainder of the period of a validity of the licence in lieu of which it is issued.

(G) Without prejudice to the powers conferred by sub-section (7), the Authority, if satisfied that the holder of any licence has made a statement which is false in material particulars with regard to his eligibility for obtaining such licence or has, after the issue or renewal of such licence, acquired any of the disqualifications mentioned in sub-section (4) of Section 42, may, after giving a reasonable opportunity to the holder of such licence of being heard, by order cancel such licence and notify such cancellation in the official Gazette.

- (1A) Every surveyor and loss assessor shall comply with the code of conduct in respect of their duties, responsibilities and other professional requirements as may be specified by the regulations made by the Authority.
- (2) No claim in respect of a loss which has occurred in India and requiring to be paid or settled in India equal to or exceeding twenty thousand rupees in value on any policy of insurance, arising or intimated to an insurer at any time after the expiry of a period of one year from the commencement of the Insurance (Amendment) Act, 1968, shall, unless otherwise directed by the Authority, be admitted for payment or settled by the insurer unless he has obtained a report, on the loss that has occurred, from a person who holds a licence issued under this section to act as a surveyor or loss assessor (hereafter referred to as “approved surveyor or loss assessors)

Provided that nothing in this sub-section shall be deemed to take away or abridge the right of the insurer to pay or settle any claim at any amount different from the amount assessed by the approved surveyor or loss assessor.

- (3) The Authority may, at any time, in respect of any claim of the nature referred to in sub-section (2), call for an independent report from any other approved surveyor or loss assessor specified by him and such surveyor or loss assessor shall furnish such report to the Authority within such time as may

be specified by the Authority or if no time limit has been specified by him within reasonable time and the cost of, or incidental to, such report shall be borne by the insurer.

- (4) The Authority may, on receipt of a report referred to in sub-section (3), issue such directions as he may consider necessary with regard to the settlement of the claim including any direction to settle a claim at a figure less than, or more than, that at which it is proposed to settle it or it was settled and the insurer shall be bound to comply with such directions:

Provided that where the Authority issues a direction for settling a claim at a figure lower than that at which it has already been settled, the insurer shall be deemed to comply with such direction if he satisfies the Authority that all reasonable steps with due regard to the question whether the expenditure involved is not disproportionate to the amount required to be recovered, have been taken with due despatch by him:

Provided further that no direction for the payment of a lesser sum shall be made where the amount of the claim has already been paid and the Authority is of opinion that the recovery of the amount paid in excess would cause undue hardship to the insured:

Provided also that nothing in this section shall relieve the insurer from any liability, civil or criminal, to which he would have been subject but for the provisions of this sub-section.

- (5) No insurer shall, after the expiry of a period of one year from the commencement of the Insurance (Amendment) Act, 1968, pay to any person any fee or remuneration for surveying, verifying or reporting on a claim of loss under a policy of insurance unless the person making such survey, verification or report is an approved surveyor or loss assessor.
- (6) Where, in the case of a claim of less than twenty thousand rupees in value on any policy of insurance it is not practicable for an insurer to employ an approved surveyor or loss assessor without incurring expenses disproportionate to the amount of the claim, the insurer may employ any other person (not being a person disqualified for fee time being for being employed as a surveyor or loss assessor) for surveying such loss and may pay such reasonable fee or remuneration to the person so employed as he may think fit.
- (7) If the Authority is satisfied that an approved surveyor or loss assessor has been guilty of wilfully making a false statement knowing it to be false or of being knowingly a party to the settlement of a claim in a fraudulent manner, he may, after giving such surveyor or loss assessor an opportunity of being heard, cancel the licence issued to him with effect from such date as may be specified by him and shall notify such cancellation in the official Gazette.
- (8) Any surveyor or loss assessor whose licence has been cancelled shall not be eligible for having a licence to act as a surveyor or loss assessor for a period of three years from the date on which the cancellation is notified in the official Gazette.
- (9) The Authority may in respect of any claim of value of less than twenty thousand rupees on an insurance policy, if the claim has not been or is not proposed to be reported upon by a surveyor or loss assessor, direct that such claim shall be reported upon by an approved surveyor or loss assessor and where the Authority makes such direction, the provisions of sub sections (3) and (4) shall apply in respect of such claim.
- (10) Where, in relation to any class of claims, the Authority is satisfied that it is customary to entrust the work of survey or loss assessment to any person other than a licensed surveyor or loss assessor, or if not practicable to make any survey or loss assessment, it may, by an order published in the Gazette, exempt such class of claims from the operation of this section.

Assets and liabilities how to be valued [Section 64V]

- (1) For the purpose of ascertaining compliance with the provisions of Section 64 VA,—
- (i) assets shall be valued at values not exceeding their market or realisable value and the



assets hereafter mentioned shall be excluded to the extent indicated, namely:

- (a) agents' balances and outstanding premiums in India, to the extent they are not realized within a period of thirty days;
 - (b) agents' balances and outstanding premiums outside India, to the extent they are not realisable;
 - (c) sundry debts, to the extent they are not realizable;
 - (d) advances of an unrealizable character;
 - (e) furniture, fixtures, dead stock and stationery;
 - (f) deferred expenses;
 - (g) profit and loss appropriation account balance and any fictitious assets other than pre-paid expenses;
 - (h) such other asset or assets as may be specified by the regulations made in this behalf.
- (ii) a proper value shall be placed on every item of liability and liabilities in respect of share capital, general reserve and other reserves of similar nature not created to meet specific liabilities and investment reserves, reserve for bad and doubtful debts, and depreciation fund shall be excluded and liabilities hereafter mentioned shall be included to the extent indicated, namely:
- (a) provision for dividends declared or recommended, and outstanding dividends in full;
 - (b) reserves for unexpired risks in respect of
 - (i) fire and miscellaneous business, 50 per cent.,
 - (ii) marine cargo business, 50 per cent., and
 - (iii) marine hull business, 100 per cent., of the premium, net of re-insurances, during the preceding twelve months;
 - (c) estimated liability in respect of outstanding claims, in full;
 - (d) amount due to insurance companies carrying on insurance business in full;
 - (e) amounts due to sundry creditors, in full;
 - (f) provision for taxation, in full.
 - (g) such other liability which may be made in this behalf to be included for the purpose of clause (ii)

Explanation.- In the case of an insurer, whose principal place of business or domicile is outside India, where, in the accounts filed with the public authority of the country in which the insurer is constituted, incorporated or domiciled, in respect of marine insurance business, the provisions for unexpired risks and outstanding claims are not shown separately, the liabilities under items (b) and (c) of Clause (ii) in respect of marine insurance business shall be taken together at a figure of not less than the total premium less-reinsurances in respect of that class of business during the preceding twelve months.

- (2) Every insurer shall furnish to the Authority with his returns under section 15 or section 16, as the case may be, a statement certified by an auditor approved by the Authority in respect of general insurance business, or an actuary approved by the Authority in respect of life insurance business, as the case may be, of his assets and liabilities assessed in the manner required by this section as on the 31st day of March of the preceding year.

- (3) Every insurer shall value his assets and liabilities in the manner required by this section and in accordance with the regulations which may be made by the Authority in this behalf.

Sufficiency of assets [Section 64VA]

- (1) An insurer shall, "at all times before the commencement of the Insurance Regulatory and Development Authority Act, 1999" before the commencement of the Insurance Regulatory and Development Authority Act, 1999, maintain an excess of the value of his assets over the amount of his liabilities of not less than the amount arrived at as follows (hereafter in this section referred to as the "relevant amount"), namely—
- (i) in the case of an insurer whose total premium income less reinsurances in respect of general insurance business (hereafter in this subsection referred to as the "said income") in the preceding twelve months did not exceed five crores of rupees, one fifth of the said income subject to a minimum of
 - a. five lakhs of rupees in the case of an insurer who is a cooperative society registered under the Cooperative Societies Act, 1912 (2 of 1912), or any other law for the time being in force in any State relating to co-operative societies, or
 - b. ten lakhs of rupees in the case of any other insurer; and
 - (ii) in the case of an insurer whose said income in the preceding twelve months exceeded five crores of rupees, the aggregate of one-fifth of the first five crores of rupees of the said income and one-tenth of the amount by which the said income in the preceding twelve months exceeded five crores of rupees:

Provided that where a number of insurers occupying the status of parent and subsidiary companies prepare, under the laws of the country of origin of the parent company, a consolidated balance sheet, the provisions of this subsection shall apply to such of them as are not members of any group as if they constituted a single insurer, subject to the further condition that the relevant amount shall, in no case, be less than a sum equal to—

the number of such insurers multiplied by ten lakhs of rupees, or

where all the insurers are co-operative societies registered under the Co-operative Societies Act, 1912 (2 of 1912), or any other law for the time being in force in any State relating to co-operative societies, the number of such insurers multiplied by five lakhs of rupees:

Provided further that If in respect of any insurer the Central Government is satisfied that either by reason of an unfavorable claim, experience or because of a sharp increase in the volume of new business or for any other reason, compliance with the provisions of this sub-section would cause undue hardship to the insurer, it may direct that for such period and subject to such conditions as it may specify, the provisions of this sub-section shall apply to that insurer with the modification that instead of the proportion of one-fifth, wherever mentioned in this sub-section, such other proportion being not less than one-tenth as may be specified by that Government shall be applicable to that insurer:

Provided also that in the case of an insurer carrying on insurance business at the commencement of the Insurance (Amendment) Act, 1968, it shall be sufficient compliance with the provisions of this sub-section until the 31st December, 1972 or until such subsequent date, not being later than 31st December, 1976, as the Central Government may, at its discretion, allow for any particular insurer, if he progressively brings up the excess of the value of his assets over the amount of his liabilities, in such manner as may be prescribed, to the relevant amount.



(1-A) Every insurer shall, at all times, on or after the commencement of the Insurance Regulatory and Development Authority Act, 1999, maintain an excess of the value of his assets over the amount of his liabilities of not less than the amount arrived at as follows (hereinafter referred to in this section referred to as the "required solvency margin"), namely:-

- (i) in the case of an insurer carrying on life insurance business, the required solvency margin shall be the higher of the following amounts-
 - (a) fifty crores of rupees (one hundred crores of rupees in case of re-insurers); or
 - (b) the aggregate sums of the results arrived at in items (I) and (II) stated below:-
 - (I) the aggregate of the results arrived at by applying the calculation described in item (A) below (Step I) and the calculation described in item (B) below (Step II):
 - (A) for Step I -
 - (A.1) there shall be taken, a sum equal to a percentage determined by the regulations not exceeding five per cent. of the mathematical reserves for direct business and re-insurance acceptances without any deduction for re-insurance cessions;
 - (A.2) the amount of mathematical reserves at the end of the preceding financial year after the deduction of re-insurance cessions shall be expressed as a percentage of the amount of those mathematical reserves before any such deduction; and
 - (A.3) the sum mentioned in item (A. 1) above shall be multiplied---
 - (A.3.1) where the percentage arrived at under item (A.2) above is greater than eighty-five per cent. (or in the case of a re-insurer carrying on exclusive reinsurance business, fifty per cent.), by that greater percentage; and
 - (A.3.2) in any other case, by eighty-five per cent. (or in the case of a re-insurer carrying on exclusive re-insurance business, fifty per cent.);
 - (B) for Step II-
 - (B.1) there shall be taken, a sum equal to a percentage determined by the regulations made by the Authority not exceeding one per cent. of the sum at risk for the policies on which the sum at risk is not a negative figure, and
 - (B.2) the amount of sum at risk at the end of the preceding financial year for policies on which the sum at risk is not a negative figure after the deduction of reinsurance cession shall be expressed as a percentage of the amount of that sum at risk before any such deduction, and
 - (B.3) the sum arrived at under item (B.1) above shall be multiplied-
 - (B.3.1) where the percentage arrived at under item (B.2) above is greater than fifty per cent., by that greater percentage; and
 - (B.3.2) in any other case, by fifty per cent.;
 - (II) a percentage determined by the regulations made by the Authority of the value of assets determined in accordance with the provisions of section 64-V;
 - (ii) in the case of an insurer carrying on general insurance business, the required solvency margin, shall be the highest of the following amounts:-
 - (a) fifty crores of rupees (one hundred crores of rupees in case of re-insurer); or

- (b) a sum equivalent to twenty per cent. of net premium income; or
- (c) a sum equivalent to thirty per cent. of net incurred claims,

subject to credit for re-insurance in computing net premiums and net incurred claims being actual but a percentage, determined by the regulation not exceeding fifty per cent.:

Provided that if in respect of any insurer, the Authority is satisfied that either by reason of an unfavourable claim experience or because of sharp increase in the volume of the business, or for any other reason, compliance with the provisions of this sub-section would cause undue hardship to the insurer, the Authority may direct, for such period and subject to such conditions, such solvency margin not being less than the lower of the amount mentioned in sub-clause (i) or sub-clause (ii) above, as the case may be.

Explanation. -For the purposes of this sub-section, the expressions-

- (i) "mathematical reserves" means the provision made by an insurer to cover liabilities (excluding liabilities which have fallen due and liabilities arising from deposit back arrangement in relation to any policy whereby an amount is deposited by re-insurer with the cedant) arising under or in connection with policies or contracts for life insurance business. Mathematical reserves also include specific provision for adverse deviations of the bases, such as mortality and morbidity rates, interest rates, and expense rates, and any explicit provisions made, in the valuation of liabilities, in accordance with the regulations made by the Authority for this purpose;
 - (ii) "net incurred claims" means the average of the net incurred claims during the specified period of not exceeding three preceding financial years;
 - (iii) "sum at risk", in relation to a life insurance policy, means a sum which is-
 - (a) in any case in which an amount is payable in consequence of death other than a case falling within sub-clause (b) below, the amount payable on death, and
 - (b) in any case in which the benefit under the policy in question consists of the making, in consequence of death, of the payments of annuity, payment of a sum by installments or any other kind of periodic payments, the present value of that benefit, less in either case the mathematical reserve in respect of the relevant policies.";
- (2) An insurer who does not comply with the provisions of sub-section (1) shall be deemed to be insolvent and may be wound up by the Court.
- (2-A) If, at any time an insurer does not maintain the required solvency margin in accordance with the provisions of this section, he shall, in accordance with the directions issued by the Authority, submit a financial plan, indicating a plan of action to correct the deficiency to the Authority within a specified period not exceeding three months.
- (2-B) An insurer who has submitted a plan under sub-section (2-A) to the Authority shall propose modifications to the plan if the Authority considers it inadequate, and shall give effect to any plan accepted by the Authority as adequate.
- (2-C) An insurer who does not comply with the provisions of sub-section (2-A) shall be deemed to be insolvent and may be wound up by the Court.";
- (3) The Authority shall be entitled at any time to take such steps as he may consider necessary for the inspection or verification of the assets and liabilities of any insurer or for securing the particulars necessary to establish that the requirements of this section have been complied with as on any date and the insurer shall comply with any requisition made in this behalf by the Authority, and if he fails to do so within two months from the receipt of the requisition, he shall be deemed to have made default in complying with the requirements of this section.



- (4) The provisions of this section shall not apply to an insurer specified in sub-clause (c) of Clause (9) of Section 2.
- (5) In applying the provisions of sub-section (1) to any insurer, who is a member of a group, the relevant amount for that insurer shall be an amount equal to that proportion of the relevant amount which that group, if considered as a single insurer, would have been required to maintain as the proportion of his share of the risk on each policy issued by the group bears to the total risk on that policy:

Provided that when a group of insurers ceases to be a group, every insurer in that group who continues to carry on any class of insurance business in India shall comply with the requirements of sub-section (1) as if he had not been an insurer in a group at any time:

Provided further that it shall be sufficient compliance with the provisions of the foregoing proviso if the insurer brings up the excess of the value of his assets over the amount of his liabilities to the required amount within a period of six months from the date of cessation of the group:

Provided also that the Central Government may, on sufficient cause being shown, extend the said period of six months by such further periods as it may think fit, so however that the total period may not in any case exceed one year.

- (6) The Central Government may, by notification in the Official Gazette, reduce the sum of ten lakhs of rupees or five lakhs of rupees, as the case may be, referred to in sub-section (1) to a lower figure not less than one hundred thousand rupees in respect of a country craft insurer or in respect of an insurer not having a share capital and carrying on only such insurance business as, in the opinion of the Central Government, is not carried on ordinarily by insurers under separate policies.
- (7) Every insurer shall furnish to the Authority his returns under section 15 or section 16, as the case may be, in case of life insurance business a statement certified by an actuary approved by the Authority, and in case of general insurance business a statement certified by an auditor approved by the Authority, of the required solvency margin maintained by the insurer in the manner required by sub-section (1-A).

No risk to be assumed unless premium is received in advance [Section 64VB]

- (1) No insurer shall assume any risk in India in respect of any insurance business on which premium is not ordinarily payable outside India unless and until the premium payable is received by him or is guaranteed to be paid by such person in such manner and within such time as may be prescribed or unless and until deposit of such amount as may be prescribed, is made in advance in the prescribed manner.
- (2) For the purposes of this section, in the case of risks for which premium can be ascertained in advance, the risk may be assumed not earlier than the date on which the premium has been paid in cash or by cheque to the insurer.

Explanation.- Where the premium is tendered by postal money-order or cheque sent by post, the risk may be assumed on the date on which the money-order is booked or the cheque is posted, as the case may be.

- (3) Any refund of premium which may become due to an insured on account of the cancellation of a policy or alteration in its terms and conditions or otherwise shall be paid by the insurer directly to the insured by a crossed or order cheque or by postal money-order and a proper receipt shall be obtained by the insurer from the insured, and such refund shall in no case be credited to the account of the agent.
- (4) Where an insurance agent collects a premium on a policy of insurance on behalf of an insurer, he shall deposit with, or despatch by post to, the insurer, the premium so collected in full without

deduction of his commission within twenty-four hours of the collections excluding bank and postal holidays.

- (5) The Central Government may, by rules, relax the requirements of sub-section (1) in respect of particular categories in insurance policies.

Restrictions on the opening of a new place of business [Section 64VC]

- (1) No insurer shall, after the commencement of the Insurance (Amendment) Act, 1968, open a new place of business in India or change otherwise than within the same city, town or village, the location of an existing place of business situated in India without obtaining the prior permission of the Authority.
- (2) The Authority may grant permission under sub-section (1) subject to such conditions as he may think fit to impose either generally or with reference to any particular case.
- (3) Where, in the opinion of the Authority, an insurer has, at any time, failed to comply with any of the conditions imposed on him under this section, the Authority may, by order in writing and after affording reasonable opportunity to the insurer for showing cause against the action proposed to be taken against him, revoke any permission granted under this section.

Explanation.—For the purposes of this section, “place of business” include a branch, sub-branch, inspectorate, organisation office and any other office, by whatever name called.

Provident Societies [Section 65]

Definition of “provident society”. –

- (1) In this Part “Provident society” means a person who, or a body of persons (whether corporate or unincorporate, which, not being an insurer registered for the time being under Part II of this Act, carries on the: business of insuring the payment, on the happening of any of the contingencies mentioned in sub-section (2), of—
- (a) an annuity of or equivalent to one hundred rupees or less, payable for an uncertain period, or
- (b) a gross sum of one thousand rupees or less whether paid for payable in a lump sum or in two or more installments over a certain period,
- exclusively in both cases (a) and (b) of any profit or bonus not being a guaranteed profit or bonus.

Explanation.—For the purposes of this sub-section a period is “certain” if its duration is ascertainable in advance and “uncertain” if its duration is not so ascertainable.

- (2) The contingencies referred to in sub-section (1) are the following, namely:
- a) the birth, marriage or death of any person or the survival by a person of a stated or implied age or contingency;
- b) failure of issue;
- c) the occurrence of social, religious or other ceremonial occasion;
- d) loss of or retirement from employment;
- e) disablement in consequence of sickness or accident;
- f) the necessity of providing for the education of a dependent;
- g) any other contingency which may be prescribed or which may be authorised by the State Government with the approval of the Central Government.



(3) For the purposes of sub-sections (1) and (2),—

- (a) contracts entered into before the commencement of this Act shall not be taken into account;
 - (b) two or more policies issued to one person shall, for the purposes of determining whether the limits fixed by sub-section (1) have or have not been exceeded, be deemed to be one policy if the contingencies on the happening of which the sums are payable under the policies (whether the contingencies be the same or different) relate to one-person only, whether he be the policy-holder or some other person.
- (4) Every person or body of persons for the time being registered as a provident society under the Provident Insurance Societies Act, 1912 (5 of 1912) and every person or body of persons for the time being registered as a provident society under this Act shall be deemed to be a provident society for all the purposes of this Act.
- (5) If any question arises whether any person or body of persons is or is not a provident society within the meaning of this section, the Authority shall decide the question and his decision shall be final.

Prohibition of transaction of insurance business by provident societies other than public companies or co-operative societies [Section 65A]

No person shall, after the commencement of the Insurance (Amendment) Act, 1950 (47 of 1950), begin to carry on in India any business specified in sub-section (1) of Section 65, and no provident society carrying on any such business in India shall, after the expiry of one year from such commencement continue to carry on any such business, unless he or it is—

- (a) a public company, or
- (b) a society registered under the Co-operative Societies Act, 1912 (2 of 1912), or under any other law for the time being in force in any State relating to co-operative societies, or
- (c) a body corporate incorporated under the law of any country outside India not being of the nature of a private company.

Restrictions on provident societies [Section 66]

No provident society shall undertake any form of insurance not falling within the limits fixed by sub-section (1) of Section 65, nor shall any provident society be eligible to be registered under Section 3.

Name [Section 67]

No provident society established after the commencement of this Act shall adopt as its name, and no provident society established before the commencement of this Act shall continue after the expiry of six months from the commencement thereof to use as its name any combination of words which fails to include the word “provident” or which includes the word “life”.

Insurable interest [Section 68]

Repealed by the Insurance (Amendment) Act, 1950

Dividing business [Section 69]

- (1) No provident society shall carry on any business upon the dividing principle, that is to say, on the principle that the benefit secured by a policy is not fixed but depends either wholly or partly on the results of a distribution of certain sums amongst policies becoming claims within certain time-limits, or on the principle that the premiums payable by a policy-holder depend wholly or partly on the number of policies becoming claims within certain time-limits.
- (2) The Authority shall, as so-on as possible, take steps to have any provident society which carries on business on dividing principle wound up:

Provided that, where any such provident society in existence at the commencement of this Act applies within three months of such commencement to the Authority for permission to continue carrying on its business with a view meanwhile to reorganise its business in accordance with the provisions of this Act, the Authority may at his discretion, with due regard to the past history of the society, permit the society to continue business for a period not exceeding two years from the date of receipt of such permission, so however that no new business on the dividing principle is undertaken by the society.

- (3) Where after the commencement of the Insurance (Amendment) Act, 1941 (13 of 1941), a provident society is to be wound up in pursuance of this section, or where, whether before or after the commencement of that Act, a provident society ceases to carry on business on the dividing principle the provisions of sub-sections (2) and (3) of Section 52 shall, so far as may be apply in like manner as they apply to an insurer ceasing to carry on business on the dividing principle.

Registration [Section 70]

- (1) No provident society except a provident society registered under the provisions of the Provident Insurance Societies Act, 1912 (5 of 1912), shall receive any premium or contribution until it has, obtained from the Authority, before the date of commencement of the Insurance Regulatory and Development Authority Act, 1999, a certificate of registration.
- (2) Every application for registration shall be accompanied by:
 - (a) a certified copy of the rules of the society, and when the society is a company incorporated under the Indian Companies Act, 1913 (7 of 1913) or under the Indian Companies Act, 1882 (6 of 1882), or under the Indian Companies Act, 1866 (10 of 1866), or under any Act repealed thereby,] a certified copy of the memorandum and articles of association or where the society is not such a company a certified copy of the deed of constitution of the society;
 - (b) the names and addresses of the proprietors or directors, and the managers of the society, the full address of the registered office of the society, the full address of the principal office of the society in India the name of the manager at such office, and the name and address of some one or more persons resident in India authorised to accept any notice required to be served on the society;
 - (c) a certificate from the Reserve Bank of India that the initial deposit referred to in Section 73 has been made;
 - (d) a declaration verified by an affidavit made by the principal officer of the society authorised in that behalf that the minimum working capital required by Section 72 is available; and
 - (e) the receipt showing payment in the prescribed manner of the prescribed fee for registration being not more than two hundred rupees.
- (3) The Authority may refuse to issue a certificate of registration until he is satisfied that the rules of the society comply with the provisions of this Act and that the society complies with the provisions of Sections 65-A, 67, 71, 72, 73 and 73-A, but if he is so satisfied he shall register the society and its rules.
- (4) The Authority may, after giving previous notice in writing in such manner as he thinks fit specifying the grounds for the proposed cancellation, and allowing the society concerned an opportunity of being heard, apply to the Court and obtain sanction for cancellation of the registration made under this section or made under the provisions of the Provident Insurance Societies Act, 1912 (5 of 1912).—
 - (a) if he is satisfied from the returns furnished under the provisions of this Act or as the result of



an inquiry made under Section 87 -

- I. that the society is insolvent or is likely to become so, or
 - II. that the business of the society is conducted fraudulently or not in accordance with the rules thereof, or that it is in the interests of the policy-holders that the society should cease to carry on business, or
- (b) if the society, having failed to comply with any requirement or having contravened any provision of this Act, has continued such failure or contravention for a period of one month after notice of such failure or contravention has been conveyed to the society by the Authority:

Provided that the Authority may, if he thinks fit, instead of applying for cancellation of the registration under sub-clause (i) of Clause (a) of this subsection make a recommendation to the Court that the contracts of the society should be reduced in such manner and subject to such conditions as he may indicate:

Provided further that the Authority may, without previous notice and without application to the Court for sanction,—

- (a) cancel the registration of a provident society which has failed to have its registration renewed, or
 - (aa) cancel the registration of a provident society if any deposit required by Sec. 73 has not been made, or
 - (b) cancel' on such terms and conditions as he thinks fit, the registration of any provident society which applies to him for such cancellation if he is satisfied that the society has ceased to carry on insurance business and the all its liabilities in respect of insurance policies are either satisfied or otherwise provided for, or
 - (c) cancel the registration of a provident society if he has reason to believe that any claim upon the society arising in India under any policy of insurance remains unpaid for three months after final judgment in regular course of law.
- (5) When a registration is cancelled the provident society shall not, after the cancellation has taken effect, enter into any new contracts of insurance, but all rights and liabilities in respect of contracts of insurance entered into by it before such cancellation takes effect shall, subject to the provisions of Section 88, continue as if the cancellation had not taken place.
- (6) Where a registration is cancelled under Clause b of sub-section (4), or Clause (c) of the second proviso to that sub-section, or because the society has failed to have its registration renewed, the Authority may at his discretion revise the registration of the provident society, within six months from the date on which the cancellation took effect, make the deposits required by Section 73 or satisfies the Authority that no claim upon it such as is referred to in the said Clause © remains unpaid, or has had an application under sub-section (3) of Sec. 70A accepted, as the case may be, and complies with any directions which may be given to it by the Authority.
- (7) The Authority may, on payment of the prescribed fee which shall not exceed five rupees, issue a duplicate certificate of registration to replace a certificate lost, destroyed or mutilated, or in any other case where he is of opinion that the issue of a duplicate certificate is necessary.

Renewal of registration [Section 70A]

- (1) Every provident society registered under this Act, or under the Provident Insurance Societies Act, 1912 (5 of 1912), shall have its registration renewed annually for each period of twelve months after that ending on the 30th day of June, 1942.

- (2) An application for the renewal of a registration shall be made by the society to the Authority before the 30th day of June preceding the period for which renewal is sought, and shall be accompanied as provided in sub-section (3) by evidence of payment of the prescribed fee which shall not exceed two hundred rupees but may vary according to the volume of insurance business done by the society.
- (3) The prescribed fee for the renewal of a registration for any year shall be paid into the Reserve Bank of India, or, where there is no office of that Bank, into the Imperial Bank of India acting as the agent of that Bank, or into any Government treasury, and the receipt shall be sent along with the application for renewal of the registration.
- (4) If a provident society fails to apply for renewal of registration before the date specified in sub-section (2) the Authority may, so long as he has taken no action under Section 88 to have the society wound up, accept an application for renewal of registration on receipt from the society of the fee payable with the application and such penalty, not exceeding the prescribed fee payable by the society, as he may require.
- (5) The Authority shall, on being satisfied that the society has fulfilled the requirements of this section, renew the registration and grant it a certificate of renewal of registration.

Supplements information and reports of alterations in particulars furnished with application for registration [Section 70B]

- (1) Every provident society registered under Section 70 before the commencement of the Insurance (Amendment) Act, 1941 (13 of 1941), shall, before the expiration of three months from the commencement of the Insurance (Amendment) Act, 1941 furnish to the Authority such particulars in addition to those already supplied for the purpose of obtaining registration as are required by sub-section (2) of Section 70 of this Act as amended by the Insurance (Amendment) Act, 1941.
- (2) Every provident society registered under the provisions of the Provident Insurance Societies Act, 1912 (5 of 1912), shall, before the expiration of three months from the commencement of the Insurance (Amendment) Act, 1941 (13 of 1941), furnish to the Authority so far as it has not already done so the documents and information required by Clauses (a) and (b) of sub-section (2) of Section 70 to accompany an application by a provident society for registration under that section.
- (3) When any alteration occurs or is made which affects any of the matters which are required under the provisions of sub-section (2) of Section 70 to accompany an application by provident society for registration under that section, or are to be furnished to the Authority, under this section, the provident society shall furnish forthwith to the Authority full particulars duly authenticated of such alteration.

Certain provisions of Part II to apply to provident societies [Section 71]

The provisions of sub-sections (2) and (3) of Section 10, Section 20, sub-section (1) of Section 27, Sections 27-A, 28, 29, 31-A, 31-B 32, 46 and 53A shall apply to provident societies as they apply to insurers, and in such application references to shareholders of an insurer shall be construed as references to members of a provident society and references to Section 7 or Section 98 shall be construed as references to Section 73:

Provided that a provident society may charge a fee not exceeding one rupee for supplying a copy of any document referred to in sub-section (2) of Section 20.

Working capital [Section 72]

No provident society shall be registered unless it has a paid-up capital sufficient to provide as working capital a net sum of not less than five thousand rupees exclusive of deposits made under this Act and exclusive in the case of a company of any expenses incurred in connection with the formation of the company.



Deposits [Section 73]

- (1) Every provident society shall, if established before the commencement of this Act within one year from such commencement, apply for registration under Section 70, deposit and keep deposited with the Reserve Bank of India in one of the offices in India of the Bank, for and on behalf of the Central Government, cash or approved securities amounting at the market value of the securities on the date of deposit to five thousand rupees, and shall thereafter make each calendar year a further deposit amounting to not less than one-fifth of the premium income for the preceding calendar year as shown in the revenue account of the society (including admission fees and other fees received by the society) until the total amount so deposited and kept is fifty thousand rupees.
- (2) The provisions of sub-sections (8), (9), (9-A), (9-B) and (10) of Section 7 and of sub-section (1) of Section 8 and of Section 9 shall apply to the deposits made under this section as they apply to deposits made by an insurer.

Restriction on name of provident society [Section 73A]

- (1) A provident society shall not be registered by a name identical with that by which an insurer or another provident society in existence is already registered, or so nearly resembling that name as to be calculated to deceive, except when the provident society in existence is in the course of being dissolved and signifies its consent, or the insurer in existence signifies his consent to the Authority.
- (2) If a provident society, through inadvertence or otherwise, is without such consent as aforesaid registered by a name identical with that by which an insurer or another provident society already in existence is registered, or so nearly resembling it as to be calculated to deceive, the first-mentioned society shall, if called upon to do so by the Authority on the application of the insurer or the second-mentioned society, change its name within a time to be fixed by the Authority:

Provided that nothing in this section shall apply to any provident society carrying on business before the commencement of the Insurance (Amendment) Act, 1946 (6 of 1946)

Rules [Section 74]

- (1) Every provident society shall, in its rules, set forth-
 - (a) the name, the object and the location of the registered office of the society
 - (b) the contingencies or classes of contingency on the happening, of which money is to be paid;
 - (c) the condition to be complied with before, and the payments to be made on, admission to the society;
 - (d) the rates of premium or contribution, and the periods for which or the times at which premiums or contributions are payable;
 - (e) the maximum amount payable to a subscriber or policy-holder;
 - (f) the nature and amounts of the benefits provided for by the society;
 - (g) the circumstances in which a bonus may be paid to a policyholder;
 - (h) the nature of the evidence required for the proof of the happening of any contingency on which money is to be paid;
 - (i) the circumstances in which policies may be forfeited or renewed or the whole or a part of the premiums paid on a policy may be returned or a surrender value of a policy may be granted;

- (j) the penalties for delay in paying or failure to pay premiums or contributions;
 - (k) the proportion of the annual income of society which may be disbursed on and the provisions to be made for meeting the expenses of the management of the society;
 - (l) the person or persons who or the authority which shall have power to invest the funds of the society;
 - (m) the provisions for appointment of auditors and their remunerations;
 - (n) the procedure to be adopted in altering the rules of the society;
 - (o) unless these are provided for in the articles of association of a society which is a company incorporated under the Indian Companies Act, 1913 (7 of 1913), or under the Indian Companies Act, 1882 (6 of 1882) or under the Indian Companies Act, 1866 (10 of 1866), or under any Act repealed thereby:
 - the mode of appointment and removal, the qualification and the powers of a director, manager, secretary or other officer of the society;
 - the manner of raising additional capital; and
 - the provisions for the holding of general meetings of the members and policy holders and for the powers to be exercised and the procedure to be followed thereat; and
 - (p) such other matters as may be prescribed.
- (2) Where the rules of any provident society registered under the Provident Insurance Societies Act, 1912 (5 of 1912), fail to comply with the provisions of this section, the society shall, before the expiry of twelve months from the commencement of this Act, amend the rules so as to comply with these provisions.

Amendment of rules [Section 75]

- (1) No amendment of any rule of a provident society shall be valid until it has been sent to the Authority and has been registered by him.
- (2) The Authority on being satisfied that the proposed amendment is not contrary to the provisions of this Act shall, unless he is of opinion that the amendment unfairly affects the rights of existing members or policy-holders of the society, issue to the society an acknowledgment of the registration of the amended rule.

Supply of copy of rules [Section 76]

Every provident society shall on demand deliver free of cost to any member of the society a copy of the rules of the society and to any person other than a member a copy of such rules on the payment of a sum not exceeding one rupee.

Registered office [Section 77]

Every provident society shall have in India a principal office (on the outside of which it shall keep displayed its name in a conspicuous position in legible characters) to which all communications and notices may be addressed, and shall give notice to the Authority of any change in the location thereof within twenty-eight days of its occurrence.

Publication of authorised capital to contain also subscribed and paid-up capital [Section 78]

Where any notice, advertisement or other official publication of a provident society contains a statement of the amount of the authorised capital of the society, the publication shall also contain a statement of the amount of the capital which has been subscribed and the amount paid-up.



Registers and books [Section 79]

Every provident society shall keep at its principal office in India

- (a) such registers in such form as may be prescribed
- (b) a cash book in Which shall be entered separately for each class of contingency separately specified in Section 65 all sums received and expended by the society and matters in respect of which the receipt or expenditure takes place,
- (c) a ledger;
- (d) a journal.

Revenue account, balance-sheet and annual statements [Section 80]

- (1) Every provident society shall at the expiry of the calendar year prepare a revenue account and balance-sheet in the prescribed form verified in the prescribed manner, together with a report on the general state of the society's affairs and shall cause the revenue account and balance-sheet to be audited by an auditor, and the auditor shall so far as may be the audit of a provident society have the powers of, exercise the functions vested in, and discharge the duties and be subject to the liabilities imposed on, an auditor of companies by Section 145 of the Indian Companies Act, 1913 (7 of 1913).
- (2) Every provident society shall at the expiry of the calendar year prepare with respect to that year-
 - (a) a statement showing separately for each class of contingency separately specified in Section 65
 - i. the number of new policies effected, the total amount insured thereby and the total premium income received in respect thereof and the number of existing policies discontinued during the year with the total amount insured thereby, and
 - ii. the total amount of claims made and the total amount paid in satisfaction thereof;
 - (b) a statement showing details of every insurance effected on a life other than the life of the person insuring; and
 - (c) a statement showing the total amount paid as allowances to agents and canvassers.
- (3) Until the expiry of two years from the commencement of this Act this section and Section 73 shall apply to provident societies registered before the commencement of this Act under the Provident Insurance-Societies Act, 1912 (5 of 1912), as if the reference to the calendar year were a reference to either the financial year or the calendar year.

Actuarial report and abstract [Section 81]

Every provident society shall once in every five years or at such shorter intervals as may be laid down by the rules of the society cause an investigation to be made as at the last day of a calendar year into its financial condition including the valuation of its liabilities and assets by an actuary.

- (2) The report of the actuary shall contain an abstract in which shall be stated .
 - (a) the general principles adopted in the valuation, including the method by which the valuation age of lives was ascertained,
 - (b) the rate at each age of the mortality and any other factor assumed and the annuity values used in valuation,
 - (c) the reserve values held against policies effected,
 - (d) the rate of interest assumed, and
 - (e) the provision made for expenses,

and shall have appended to it a certificate signed by a principal officer of the society that all material necessary for proper valuation has been placed at the disposal of the actuary and that full and accurate particulars of every policy under which there is a liability either actual or contingent have been furnished to the actuary for the purpose of the investigation.

- (3) If the actuary finds that the financial conditions of the society is such that no surplus exists for distribution as bonus to the policy-holders, or as dividend to the shareholders, he shall state in his report whether in his opinion the society is insolvent and, if so, whether it should be wound up or not, and the extent to which in his opinion existing contracts should be modified or existing rates of premium should be adjusted to make good the deficiency in the assets.

Submission of returns to Authority [Section 82]

- (1) The revenue account and balance-sheet with the auditor's report thereon and the report on the general state of the society's affairs referred to in sub-section (2) of Section 80, shall be printed and four copies of these and of the statements referred to in sub-section (2) of Section 80, shall be furnished as returns to the Authority within six months from the end of the period to which they relate.
- (2) All the material necessary for the proper valuation of the liabilities of the society under the provisions of Section 81 shall be placed at disposal of the actuary within three months from the end of the period to which such material relates, and the report and abstract referred to in Section 81 shall be furnished as a return to the Authority within a further period of three months:

Provided that the Central Government may, in any case, extend the time allowed by this sub-section for the furnishing of such return by a period not exceeding three months.

- (3) The provisions of sub-section (2) of Section 15 relating to the copies therein referred shall apply to the returns referred to in sub-section (1) of this section, and the provisions of Section 17 shall apply to the accounts and balance sheet of provident society being a company incorporated under the Indian Companies Act, 1913 (7 of 1913), or under the Indian Companies Act, 1882 (6 of 1882), or under the Indian Companies Act, 1866 (10 of 1866) or under any Act repealed thereby, as they apply to the accounts and balance-sheet of an insurer, and the Authority may exercise, in respect of returns made by a provident society and in respect of an investigation or valuation to which Section 81 refers, the same powers as are exercisable by him under Sections 21 and 22, respectively, in the case of an insurer.

Actuarial examination of schemes [Section 83]

- (1) Every provident society, registered after the commencement of this Act, shall cause every scheme of insurance which it proposes to put into operation, and every provident society registered before the commencement of this Act under the provisions of the Provident Insurance Societies Act, 1912 (5 of 1912), shall cause any scheme which it proposes to put into operation for the first time, after such commencement to be examined by an actuary, and shall not receive any premium or contribution in connection with the scheme until the actuary has certified that the rates, advantages, terms and conditions of the scheme are workable and sound and such certificate has been forwarded to the Authority.
- (2) The provisions of sub-section (1) shall apply to any alteration of a scheme already in operation, but the Authority may, if he is of opinion that the alteration unfairly affects the interests of existing policy holders, prohibit the alteration, and, if he does so, the society shall not put the altered scheme into operation, unless it first discharges to the satisfaction of the Authority all its liabilities to those of the existing policy holders who dissent from the alteration.
- (3) Every provident society registered before the commencement of this Act under the provisions of the Provident Insurance Societies Act, 1912 (5 of 1912), shall, as soon as may be and in any event before the expiry of six months from the commencement of this Act, submit all schemes of



insurance which the society has in operation at the commencement of this Act to examination by an actuary and shall, before the expiration of six months from the commencement of the Insurance (Amendment) Act, 1941 (13 of 1941), send the report of the actuary thereon to the Authority

- (4) The report of the actuary shall state in respect of each scheme whether the advantages, terms and conditions are workable and sound and, where no actuarial report such as is referred to in Section 81 has been made within the two years preceding the examination the report shall also state whether the assets of the society are sufficient to meet its liabilities under the existing schemes, and, if not how in the opinion of the actuary the existing contracts should be modified.
- (5) If the rates, advantages, terms and conditions of any scheme are not reported by the actuary to be workable and sound, Authority shall give notice to the society prohibiting the scheme, and the society shall not after its receipt of such notice enter into any new contract of insurance under the scheme, but all rights and liabilities in respect of contracts of insurance entered into by the society before receipt of the notice shall, subject to the provisions of subsection (6), continue as if the notice had not been given.
- (6) Where a scheme is prohibited under the provisions of subsection (5) the society shall, where its assets are sufficient to meet-all existing liabilities, set apart out of its assets the sum sufficient in the opinion of the actuary to meet the liabilities incurred under the scheme so prohibited, and, where its assets are not so sufficient, within three months from the date of the prohibition, apply to the Court for a modification of its existing contracts or failing such modification for the winding up of the society.

Separation of accounts and funds [Section 84]

Where a provident society effects policies of insurance in connection with more than one of the classes of contingency separately specified in sub-section (2) of Section 65, the receipts and payments in respect of each such class shall be recorded in a separate account in the cash book kept in accordance with Section 79.

Investment of funds [Section 85]

- (1) [Repealed]
- (2) No funds or investments of a provident society except a deposit made under Section 73 or under the law of any State or country relating to insurance shall be kept otherwise than in the name of the society or in the name of a public officer approved by the Central Government.
- (3) No loan shall be made out of the assets of a provident society to any director, manager, managing agent, auditor, actuary, officer or partner of the society, except on the security of a policy of insurance held in the society and within its surrender value and no such loans shall be made to any concern of which a director, manager, managing agent, actuary, officer or partner of the society is a director, manager managing agent, actuary, officer or partner:

Provided that nothing in this sub-section shall apply to loans made by a provident society to a banking company:

Provided further that where any event occurs giving rise to circumstances, the existence of which at the time of the grant of any subsisting loan would have made such grant a contravention of this sub-section, such loan shall, notwithstanding any contract to the contrary, be repaid within three months from the occurrence of such event or from the commencement of the Insurance (Amendment) Act, 1946 (6 of 1946), whichever is later; and in case of default, the director, manager, auditor, actuary or partner concerned shall, without prejudice to any other penalty which he may incur, cease to hold office in the society on the expiry of the said three months.

- (3A) Any loan prohibited under sub-section (3), made before and outstanding at the commencement of the Insurance (Amendment) Act, 1940 (2 of 1940) shall be repaid before the 1st day of January, 1941, and in case of default the director, manager managing agent, auditor, actuary, officer or partner who has received the loan or is connected with the concern which has received the loan, as the case may be, shall cease to hold office in or be a partner of the society and shall be ineligible to hold office in or to be a partner of the society until the loan is repaid.
- (4) Any director, manager, managing agent, auditor, actuary, officer or partner of a society which contravenes the provisions of sub-section (3), who is knowingly a party to the contravention, shall without prejudice to any other penalty which he may incur be jointly and severally liable to the society for the amount of the loan, and such amount, together with interest from the date of the loan at such rate not exceeding twelve per cent per annum as the Authority may fix, shall on application by the Authority to any civil court of competent jurisdiction be recoverable by execution as if a decree for such amount had been passed by that Court.
- (5) The provisions of Section 86D of the Indian Companies Act, 1913 (7 of 1913), shall not apply to a loan granted to a director of a provident society being a company if the loan is one granted on the security of a policy on which the society bears the risk and the policy was issued to the director on his own life and the loan is within the surrender value of the policy.

Inspection of books [Section 86]

86. The books of every provident society shall at all reasonable times be open to inspection by the Authority or any person appointed by him in this behalf or by any member or policy-holder of the society who has, on application in this behalf, been permitted by the Authority subject to such conditions, if any, as he may impose, to make such inspection.

Inquiry by or on behalf of Authority [Section 87]

- (1) The Authority shall at least once in two years and may, if he thinks fit, at any time visit personally or depute a suitable person to visit the principal office of a provident society or the principal office in India of a society having its principal place of business or domicile outside India and inquire into the affairs of the society or may, after giving notice to the society and giving it an opportunity to be heard, direct such an inquiry to be made by an auditor or actuary appointed by him or by both an auditor and an actuary appointed simultaneously, or first by an auditor only or an actuary only and afterwards by an actuary or auditor.
- (2) For the purposes of any such inquiry Authority or the auditor or actuary, as the case may be, shall be entitled to examine all books and documents of the society and may demand from the society or any officer of the society such explanations as he may require on any matter relating to the affairs of the society.
- (3) The results of any such inquiry shall be recorded in writing by the person making the inquiry, and four copies of the record shall be supplied to the Authority and when the inquiry is completed, a copy of the record, or of each such record where more than one are made in the course of the same inquiry, shall be sent by the Authority to the society concerned and shall be open to inspection by any member or policy-holder of the society.
- (4) All expenses of incidental to any inquiry made by an auditor or actuary under sub-section (1) including any expenses incurred before the date on which the Authority receives notice of an appeal under Clause (e) of sub-section (1) of Section 110 shall be defrayed by the provident society, shall have priority over other debts due from the society, and shall be recoverable as an arrear of land-revenue.
- (5) The Authority may by notice in writing require the provident society to comply within a time to be



specified therein (not being less than fifteen days from the receipt of the notice by the society) with any directions he may issue to remedy defects disclosed by an inquiry under this section.

- (6) If the society fails to comply with any direction issued under subsection (5), the Authority may, after giving notice to the society and giving it an opportunity to be heard, apply to the Court for the winding up of the society.

Amalgamation and transfer of insurance business [Section 87A]

- (1) The insurance business of a provident society may be transferred to any person or transferred to or amalgamated with the insurance business of any other provident society in accordance with a scheme prepared under this section and sanctioned by the Authority.
- (2) Any scheme prepared under this section shall set out the agreement under which the transfer or amalgamation is proposed to be effected, and shall contain such further provisions as may be necessary for giving effect to the scheme.
- (3) Before an application is made to the Authority to sanction any such scheme, notice of the intention to make the application together with a statement of the nature of the amalgamation or transfer, as the case may be, and of the reason there for, shall at least two months before the application is made, be sent to the Authority and certified copies, four in number, of each of the following documents shall be furnished to him, and other such copies shall during the two months aforesaid be kept open for the inspection of the members and policy-holders at the principal and branch offices of the provident societies concerned, namely:
 - a) a draft of the agreement or deed under which it is proposed to effect the amalgamation or transfer,
 - b) balance-sheets in respect of the insurance business of each of the provident societies concerned in such amalgamation or transfer,
 - c) actuarial reports and abstracts in respect of the insurance business of each of the provident societies so concerned,
 - d) a report on the proposed amalgamation or transfer, prepared by an independent actuary,
 - e) any other reports on which the scheme of amalgamation or transfer was founded;

and the balance-sheets, reports and abstracts referred to in Clauses (b), (c) and (d) shall all be prepared as at the date at which the amalgamation or transfer if sanctioned by the Authority is to take effect, which date shall not be more than twelve months before the date on which the application to the Authority is made under this section:

Provided that the Authority may exempt the provident society or societies concerned from furnishing to him and from keeping open for inspection any one or more of the above documents

- (4) When any application such as is referred to in sub-section (3) is made to the Authority, he may require, if for special reasons he so directs, notice of the application to be sent to every person resident in India who is the holder Of a policy of any provident society concerned and may cause a statement of the nature and terms of the amalgamation or transfer, as the case may be, to be published in such manner and for such periods as he may direct, and after hearing: the societies concerned, such policy-holders as apply to be heard and such other persons as he may deem fit, may sanction the arrangement, if he is satisfied that no sufficient objection to the arrangement has been established and shall make such consequential orders as are necessary to give effect to the arrangement, including orders as to the disposal of any deposit made under Section 73:

Provided that:

- a) no part of the deposit made by any party to the amalgamation or transfer shall be returned except where, after effect is given to the arrangement the whole of the deposit to be made by the provident society carrying on the amalgamated business or the person to whom the business is transferred is completed;
 - b) only so much shall be returned as is no longer required to complete the deposit last mentioned in Clause (a);
 - c) while the deposit last mentioned in Clause (a) remains uncompleted, no accession, resulting from the arrangement, to the amount already deposited by the provident society carrying on the amalgamated business or the person to whom the business is transferred shall be appropriated as payment or part payment of any instalment of deposit subsequently due from it or him under Section 73.
- (5) A copy of the order under subsection (4) sanctioning or refusing to sanction the arrangement shall be sent to each of the societies concerned and to each of the policy-holders who applied to be heard.
- (6) If the scheme involves a reduction of the amount of the insurance and other contracts of the transfer or society or of any or all of the societies concerned in the amalgamation, the Authority may sanction the scheme, reducing the amount of such contracts upon such terms and subject to such conditions as he may think proper, and the reduction of the contracts as sanctioned by the Authority shall be valid and binding on all the parties concerned.

Winding up by Court and voluntary winding up [Section 88]

- (1) The Court may order the winding up of a provident society being a company incorporated under the Indian Companies Act, 1913 (7 of 1913), or under the Indian Companies Act, 1882, (6 of 1882) or under the Indian Companies Act, 1866 (10 of 1866), or under any Act repealed thereby and the provisions of the Indian Companies Act, 1913 (7 of 1913) shall, subject to the provisions of this Part, apply accordingly.
- (2) In addition to the grounds on which an order may be based, the Court may order the winding up of a provident society if the Authority, who is hereby authorised to do so, applies in this behalf to the Court on any of the following grounds, namely:
- (a) that the registration of the society has been cancelled under subsection (4) of Section 70;
 - (b) that it appears from the returns furnished under the provisions of this Act or as the result of an inquiry made under Section 87 that the society, is insolvent;
 - (c) that the continuance of society is prejudicial to interests of the policy-holders.
- (3) A provident society being a company incorporated under the Indian Companies Act, 1913 (7 of 1913) or under the Indian Companies Act, 1882, (6 of 1882), or under the Indian Companies Act 1866 (10 of 1866) or under any Act repealed thereby may be wound up voluntarily in accordance with the provisions of the Indian Companies Act, 1913, but shall not be so wound up except for the purpose of effecting an amalgamation or re-construction of the society or on the ground that by reason of its liabilities it cannot continue its business.
- (4) A provident society not being a company incorporated under the Indian Companies Act, 1913 (7 of 1913) if or under the Indian Companies Act 1882 (6 of 1882), or under the Indian Companies Act, 1866 (10 of 1866) or under any Act repealed thereby may be wound up voluntarily under this Act if a resolution is passed by the proprietors that the society should be wound up voluntarily for the purposes or on the ground specified in sub-section (3), and the Authority may, in any case where he has ordered the cancellation of the registration of a society under sub-section (4) of Sec. 70, order the winding up of the society under this Act.



Reduction of insurance contracts [Section 89]

The Court may make an order reducing the amount of the insurance contracts of a provident society upon such terms and subject to such conditions as the Court thinks just-

- (a) if the Authority as an alternative to canceling the registration of a society under sub-section (4) of Section 70 applies to the Court in this behalf;
- (b) if while a society is in liquidation the Court thinks fit;
- (c) if when a society has been proved to be insolvent the Court thinks fit to do so in place of making an order for the winding up of the society; or
- (d) if the Court is satisfied on an application made in this behalf by the society supported by the report of an actuary, and after giving the policy-holders an opportunity to be heard that it is desirable to do so.

Appointment of liquidator [Section 90]

- (1) Where a provident society is to be wound up whether under the Indian Companies Act, 1913 (7 of 1913), or under this Act, the society shall, within seven days from the date of the order of the Court ordering the winding up of the passing of the resolution authorising the winding up, as the case may be, give notice thereof to the Authority shall appoint the liquidator and shall determine the remuneration to be paid to him:

Provided that if the Authority is not satisfied that the assets of the society are sufficient to meet the costs of liquidation including the remuneration of the liquidator, he may decline to make such appointment, and in such a case the society shall itself appoint a liquidator who shall carry out the liquidation as if the winding up was being done by an order of the Court.

- (2) Any liquidator appointed by the Authority under subsection (1) may be removed by the Authority if satisfied that the duties entrusted to him are not being properly discharged.

Application of Act to liquidators

90A. Notwithstanding anything to the contrary contained in the Indian Companies Act, 1913 (7 of 1913), the provisions of Sections 91, 92 and 93 shall apply to any liquidator appointed to wind up a provident society, whether by the Court, the Authority or the society itself.

Powers of liquidator [Section 91]

- (1) A liquidator appointed to wind up a society shall have power
 - (a) to institute or defend any legal proceedings on behalf of the society by his name or office;
 - (b) to determine the contribution to be made by members of the society respectively to the assets of the society;
 - (c) to investigate all claims against the society and to decide questions of priority arising between claimants;
 - (d) to determine by what persons and in what proportion the costs of the liquidation including the remuneration of the liquidator and any expenses incurred under clause (g) of this sub-section are to be borne;
 - (e) to give such directions in regard to the collection and distribution of the assets of the society as may appear to him to be necessary for winding up the affairs of the society;
 - (f) to summon, and enforce the attendance of, witnesses and to compel the production of documents by the same means and as far as may be in the same manner as is provided in the case of a civil court by the Code of Civil Procedure, 1908 (5 of 1908);

- (g) with the sanction of the Authority to employ such establishment and to obtain such assistance from an actuary or an auditor as may be necessary for the discharge of his duties;
 - (h) to sell the immoveable and moveable property of the society by public auction or private contract, with power to transfer the whole thereof to any person or society or to sell the same in parcels.
- (2) The liquidator shall, for settling the list of contributories and releasing the amount of contributions, have the same powers as an official liquidator appointed by the Court for the winding up of a company under the Indian Companies Act, 1913 (7 of 1913).

Procedure at liquidation [Section 92]

- (1) As soon as a liquidator is appointed to wind up a society he shall take charge of all property moveable or immoveable of the society and of all its books and documents.
- (2) If any proprietor or officer of the society or any other person retains any portion of the assets of the society or fails to deliver to the liquidator any book or document when so required by the liquidator, he shall be punishable with imprisonment which may extend to six months, or with fine which may extend to five hundred rupees, or with both, and the Court may order the delivery of the assets or book or document to the liquidator.
- (3) The liquidator shall, within fifteen days of his appointments send notice by post to all persons who appear to him to be creditors of the society that a meeting of the creditors of the society will be held on a date not being less than twenty-one or more than twenty-eight days after his appointment, and at a place and hour to be specified in the notice, and shall also advertise notice of the meeting once in the local official Gazette and once at least in two newspapers circulating in the State in which the society is situated.
- (4) At the meeting so held the creditors shall determine whether an application shall be made for the appointment of any person as liquidator in the place of or jointly with the liquidator already appointed, or for the appointment of a committee of inspection, and, if they so resolve and an application accordingly is made at any time not later than fourteen days after the date of the meeting by any creditor appointed for the purpose at the meeting, the Authority may, if he thinks fit, appoint a suitable person in place of or jointly with the liquidator already appointed, and determine the remuneration to be paid to him and if he considers it desirable, may also appoint a committee of inspection.
- (5) The committee of inspection shall, subject to any prescribed conditions, have a general power of supervision over the acts of the liquidator and shall have the right to inspect his accounts at all reasonable times.
- (6) The liquidator shall, with such assistance from an actuary as may be required, ascertain as soon as practicable the amount of the society's liability to every person appearing by the society's books to be entitled to or interested in any policy issued by the society, and shall give notice of the amount so found to each such person in the prescribed manner and each such person on receiving such notice shall be bound by the value so ascertained.
- (7) The liquidator shall make a valuation of the assets of the society and an estimate of the costs of the winding up, and shall, on the basis of these settle the list of contributories.
- (8) The liquidator shall apply to the Authority for an order for the return of the deposit made by the society under Section 73 and the Authority shall on such application order the return of the deposit subject to such terms and conditions as he may think fit.
- (9) In administering and distributing the assets of the society the liquidator shall have regard to any directions that may be given by the creditors or contributories at a general meeting or by the Authority.



- (10) The liquidator shall keep books of account in which he shall record the proceedings at all meetings attended by him, all amounts received or expended by him and any other matter that may be prescribed, and these books may with the sanction of the Authority be inspected by any creditor or contributory.
- (11) If the winding up continues for more than a year the liquidator shall summon a meeting of the creditors and contributories at the end of the first year and of each succeeding year, and shall lay before them an account of his acts and dealings and of the conduct of the winding up, and that account together with any views expressed thereon by the meeting shall be forward by the liquidator within one week after the meeting to the Authority.
- (12) So far as is not otherwise provided herein or is not otherwise prescribed under this Act, the liquidator shall so far as practicable follow the procedure to be followed by an official liquidator appointed by the Court for the winding up of a company under the Indian Companies Act, 1913 (7 of 1913).
- (13) The costs of the liquidation including the remuneration of the liquidator and any expenses incurred under Clause (g) of sub-section (1) of Section 91 shall, if the liquidator decides that they shall be payable out of the assets of the society, be payable in priority to all other claims.

Dissolution of provident society [Section 93]

- (1) As soon as the affairs of a provident society are fully wound up the liquidator shall prepare an account of the winding up showing how the winding up has been conducted and the property of the society has been disposed of and shall call a meeting of the members, creditors and contributories for the purpose of laying before it the account and giving any explanation there of.
- (2) Notice of the meeting shall be sent to each person individually and shall be advertised in the local official Gazette and in at least two newspapers circulating in the State in which the society is situated.
- (3) Within one week after the meeting the liquidator shall send to the Authority a Copy of the account and shall report to him the holding of the meeting and its date and shall forward to him a copy of the proceedings of the meeting.
- (4) The Authority may return the account to the liquidator if it is incomplete or unsatisfactory and may require the liquidator to carry out any further steps necessary to complete the winding up and the liquidator shall comply with such requirement and shall submit a further report to the Authority within six months.
- (5) If the Authority is satisfied that the affairs of the society have been fully wound up he shall register the account of the liquidator who shall forthwith make over to the Authority sums, if any, remaining undisposed of; and on the expiry of three months from the registering of the account the Authority shall declare the society dissolved and cause the dissolution of the society to be notified in the local official Gazette, and the liquidator shall thereupon be discharged from further responsibility.
- (6) If within a period of five years from the date on which any sums have been made over to the Authority under sub-section (5) an order of a court of competent jurisdiction has not been obtained at the instance of any claimant to such sums for their disposal, the said sums shall become the property of Government.

Nominations and assignments [Section 94]

- (1) The provisions of Sections 38 and 39 relating to assignment, transfer and nomination in the case of life insurance policies shall, subject to the provisions of this section, apply to policies of insurance issued by any provident society covering any of the contingencies specified in Clause (a) of sub-section (2) of Section 65.

MUTUAL INSURANCE COMPANIES AND CO-OPERATIVE LIFE INSURANCE SOCIETIES

Definitions [Section 95]

- (1) In this Part, before the date of commencement of the Insurance Regulatory and Development Authority Act, 1999, -
 - (a) "Mutual Insurance Company" means an insurer, being a company incorporated under the Indian Companies Act, 1913 (7 of 1913), or under the Indian Companies Act, 1882 (6 of 1882), or under the Indian Companies Act, 1866 (10 of 1866) or under any Act, repealed thereby, which has no share capital and of which by its constitution only and all policy-holders are members; and
 - (b) "Co-operative Life Insurance Society" means an insurer being a society registered under the Co-operative Societies Act, 1912 (2 of 1912) or under an Act of a State Legislature governing the registration of cooperative societies which carries on the business of life insurance and which has no share capital on which dividend or bonus is payable and of which by its constitution only original members on whose application the society is registered and all policy-holders are members:
Provided that any co-operative life insurance society in existence at the commencement of this Act shall be allowed a period of one year to comply with the provisions of this Act.
- (2) Notwithstanding anything contained in sub-section (1), other cooperative societies may be admitted as members of a co-operative life insurance society, without being eligible to any dividend, profit or bonus.
- (3) A State Government may, subject to any rules made by the Central Government, empower the Registrar of Co-operative Societies of the State to register co-operative societies for the insurance of cattle or crops or both under the provisions of the Co-operative Societies Act in force in the State.
- (4) A State Government may make rules not inconsistent with any rules made by the Central Government to govern such societies, and the provisions of this Act, in so far as they are inconsistent with those rules, shall not apply to such societies.

Application of Act to Mutual Insurance Companies and Co-operative Life Insurance Societies [Section 96]

The provisions of Sections 6 and 7 and of sub-section (2) of Section 20, so far as those provisions are inconsistent with the provisions of this part, shall not apply, and the provisions of this Part shall apply, to co-operative life insurance societies.

Working capital of Mutual Insurance Companies and Co-operative Life Insurance Societies [Section 97]

No co-operative life insurance society registered after the 26th day of January, 1937 under the Co-operative Societies Act, 1912 (2 of 1912) or under an Act of a State Legislature governing the registration of co-operative societies shall be registered under this Act, unless it has as working capital a sum of fifteen thousand rupees, exclusive of the deposit to be made before or at the time of application for registration in accordance with sub-section (2) of Section 98 of this Act and of the preliminary expenses, if any, incurred in the formation of the company or society.

Deposit to be made by Mutual Insurance Companies and Co-operative Life Insurance Societies [Section 98]

- (1) Everyday Co-operative Life Insurance Society shall, in respect of the life insurance business carried on by it in India, deposit and keep deposited with one of the offices in India, of the Reserve Bank of India for and on behalf of the Central Government, a sum of two hundred thousand rupees in cash or in approved securities estimated at the market value of the securities on the day of deposit.



- (2) The deposit referred to in sub-section (1) may be made in instalments, of which the first shall be a payment, made before or at the time the application for registration under this Act is made, of not less than twenty five thousand rupees or such sum as with any deposit previously made by the insurer under the provisions of the Indian Life Assurance Companies Act, 1912 (6 of 1912), brings the amount deposited up to not less than twenty-five thousand rupees, and the subsequent instalments shall be annual instalments made before the expiry of each subsequent calendar year of an amount in cash or in approved securities estimated at the marked value of the securities on the day of payment of the instalment, equal to not less than one-third of the premium income in the preceding calendar year as shown in the revenue account.
- (3) The provisions of sub-section (7) of Section 7 shall apply in respect of a co-operative life insurance society as if for the words "under the foregoing provisions of this section" the words and figures "under the provisions of Sec. 98" were substituted.

Prohibition of loans [Section 98A]

The provisions of Section 29 shall apply to cooperative life insurance societies as they apply to other insurers.

Transferees and assignees of policies not to become members [Section 99]

No transferee or assignee of a policy issued by an insurer to whom this Part applies shall become a member of a mutual insurance company or a cooperative life insurance society merely by reason of any such transfer or assignment.

Publication of notices and documents of Mutual Insurance Companies and Cooperative Life Insurance Societies [Section 100]

Notwithstanding the provisions of Sections 79 and 131 of the Indian Companies Act, 1913 (7 of 1913), a mutual insurance company or a co-operative life insurance society may, instead of sending the notices and the copies of the balance-sheet, revenue account and other documents which they are required to send to the members under those sections, publish such notice together with a summary in the prescribed form of the balance-sheet and revenue account once in a newspaper published in the English language and in a newspaper published in an Indian language circulating in the place where the principal office of the company is situated:

Provided that, where any members of the company are domiciled in a State other than that in which the principal office of the company is situated, publication of the notice of the meetings shall be made in a newspaper or newspapers published in the principal languages of that State and circulating therein and any member of the company domiciled in that State shall be entitled on application to the company to receive from it a copy of the balance-sheet and revenue account.

Supply of documents to members [Section 101]

Every mutual insurance company and every Co-operative Life Insurance Society shall, on the application of any members made within two years from the date on which any such document is furnished to the Registrar of Companies under the provisions of Section 134 of the Indian Companies Act, 1913 (7 of 1913), or to the Registrar of Co-operative Societies of the State in which the Co-operative Life Insurance Society is registered furnish a copy of the document free of cost to the member within fourteen days of the application.

RE-INSURANCE

Re-insurance with Indian reinsurers [Section 101A]

- (1) Every insurer shall re insure with Indian re-insurers such percentage of the sum assured on each policy as may be specified by the Authority with the previous approval of the Central Government under sub-section (2).

- (2) For the purposes of sub-section (1), the Authority may, by notification in the official Gazette,—
- (a) specify the percentage of the sum assured on each policy to be reinsured and different percentages may be specified for different classes of insurance:
Provided that no percentage so specified shall exceed thirty per cent of the sum assured on such policy; and
 - (b) also specify the proportions in which the said percentage shall be allocated among the Indian re-insurers.
- (3) Notwithstanding anything contained in sub-section (1), an insurer carrying on fire-insurance business in India may, in lieu of re-insuring the percentage specified under sub-section (2) of the sum assured on each policy in respect of such business, re-insure with Indian re-insurers such amount out of the first surplus in respect of that business as he thinks fit, so however that the aggregate amount of the premiums payable by him on such re-insurance in any year is not less than the said percentage of the premium income (without taking into account premiums on re-insurance ceded or accepted) in respect of such business during that year
- Explanation-** For the purposes of this-section, the year 1961 shall be deemed to mean the period from the 1st April to the 31st December of that year.
- (4) A notification under subsection (2) may also specify the terms and conditions in respect of any business of re-insurance required to be transacted under this section and such terms and conditions shall be binding on Indian re-insurers and other insurers.
- (5) No notification under sub-section (2) shall be issued except after consultation with the Advisory Committee constituted under Section 101B.
- (6) Every notification issued under this section shall be laid before each House of Parliament, as soon as may be, after it is made.
- (7) For the removal of doubts, it is hereby declared that nothing in subsection (1) shall be construed as preventing an insurer from reinsuring with any Indian re-insurer or other insurer the entire sum assured on any policy or any portion thereof in excess of the percentage specified under sub-section (2).
- (8) In this section,
- i. "policy" means a policy issued or renewed on or after the 1st day of April, 1961, in Respect of general insurance business transacted in India and does not include a re-insurance policy; and
 - ii. "Indian re-insurer" means an insurer specified in sub-clause (b) of Clause (9) of Section 2 who carries on exclusively re-insurance business and is approved in this behalf by the Central Government.

Advisory Committee [Section 101B]

- (1) The Authority with the previous approval of the Central Government shall, for the purposes of Section 101A, constitute an Advisory Committee consisting of not more than five persons having special Knowledge and experience of the business of insurance.
- (2) The term of office of, and the allowance payable to, members of the Advisory Committee, the procedure to be followed by, and the quorum necessary for the transaction of business of, the Committee and the manner of filling casual vacancies therein shall be such as may be determined by the regulations made by the Authority.



Examination of re-insurance treaties [Section 101C]

The Authority may, at any time

- (a) call upon an insurer to submit for his examination at the principal place of business of the insurer in India all re-insurance treaties and other re-insurance contracts entered into by the insurer;
- (b) examine any officer of the insurer on oath in relation to any such document as is referred to in Clause (a) above; or
- (c) by notice in writing, require any insurer to supply him with copies of any of the documents referred to in Clause (a), certified by a principal officer of the insurer.

Penalty for default in complying with or act in contravention of, this Act [Section 102]

If any person, who is required under this Act, or rules or regulations made thereunder,-

- (a) to furnish any document, statement, account, return or report to the Authority, fails to furnish the same; or
- (b) to comply with the directions, fails to comply with such directions;
- (c) to maintain solvency margin, fails to maintain such solvency margin;
- (d) to comply with the directions on the insurance treaties, fails to comply with such directions on the insurance treaties,

he shall be liable to a penalty not exceeding five lakh rupees for each such failure and punishable with fine.

Penalty for carrying on insurance business in contravention of sections 3, 7 and 98 [Section 103]

If a person makes a statement, or furnishes any document, statement, account, return or report which is false and which he either knows or believes to be false or does not believe to be true,-

- (a) he shall be liable to a penalty not exceeding five lakh rupees for each such failure; and
- (b) he shall be punishable with imprisonment which may extend to three years or with fine for each such failure.

Penalty for false statement in document [Section 104]

If a person fails to comply with the provisions of section 27 or section 27-A or section 27-B or section 27-C or section 27-D, he shall be liable to a penalty not exceeding five lakh rupees for each such failure.

Wrongfully obtaining or withholding property [Section 105]

If any director, managing director, manager or other officer or employee of an insurer wrongfully obtains possession of any property or wrongfully applies to any purpose of the Act, he shall be liable to a penalty not exceeding two rupees for each such failure.

Offences by companies [Section 105A]

- (1) Where any offence under this Act has been committed by a company, every person who, at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company as well as the company shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Provided that nothing contained in this sub-section shall render any such person liable to any punishment, if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

- (2) Notwithstanding anything contained in sub-section (1), where any offence under this Act has been committed by a company and it is proved that the offence has been committed with the

consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Explanation. -For the purposes of this section,-

- (a) "company" means anybody corporate, and includes-
 - (i) a firm; and
 - (ii) an association of persons or a body of individuals whether incorporated or not; and
- (b) "director", in relation to-
 - (i) a firm, means a partner in the firm;
 - (ii) an association of persons or a body of individuals, means any member controlling the affairs thereof.

Penalty for failure to comply with section 32-B [Section 105B]

If an insurer fails to comply with the provisions of section 32-B, he shall be liable to a penalty not exceeding five lakh rupees for each such failure and shall be punishable with imprisonment which may extend to three years or with fine for each such failure.

Penalty for failure to comply with section 32-C [Section 105C]

If an insurer fails to comply with the provisions of section 32-C, he shall be liable to a penalty not exceeding twenty-five lakh rupees for each such failure and in the case of subsequent and continuing failure, the registration granted to such insurer "under section 3 shall be cancelled by the Authority." .

Power of Court to order restoration of property of insurer or compensation in certain cases [Section 106]

- (l) If, on the application of the Authority or an Administrator appointed under Section 52-A or an insurer or any policy-holder or any member of an insurance company or the liquidator of an insurance company (in the event of the insurance company being in liquidation), the Court is satisfied—
 - (a) that any insurer (including in any case where the insurer is an insurance company any person who has taken part in the promotion or formation of the insurance company or any past or present director, managing agent, manager secretary or liquidator) or any officer employee or agent of the insurer,—
 - i. has misapplied or retained or become liable or become accountable for any money or property of the insurer; or
 - ii. has been guilty of any misfeasance or breach of trust in relation to the insurer; or
- (b) that any person, whether he is or has been in any way connected with the affairs of the insurer or not, is in wrongful possession of any money or property of the insurer or having any such money or property in his possession wrongfully withholds it or has converted it to any use other than that of the insurer; or
- (b) that by reason of any contravention of the provisions of this Act, the amount of the life-insurance fund has been diminished;

the Court may examine any such insurer, director, managing agent, manager, secretary or liquidator or any such other officer, employee or agent of the insurer or such other person, as the case may be, and may compel him to contribute such sums to the assets of the insurer by way of compensation in respect of the misapplication, retainer, misfeasance or breach of trust, as the



Court thinks fit, or to pay such sum as may be found due from him in respect of any money or property of the insurer for which he is liable or accountable or to restore any money or property of the insurer or any part thereof, as the case may be; and where the amount of the life insurance fund has been diminished by reason of any contravention of the provisions of this Act, the Court shall have power to assess the sum by which the amount of the fund has been diminished and to order the person guilty of such contravention to contribute to the fund the whole or any part of that sum by way of compensation; and in any of the aforesaid cases the Court shall have power to order interest to be paid at such rate and cases the Court shall have power to order interest to be paid at such rate and from such time as the Court may deem fit.

- (2) Without prejudice to the provisions contained in sub-section (1) or subsection (3), where it is proved that any money or property of an insurer has disappeared or has been lost' the Court shall presume that every person in charge of, or having a disposing power over, such money or property at the relevant time (whether a director, manager, principal officer or any other officer) has become accountable for such money or property within the meaning of sub-clause (i) of Clause (a) to sub-section (1), and the provisions of that subsection shall apply accordingly, unless such person proves that the money or property has been utilised or disposed of in the ordinary course of the business of the insurer and for the purpose of that business or that he took all reasonable steps to prevent the disappearance or loss of such money or property or otherwise satisfactorily accounts for such disappearance or loss.
- (3) Where the insurer is an insurance company and any of the acts referred to in Clauses (a), (b) and (c) of sub-section (1) has been committed by any person, every person who was at the relevant time a director, managing agent, manager, liquidator, secretary or other officer of the insurance company shall, for the purposes of that sub-section, be deemed to be liable for that act in the same manner and to the same extent as the person who has committed the act, unless she proves that the act was committed without his consent or connivance and was not facilitated by any neglect or omission on his part.
- (4) Where at any stage of the proceedings against any person under this section (hereinafter referred to as the delinquent), the Court is satisfied by affidavit or otherwise—
 - (a) that a prima facie case has been made out against the delinquent; and
 - (b) that it is just and proper so to do in the interests of the policyholders of an insurer or of the members of an insurance company, the Court may direct the attachment of
 - i. any property of the insurer in the possession of the delinquent;
 - ii. any property of the delinquent which belongs to him or is deemed to belong to him with the meaning of sub-section (5);
 - iii. any property transferred by the delinquent within two years before the commencement of proceedings under sub-section (1) or during the pendency of such proceedings/ if the Court is satisfied by affidavit or otherwise that the transfer was otherwise than in good faith and for consideration.
- (5) For the purposes of sub-section (4), the following classes of property shall be deemed to belong to a delinquent:
 - (a) any property standing in the name of any person which by reason of the person being connected with the delinquent, whether by way of relationship or otherwise, or on account of any other relevant circumstances appears to belong to the delinquent;
 - (b) the property of a private company in respect of the affairs of which the delinquent, by himself or through his nominees, relatives, partners or persons interested in any shares of the company is able to exercise or is entitled to acquire control, whether direct or indirect.

Explanation.—For the purposes of this section a person shall be deemed to be a nominee of a delinquent, if, whether directly or indirectly, he possesses on behalf of the delinquent, or may be required to exercise on the direction or on behalf of the delinquent, any right or power which is of such a nature as to enable the delinquent to exercise or to entitle the delinquent to acquire control over the company's affairs.

- (6) Any claim to any property attached under this section or any objection to such attachment shall be made by an application to the Court, and it shall be for the claimant or object or to adduce evidence to show that the property is not liable to attachment under this section, and the Court shall proceed to investigate the claim or objection in a summary manner.
- (7) When disposing of an application under sub-section (1), the Court shall, after giving all persons who appear to it to be interested in any property attached under this section an opportunity of being heard, make such order as it thinks fit respecting the disposal of any such property for the purpose of effectually enforcing any liability under this section, and all such persons shall be deemed to be parties to the proceedings under this section.
- (8) In any proceedings under this section the Court shall have full power and exclusive jurisdiction to decide all questions of any nature whatsoever arising there under and, in particular, with respect to any property attached under this section, and no other court shall have jurisdiction to decide any such question in any suit or other legal proceeding.
- (9) In making any order with respect to the disposal of the property of any private company referred to in Clause (b) of sub-section (5), the Court shall have due regard to the interests of all persons interested in such property other than the delinquent and persons referred to in that clause.
- (10) This section shall apply notwithstanding that the act is one for which the person concerned may be criminally liable.
- (11) In proceedings under this section the Court shall have all the powers which a court has under Section 237 of the Indian Companies Act, 1913 (7 of 1913).
- (12) This section shall apply in respect of a provident society as defined in Part III as it applies in respect of an insurer.
- (13) On and from the commencement of the Insurance (Second Amendment) Act, 1955 (54 of 1955), the Court entitled to exercise jurisdiction under this section shall be the High Court within whose jurisdiction the registered office of the insurer is situate (hereinafter referred to as the High Court) and any proceedings under this section pending at such commencement in any Court other than the High Court shall, on such commencement, stand transferred to the High Court.
- (14) The High Court may make rules providing for
 - (a) the manner in which enquiries and proceedings may be held under this section,
 - (b) any other matter for which provision has to be made for enabling the High Court to effectively exercise its jurisdiction under this section.

Notice to and hearing of Authority [Section 106A]

- (1) When application is made to the Court for the making of any order to which this section applies the Court shall, unless the Authority has himself made the application or has been made a party thereto, send a copy of the application together with intimation of the date fixed for the hearing thereof to the Authority, and shall give him an opportunity of being heard.
- (2) The orders to which this section applies are the following namely:
 - (a) an order for the attachment in execution of a decree of any deposit made under Section 7 or Section 98;



- (b) an order under Section 9 or Section 59 for the return of any such deposit;
- (c) an order under Section 36 sanctioning any arrangement for the transfer or amalgamation of life insurance business or any order consequential thereon;
- (d) an order for the winding up of an insurance company or a provident society;
- (e) an order under Section 58 confirming a scheme for the partial winding up of an insurance company;
- (f) an order under Section 89 reducing the amount of the insurance contracts of a provident society.

Previous sanction of Advocate-General for institution of proceedings [Section 107]

- (1) Except where proceedings are instituted by the Authority or an Administrator appointed under Section 52A, no proceedings under this Act against an insurer or any director, managing agent, manager, secretary or other Officer of an insurer or any liquidator or any employee or agent of an insurer or any person who is liable under sub-section (2) of Sec. 41 or any other person shall be instituted by any person unless he has previous thereto obtained the sanction of the Advocate-General of the State where the principal place of business in India of such insurer is situate to the institution of such proceedings:

Provided that where the principal place of business of such insurer is situated in a Union territory references in this section to the Advocate General of the Province shall be construed as references to the Attorney General for India.

- (2) This section shall apply in respect of a provident society as defined in Part III as it applies in respect of an insurer.

Chairman, etc. to be public servant [Section 107A]

Every whole-time Chairman, whole-time director, auditor, liquidator, manager and any other employee of an insurer shall be deemed to be a public servant for the purposes of Chapter IX of the Indian Penal Code (45 of 1860).

Power of Court to grant relief [Section 108]

In any proceedings, civil or criminal, it appears to the Court hearing the case that a person is or may be liable in respect of negligence, default, breach of duty or breach of trust but that he has acted honestly and reasonably and that having regard to all the circumstances of the case he ought fairly to be excused for the negligence, default, breach of duty or breach of trust, the Court may relieve him either wholly or partly from his liability on such terms as it may think fit.

Cognizance of offences [Section 109]

- (1) No Court inferior to that of a Presidency Magistrate or a Magistrate of the first class shall try any offence under this Act. -
- (2) No Court shall take cognizance of any offence punishable under sub-section (4) of Section 34B or sub-section (1A) of Section 102 except upon complaint in writing made by an officer of the Central Government generally or specially authorised in writing, in this behalf by the Authority, and no Court inferior to that of a Presidency Magistrate or a Magistrate of the first class shall try any such offence.

Appeals [Section 110]

- (1) An appeal shall lie to the Court having jurisdiction from any of the following orders, namely:
 - (a) an order under Section 3 cancelling the registration of an insurer;
 - (b) an order under Section 5 directing the insurer to change his name;

- (c) an order under Section 42 cancelling the licence issued to an agent;
 - (d) an order under Section 75 refusing to register an amendment of rules;
 - (e) an order under Section 87 or Section 87A;
 - (f) an order made in the course of the winding up or insolvency of an insurer or a provident society.
- (2) The Court having jurisdiction for the purposes of sub-section (1) shall be the principal Court of civil jurisdiction within whose local limits the principal place of business of the insurer concerned is situate.
- (3) An appeal shall lie from any order made under sub-section (1) to the authority authorised to hear appeals from the decisions of the Court making the same and the decision on such appeal shall be final.
- (4) No appeal under this section shall be entertained unless it is made before the expiration of four months from the date on which the order appealed against was communicated to the appellant.

Delegation of powers and duties of Chairperson of the Authority [Section 110A]

110A. The Chairperson of the Authority may by general or special order delegate any of his powers or duties under this act to any person subordinate to him. The exercise or discharge of any of the powers or duties so delegated shall be subject to such restrictions, limitations and conditions, if any as the Chairperson of the Authority may impose, and shall be subject to his control and revision.

Signature of documents [Section 110B]

Every document which is required by Act or by any rule made there under to be signed by the Chairperson of the Authority or by any person subordinate to him or by any officer authorised by him under sub-section (1) of Section 42 shall be deemed to be properly signed, if it bears a facsimile of the signature of such Chairperson of the Authority, person or officer printed, engraved, lithographed or impressed by any of other mechanical process approved by the Central Government.

Power to call for information [Section 110C]

- (1) The Chairperson of the Authority may, by notice in writing, require any insurer to supply him with any information relating to his insurance business, and the insurer shall comply with such requirement within such period after receipt of the notice as may be specified therein.
- (2) Any information supplied under this section shall be certified by a principal officer of the insurer and if the notice so requires also by an auditor.

Certain claims for compensation barred [Section 110D]

No person shall have any right, whether in contract or otherwise, to any compensation for any loss incurred by reason of the operation of any of the provisions contained in Section 34 or Section 34A or Section 34E or Section 37A or by reason of the compliance by an insurer with any order or direction given to him under this Act.

Sections 3A, 27B, 28B, 33, etc. to apply to general insurance business of the Life Insurance Corporation of India [Section 110E]

Notwithstanding anything contained in the Life Insurance Corporation Act, 1956 (31 of 1956), the provisions of Sections 3A, 27B, 28B, 33, 34. Clause (a) of Section 34E, 34F, 40C, 44A, 64U to 64UM (both inclusive), 64V, 64VA, 64VB, 64VC, 101A, 101C, 110 D, 110G and 110H, shall also apply, so far as may be to and in relation to the general insurance business carried on by the Life Insurance Corporation of India and the provisions of Section 37A shall also apply to that Corporation if it becomes an acquiring insurer.



Provisions applicable to State Governments, etc [Section 110F]

The provisions of Section 3, 3A, 27B, 28B, 33, 34, Clause (a) of Section 34E; 34F, 40A, 40C, 44A, 64U to 64 UM (both inclusive), 64V, 64VA, 64VB, 64VC and 101A, 101C, 110-D, 110-G and 110-H shall, notwithstanding any exemption granted under Section 118, also apply, so far as may be, and in relation to the general insurance business carried on by a State Government or a Government company as defined in Section 617 of the Companies Act, 1956 (1 of 1956).

Constitution of Consultative Committee [Section 110G]

- (1) The Central Government shall constitute a Consultative Committee consisting of the Chairperson of the Authority (who shall be the Chairman thereof) and not more than four other members having special knowledge and experience of the business of insurance.
- (2) The term of office of, and the allowance payable to the members of the Consultative Committee, the procedure to be followed by, and the quorum necessary for the transaction of business of, the Consultative Committee and the manner of filling casual vacancies therein shall be such as may be prescribed.
- (3) Before making any order under Sections 34, 34A, 34B, 34C, 34E, 34F, 34G, sub-sections (4) and (7) of Section 64UM and Section 64VC, the Authority shall consult the Consultative Committee constituted under sub-section (1).

Appeals [Section 110H]

- (1) any person aggrieved by any order made by the Authority under Sections 27D, 34, 34A, 34B, 34C, 34E, 34F, 34G, sub-sections(1), (4), and (7) of Section 64UM or Section 64VC may, within a period of thirty days from the date of such order prefer an appeal against such order to the Central Government and that Government may, by order, confirm, modify or reverse the order made by the Authority and the order so made by the Central Government shall be final.
- (2) No claim for compensation shall lie in favour of any person for anything done in pursuance of an order of the Authority so long as such order was effective.
- (3) The Central Government may, on the application of an appellant, stay, until the decision of the appeal, the operation of any order made under Section 34 or subsection (5) of Section 34-B or sub- clause (v) of Clause (b) of Section 34E.

Service of notices [Section 111]

- (1) Any process or notice required to be served on an insurer or provident society shall be sufficiently served if addressed to any person registered with the Authority as a person authorised to accept notices on behalf of the insurer or provident society and left at, or sent by registered post to, the address of such person as registered with Authority.
- (2) any notice or other document which is by this Act required to be sent to any policy-holder may be addressed and sent to the person to whom notices respecting such policy are usually sent and any notice so addressed and sent shall be deemed to be notice to the holder of such policy:

Provided that, where any person claiming to be interested in a policy as transferee, assignee or nominee has given to an insurer or to a provident society notice in writing of his interest, any notice which is by his Act required to be sent to policy-holders shall also be sent to such person at the address specified by him in his notice.

Declaration of interim bonuses [Section 112]

Notwithstanding anything to the contrary contained in this Act an insurer carrying on the business of life insurance shall be at liberty to declare an interim bonus or bonuses to policy holders whose policies mature for payment by reason of death or otherwise during the inter-valuation period on the recommendation of the investigating actuary made at the last preceding valuation.

Acquisition of surrender values by policy [Section 113]

- (1) A policy of life insurance under which the whole of the benefits become payable either on the occurrence, or at a fixed interval or fixed intervals after the occurrence, of a contingency which is bound to happen, shall, if all premiums have been paid for at least three consecutive years in the case of a policy issued by an insurer, or five years in the case of a policy issued by a provident society defined in Part III, acquire a guaranteed surrender value, to which shall be added the surrender value of any subsisting bonus already attached to the policy, and every such policy issued by insurer shall show the guaranteed surrender value of the policy at the close of each year after the second year of its currency or at the close of each period of three years throughout the currency of the policy:

Provided that the requirements of this sub-section as to the addition of the surrender value of the bonus attaching to the policy at surrender shall be deemed to have been complied with where the method of calculation of the guaranteed surrender value of the policy makes provision for the surrender value of the bonus attaching to the policy:

Provided further that the requirements of this sub-section as to the showing of the guaranteed surrender value on a policy shall be deemed to have been complied with where the insurer shows on the policy the guaranteed surrender value of the policy by means of a formula accepted in this behalf by the Authority as satisfying the said requirements:

Provided further that the provisions of this sub-section as to the showing of the guaranteed surrender value on a policy shall not take effect until after the expiry of six months from such date as the Authority may, by notification in the official Gazette, appoint in this behalf

- (2) Notwithstanding any contract to the contrary, a policy which has acquired a surrender value shall not lapse by reason of the non-payment of further premiums but shall be kept alive to the extent of the paid-up sum insured, and the paid-up sum insured shall for the purposes of this sub-section include in full all subsisting reversionary bonuses that have already attached to the policy, and shall, where the policy is one on which the maximum number of annual premiums payable is fixed and the premiums are of uniform amount, be before the inclusion of such bonuses not less than the amount bearing to the total sum insured by the policy exclusive of bonuses the same proportion as the total period for which premiums have already been paid bears to the maximum period for which premiums were originally payable.
- (3) A policy kept alive to the extent of the paid-up sum insured under sub section (2) shall not be entitled by virtue of that sub-section to participate in any profits declared distributable after the conversion of the policy into a paid-up policy.
- (4) Sub-section (2) and sub-section (3) shall not apply -
 - (a) where the paid-up sum insured by a policy being a policy issued by an insurer, is less than one hundred rupees inclusive of any attached bonus or takes the form of an annuity of less than twenty-five rupees, or where the paid-up sum insured by a policy, being a policy issued by a provident society as defined in Part III, is less than fifty rupees inclusive of any attached bonus or take the form of an annuity of less than twenty-five rupees, or
 - (b) where the parties after the default has occurred in the payment of the premium agree in writing to some other arrangement, or
 - (c) to policies in which the surrender value is automatically applied under the terms of the contract to maintaining the policy in force after its lapse through non-payment of premium.

Power of Central Government to make rules [Section 114]

- (1) The Central Government may, subject to the condition of previous publication by notification in the official Gazette, make rules to carry out the purposes of this Act.



- (2) In particular and without prejudice to the generality of the foregoing power, such rules may prescribe
- (a) the qualifications to be possessed by actuaries;
 - (aa) such other percentage of paid-up equity capital in excess of twenty-six percent of the paid-up equity capital and the period within which such excess paid-up equity capital shall be divested under sub-section (1) of section 6AA.
 - (b) the manner in which it shall be determined which of the transactions of an insurer are to be deemed for the purposes of this Act to be insurance business transacted in India.
 - (c) the procedure to be followed by the Reserve Bank of India in dealing with deposits made in pursuance of this Act, including the receipt of custody of, withdrawal of, and payment of interest on securities lodged as such deposits, and their inspection and verification by the Authority.
 - (d) the form referred to in Clause (d) of sub-section (2) of Section 16;
 - (e) the manner in which the prospectuses and tables referred to in sub-section (1) of Section 41 shall be published and the form in which they shall be drawn up;
 - (f) the matters to be prescribed for the purposes of section 48;
 - (g) (Omitted)
 - (h) the contingencies other than those specified in Clauses (a) to (f) of Section (2) of Section 65 on the happening of which money may be paid by provident societies;
 - (i) the matters other than those specified in Clauses (a) to (o) of subsection (1) of Section 74 on which a provident society shall make rules;
 - (j) the form of any account, return or register required by Part III and the manner in which such account, return or register shall be verified;
 - (k) subject to the provisions of this Act, the fees payable there under and the manner in which they are to be collected;
 - (l) the conditions and the matters which may be prescribed under sub-sections (5), (6), (10) and (12) of Section 92;
- (3) Every rule made under this section or under subsection (10) of Section 34H or under sub-section (1) of Section 64UB and every regulation made under sub-section (3) of Section 64UB and every regulation made under this part shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or regulation or both Houses agree that the rule or regulation should not be made, the rule or regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule or regulation.
- (4) All rules made by a Local Government under the provisions of Section 24 of the Provident Insurance Societies Act, 1912 (5 of 1912), and in force at the commencement of this Act shall, so far as not inconsistent with the provisions of Part III, continue in force and have effect as if duly made under this section until they are replaced by rules made under this section.

Power of Authority to make regulations [Section 114A]

- (1) The Authority may, by notification in the Official Gazette, make regulations consistent with this Act and the rules made thereunder, to carry out the purposes of this Act.

- (2) In particular, and without prejudice to the generality of the foregoing power, such regulations may provide for all or any of the following matters, namely: -
- (a) the matters including fee relating to the registration of insurers under section 3;
 - (b) the manner of suspension or cancellation of registration under sub-section (5-E) of section 3;
 - (c) such fee, not exceeding five thousand rupees, as may be determined by the regulations for issue of a duplicate certificate of registration under sub-section (7) of section 3;
 - (d) the matters relating to the renewal of registration and fee therefore under section 3-
 - (e) the manner and procedure for divesting excess share capital under sub-section (2) of section 6-AA;
 - (f) the preparation of balance-sheet, profit and loss account and a separate account of receipts and payments and revenue account under sub-section (1-A) of section 11;
 - (g) the manner in which an abstract of the report of the actuary to be specified under the fourth proviso to sub-section (1) of section 13;
 - (h) the form and the manner in which the statement referred to in sub-section (4) of section 13 shall be appended;
 - (i) the time, manner and other conditions of investment of assets held by an insurer under sub-sections (1), (2) and (3) of section 27-D;
 - (j) the minimum information to be maintained by insurer in their books, the manner in which such information should be maintained, the checks and other verifications to be adopted by insurers in that connection and all other matters incidental thereto under sub-section (8) of section 33;
 - (k) the manner for making an application, the manner and the fee for issue of a license to act as an insurance agent under sub-section (1) of section 42;
 - (l) the fee and the additional fee to be determined for renewal of license of insurance agent under sub-section (3) of section 42;
 - (m) the requisite qualifications and practical training to act as an insurance agent under clause (e) of sub-section (4) of section 42;
 - (n) the passing of examination to act as an insurance agent under clause (f) of sub-section (4) of section 42;
 - (o) the code of conduct under clause (g) of sub-section (4) of section 42;
 - (p) the fee not exceeding rupees fifty for issue of duplicate license under sub-section (6) of section 42;
 - (q) the manner and the fees for issue of a license to an intermediary or an insurance intermediary under sub-section (1) of section 42-D;
 - (r) the fee and the additional fee to be determined for renewal of license of intermediaries or insurance intermediaries under sub-section (3) of section 42-D;
 - (s) the requisite qualifications and practical training of intermediaries or insurance intermediaries under clause (e) of sub-section (5) of section 42-D;
 - (t) the examination to be passed to act as an intermediary or insurance intermediary under clause (f) of sub-section (5) of section 42-D;
 - (u) the code of conduct under clause (g) of sub-section (5) of section 42-D;

- (v) the fee for issue of duplicate license under sub-section (7) of section 42-D;
 - (w) such matters as specified under sub-section (2) of section 64-UB relating to the Tariff Advisory Committee;
 - (x) the matters relating to licensing of surveyors and loss assessors, their duties, responsibilities and other professional requirements under section 64-UM;
 - (y) such other asset or assets as may be specified under clause (h) of sub-section (1) of section 64-V for the purposes of ascertaining sufficiency of assets under section 64-VA;
 - (z) the valuation of assets and liabilities under sub-section (3) of section 64-V;
 - (za) the matters specified under sub-section (1-A) of section 64-VA relating to sufficiency of assets;
 - (zb) the matters relating to re-insurance under sections 101-A and 101-B;
 - (zc) the matters relating to redressal of grievances of policy-holders to protect their interest and to regulate, promote and ensure orderly growth of insurance industry; and
 - (zd) any other matter which is to be, or may be, specified by the regulations made by the Authority or in respect of which provision is to be made or may be made by the regulations.
- (3) Every regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the regulation or both Houses agree that the regulation should not be made, the regulation shall, thereafter, have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that regulation."

Alteration of forms [Section 115]

The Authority may, on the application or with the consent of an insurer, not being a company, alter the forms contained in the Schedules as respects that insurer, for the purpose of adapting them to the circumstances of that insurer:

Provided that nothing done under this section shall exempt the insurer from supplying all information required under this Act so far as it is possible for the insurer to do so.

Power to exempt from certain requirements [Section 116]

- (1) The Central Government may, by notification in the official Gazette, exempt any insurer constituted, incorporated or domiciled in any country or State outside India from any of the provisions of this Act which may be specified in the notification either absolutely or subject to such conditions or modifications as may be specified in the notification.
- (2) This section shall apply in respect of provident societies as defined in Part III as it applies in respect of insurers.

Summary of returns to be published [Section 116A]

The Central Government before the date of commencement of the Insurance Regulatory and Development Authority Act, 1999, shall every year cause to be published, in such manner as it may direct, a summary of the accounts, balance-sheets, statements, abstracts and other returns under this Act or purporting to be under this Act which have been furnished in pursuance of the provisions of this Act to the Authority during the year preceding the year of publication, and may append to such summary any note of the Authority or of the Central Government before the date of commencement of the Insurance Regulatory and Development Authority Act, 1999 and any correspondence:

Provided that nothing in this section shall require the publication of the statement referred to in sub-section (2) of Section 10 of the returns referred to in sub-section (1) of Section 28 or Section 28A or Section 28B or the statements referred to in subsection (2) of Section 31B or Section 40B.

Saving of provisions of Indian Companies Act, 1913 [Section 117]

Nothing in this Act shall affect the liability of an insurer being a company or a provident society as defined in Part III being a company to comply with the provisions of the Indian Companies Act, 1913 (7 of 1913), in matters not otherwise specifically provided for by this Act.

Exemptions [Section 118]

Nothing in this Act shall apply—

- (a) to any trade union registered under the Indian Trade Unions Act 1926 (16 of 1926); or
- (b) to any provident fund to which the provisions of the Provident Funds Act, 1925 (19 of 1925), apply; or
- (c) if the Central Government so orders in any case, and to such extent or subject to such conditions or modifications as may be specified in the order, to any insurance business carried on by the Central Government or a Government company as defined in Section 617 of the Companies Act, 1956 (1 of 1956); or
- (d) if the Authority so orders in any case, and to such extent or subject to such conditions or modifications as may be specified in the order, to—
 - i. any approved superannuation fund as defined in Clause (a) of Section 58-N of the Indian Income-tax Act, 1922 (11 of 1922); or
 - ii. any fund in existence and officially recognized by the Central Government before the 27th day of January, 1937 maintained by or on behalf of Government servants or Government pensioners for the mutual benefit of contributors to the fund and of their dependents or
 - iii. any mutual or provident insurance society composed wholly of Government servants or of railway servants which has been exempted from any or all of the provisions of the Provident Insurance Societies Act, 1912 (5 of 1912)

Inspection and supply of copies of published prospectus, etc [Section 119]

Any person may, on payment of a fee of five rupees, inspect the documents filed by an insurer with the Authority under Clause (f) of sub-section (2) of Section 3, and may obtain a copy of any such document or part thereof on payment in advance at the prescribed rate, for the making of the copy.

Determination of market value of securities deposited under this Act [Section 120]

The market value on the day of deposit of securities deposited in pursuance of any of the provisions of this Act with the Reserve Bank of India shall be determined by the Reserve Bank of India whose decision shall be final.



6.2 INSURANCE REGULATORY & DEVELOPMENT AUTHORITY ACT, 1999

Short title, extent and commencement [Section 1]

- (1) This Act may be called THE INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY ACT, 1999.
- (2) It extends to the whole of India.
- (3) It shall come into force on such date', as the Central Government may, by notification in the Official Gazette, appoint:

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

Definitions [Section 2]

- (l) In this Act, unless the context otherwise requires,--
 - (a) "appointed day" means the date on which the Authority is established under sub-section (1) of section 3;
 - (b) "Authority" means the Insurance Regulatory and Development Authority established under sub-section (1) of section 3;
 - (c) "Chairperson" means the Chairperson of the Authority;
 - (d) "Fund" means the Insurance Regulatory and Development Authority Fund constituted under sub-section (1) of section 16;
 - (e) "Interim Insurance Regulatory Authority" means the Insurance Regulatory Authority set up by the Central Government through Resolution No 17(2)194-Ins.-V, dated the 23rd January, 1996;
 - (f) "intermediary or insurance intermediary" includes insurance brokers reinsurance brokers, insurance consultants, surveyors and loss assessors;
 - (g) "member" means a whole-time or a part-time member of the Authority and includes the Chairperson;
 - (h) "notification" means a notification published in the Official Gazette;
 - (i) "prescribed" means prescribed by rules made under this Act; (0 "regulations" means the regulations made by the Authority.
- (2) Words and expressions used and not defined in this Act but defined in the Insurance Act, 1938 (4 of 1938) or the Life Insurance Corporation Act, 1956 (31 of 1956) or the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972) shall have the meanings respectively assigned to them in those Acts.

REGULATORY AND DEVELOPMENT AUTHORITY

Establishment and incorporation of Authority [Section 3]

- (1) With effect from such date as the Central Government may, by notification, appoint, there shall be established, for the purpose of this Act, an Authority to be called "the Insurance Regulatory and Development Authority" .
- (2) The Authority shall be a body corporate by the name aforesaid having perpetual succession and a common seal with power, subject to the provisions of this Act, to acquire, hold and dispose of property, both movable and immovable, and to contract and shall, by the said name, sue or be sued.

- (3) The head office of the Authority shall be at such place as the Central Government may decide from time to time.
- (4) The Authority may establish offices at other places in India.

Composition of Authority [Section 4]

The Authority shall consist of the following members, namely:-

- (a) a Chairperson;
- (b) not more than five whole-time members;
- (c) not more than four part-time members,

to be appointed by the Central Government from amongst persons of ability, integrity and standing who have knowledge or experience in life insurance, general insurance, actuarial science, finance, economics, law, accountancy, administration or any other discipline which would, in the opinion of the Central Government, be useful to the Authority:

Provided that the Central Government shall, while appointing the Chairperson and the whole-time members, ensure that at least one person each is a person having knowledge or experience in life insurance, general insurance or actuarial science, respectively.

Tenure of office of Chairperson and other members [Section 5]

- (1) The Chairperson and every other whole-time member shall hold office for a term of five years from the date on which he enters upon his office and shall be eligible for reappointment:
Provided that no person shall hold office as a Chairperson after he has attained the age of sixty-five years:
Provided further that no person shall hold office as a whole-time member after he has attained the age of sixty-two years.
- (2) A part-time member shall hold office for a term not exceeding five years from the date on which he enters upon his office.
- (3) Notwithstanding anything contained in sub-section (1) or sub-section (2), a member may-
 - (a) relinquish his office by giving in writing to the Central Government notice of not less than three months; or
 - (b) be removed from his office in accordance with the provisions of section 6.

Removal from office [Section 6]

- (1) The Central Government may remove from office any member who-
 - (a) is, or at any time has been, adjudged as an insolvent; or
 - (b) has become physically or mentally incapable of acting as a member; or
 - (c) has been convicted of any offence which, in the opinion of the Central Government, involves moral turpitude; or
 - (d) has acquired such financial or other interest as is likely to affect prejudicially his functions as a member; or
 - (e) has so abused his position as to render his continuation in office detrimental to the public interest.
- (2) No such member shall be removed under clause (d) or clause (e) of sub-section (1) unless he has been given a reasonable opportunity of being heard in the matter.



Salary and allowances of Chairperson and members [Section 7]

- (1) The salary and allowances payable to, and other terms and conditions of service of, the members other than part-time members shall be such as may be prescribed.
- (2) The part-time members shall receive such allowances as may be prescribed.
- (3) The salary, allowances and other conditions of service of a member shall not be varied to his disadvantage after appointment.

Bar on future employment of members [Section 8]

The Chairperson and the whole-time members shall not, for a period of two years from the date on which they cease to hold office as such, except with the previous approval of the Central Government, accept-

- (a) any employment either under the Central Government or under any State Government; or
- (c) any appointment in any company in the insurance sector.

Administrative powers of Chairperson [Section 9]

The Chairperson shall have the powers of general superintendence and direction in respect of all administrative matters of the Authority.

Meetings of Authority [Section 10]

- (1) The Authority shall meet at such time and places and shall observe such rules and procedures in regard to transaction of business at its meetings (including quorum at such meetings) as may be determined by the regulations.
- (2) The Chairperson, or if for any reason he is unable to attend a meeting of the Authority, any other member chosen by the members present from amongst themselves at the meeting, shall preside at the meeting.
- (3) All questions which come up before any meeting of the Authority shall be decided by a majority of votes by the members present and voting, and in the event of an equality of votes, the Chairperson, or in his absence, the person presiding shall have a second or casting vote.
- (4) The Authority may make regulations for the transaction of business at its meetings.

Vacancies, etc., not to invalidate proceedings of Authority [Section 11]

No act or proceeding of the Authority shall be invalid merely by reason of-

- (a) any vacancy in, or any defect in the constitution of, the Authority; or
- (b) any defect in the appointment of a person acting as a member of the Authority; or
- (c) any irregularity in the procedure of the Authority not affecting the merits of the case.

Officers and employees of Authority [Section 12]

- (1) The Authority may appoint officers and such other employees as it considers necessary for the efficient discharge of its functions under this Act.
- (2) The terms and other conditions of service of officers and other employees of the Authority appointed under sub-section (1) shall be governed by regulations made under this Act.

Transfer of assets, liabilities, etc., of Interim Insurance Regulatory Authority [Section 13]

On the appointed day,-

- (a) all the assets and liabilities of the Interim Insurance Regulation Authority shall stand transferred to, and vested in, the Authority.

Explanation. -The assets of the Interim Insurance Regulatory Authority shall be deemed to include all rights and powers, and all properties, whether movable or immovable, including, in particular, cash balances, deposits and all other interests and rights in, or arising out of, such properties as may be in the possession of the Interim Insurance Regulatory Authority and all books of account and other documents relating to the same; and liabilities shall be deemed to include all debts, liabilities and obligations of whatever kind;

- (b) without prejudice to the provisions of clause (a), all debts, obligations and liabilities incurred, all contracts entered into and all matters and things engaged to be done by, with or for the Interim Insurance Regulatory Authority immediately before that day, for or in connection with the purpose of the said Regulatory Authority, shall be deemed to have been incurred, entered into or engaged to be done by, with or for, the Authority;
- (c) all sums of money due to the Interim Insurance Regulatory Authority immediately before that day shall be deemed to be due to the Authority; and
- (d) all suits and other legal proceedings instituted or which could have been instituted by or against the Interim Insurance Regulatory Authority immediately before that day may be continued or may be instituted by or against the Authority.

Duties, powers and functions of Authority [Section 14]

- (1) Subject to the provisions of this Act and any other law for the time being in force, the Authority shall have the duty to regulate, promote and ensure orderly growth of the insurance business and reinsurance business.
- (2) Without prejudice to the generality of the provisions contained in sub -section (1), the powers and functions of the Authority shall include,-
 - (a) issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;
 - (b) protection of the interests of the policy-holders in matters concerning assigning of policy, nomination by policy-holders, insurable interest, settlement of insurance claim, surrender value of policy, and other terms and conditions of contracts of insurance;
 - (c) specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;
 - (d) specifying the code of conduct for surveyors and loss assessors;
 - (e) promoting efficiency in the conduct of insurance business;
 - (f) promoting and regulating professional organisations connected with the insurance and re-insurance business;
 - (g) levying fees and other charges for carrying out the purposes of this Act;
 - (h) calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organisations connected with the insurance business;
 - (i) control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64-U of the Insurance Act, 1938 (4 of 1938);
 - (j) specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;
 - (k) regulating investment of funds by insurance companies;



- (l) regulating maintenance of margin of solvency;
- (m) adjudication of disputes between insurers and intermediaries or insurance intermediaries;
- (n) supervising the functioning of the Tariff Advisory Committee;
- (o) specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organisations referred to in clause (f);
- (p) specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and
- (q) exercising such other powers as may be prescribed.

Grants by Central Government [Section 15]

The Central Government may, after due appropriation made by the Parliament by law in this behalf, make to the Authority grants of such sums of money as the Government may think fit for being utilised for the purposes of this Act.

Constitution of Fund [Section 16]

- (1) There shall be constituted a fund to be called “the Insurance Regulatory and Development Authority Fund” and there shall be credited thereto--
 - (a) all Government grants, fees and charges received by the Authority;
 - (b) all sums received by the Authority from such other source as may be decided upon by the Central Government;
 - (c) the percentage of prescribed premium income received from the insurer.
- (2) The Fund shall be applied for meeting-
 - (a) the salaries, allowances and other remuneration of the members, officers and other employees of the Authority;
 - (b) the other expenses of the Authority in connection with the discharge of its functions and for the purposes of this Act.

Accounts and audit [Section 17]

- (1) The Authority shall maintain proper accounts and other relevant records and prepare an annual statement of account in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor-General of India.
- (2) The accounts of the Authority shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Authority to the Comptroller and Auditor-General.
- (3) The Comptroller and Auditor-General of India and any other person appointed by him in connection with the audit of the accounts of the Authority shall have the same rights, privileges and authority in connection with such audit as the Comptroller and Auditor-General generally has in connection with the audit of the Government accounts and, in particular, shall have the right to demand the production of books of account, connected vouchers and other documents and papers and to inspect any of the offices of the Authority.
- (4) The accounts of the Authority as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf together with the audit report thereon shall be forwarded annually to the Central Government and that Government shall cause the same to be laid before each House of Parliament.

Power of Central Government to issue directions [Section 18]

- (1) Without prejudice to the foregoing provisions of this Act, the Authority shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on questions of policy, other than those relating to technical and administrative matters, as the Central Government may give in writing to it from time to time:

Provided that the Authority shall, as far as practicable, be given an opportunity to express its views before any direction is given under this sub-section.

- (2) The decision of the Central Government, whether a question is one of policy or not, shall be final.

Power of Central Government to supersede Authority [Section 19]

- (1) if, at any time, the Central Government is of the opinion-
 - (a) that, on account of circumstances beyond the control of the Authority, it is unable to discharge the functions or perform the duties imposed on it by or under the provisions of this Act; or
 - (b) that the Authority has persistently defaulted in complying with any direction given by the Central Government under this Act or in the discharge of the functions or performance of the duties imposed on it by or under the provisions of this Act and as a result of such default the financial position of the Authority or the administration of the Authority has suffered; or
 - (c) that circumstances exist which render it necessary in the public interest so to do, the Central Government may, by notification and for reasons to be specified therein, supersede the Authority for such period, not exceeding six months, as may be specified in the notification and appoint a person to be the Controller of Insurance under section 2-B of the Insurance Act, 1938 (4 of 1938), if not already done:

Provided that before issuing any such notification, the Central Government shall give a reasonable opportunity to the Authority to make representations against the proposed supersession and shall consider the representations, if any, of the Authority.

- (2) Upon the publication of a notification under sub-section (1) superseding the Authority,---
 - (a) the Chairperson and other members shall, as from the date of supersession, vacate their offices as such;
 - (b) all the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of the Authority shall, until the Authority is reconstituted under sub-section (3), be exercised and discharged by the Controller of Insurance; and
 - (c) all properties owned or controlled by the Authority shall, until the Authority is reconstituted under sub-section (3), vest in the Central Government.
- (3) On or before the expiration of the period of supersession specified in the notification issued under sub-section (1), the Central Government shall reconstitute the Authority by a fresh appointment of its Chairperson and other members and in such case any person who had vacated his office under clause (a) of sub-section (2) shall not be deemed disqualified for re-appointment.
- (4) The Central Government cause a copy of the notification issued under sub-section (1) and a full report of any action taken under this section and the circumstances leading to such action to be laid before each House of Parliament at the earliest.

Furnishing of returns, etc., to Central Government [Section 20]

- (1) The Authority shall furnish to the Central Government at such time and in such form and manner as may be prescribed, or as the Central Government may direct to furnish such returns, state-



ments and other particulars in regard to any proposed or existing programme for the promotion and development of the insurance industry as the Central Government may, from time to time, require.

- (2) Without prejudice to the provisions of sub-section (1), the Authority shall, within nine months after the close of each financial year, submit to the Central Government a report giving a true and full account of its activities including the activities for promotion and development of the insurance business during the previous financial year.
- (3) Copies of the reports received under sub-section (2) shall be laid, as soon as may be after they are received, before each House of Parliament.

Chairperson, members, officers and other employees of Authority to be public servants [Section 21]

The Chairperson, members, officers and other employees of the Authority shall be deemed, when acting or purporting to act in pursuance of any of the provisions of this Act, to be public servants within the meaning of section 21 of the Indian Penal Code (45 of 1860).

Protection of action taken in good faith [Section 22]

No suit, prosecution or other legal proceedings shall lie against the Central Government or any officer of the Central Government or any member, officer or other employee of the Authority for anything which is in good faith done or intended to be done under this Act or the rules or regulations made thereunder:

Provided that nothing in this Act shall exempt any person from any suit or other proceedings which might, apart from this Act, be brought against him.

Delegation of powers [Section 23]

- (1) The Authority may, by general or special order in writing, delegate to the Chairperson or any other member or officer of the Authority subject to such conditions, if any, as may be specified in the order, such of its powers and functions under this Act as it may deem necessary.
- (2) The Authority may, by a general or special order in writing, also form Committees of the members and delegate to them the powers and functions of the Authority as may be specified by the regulations.

Power to make rules [Section 24]

- (1) The Central Government may, by notification, make rules for carrying out the provisions of this Act.
- (2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely: -
 - (a) the salary and allowances payable to, and other terms and conditions of service of, the members other than part-time members under sub-section (1) of section 7;
 - (b) the allowances to be paid to the part-time members under sub-section (2) of section 7;
 - (c) such other powers that may be exercised by the Authority under clause (q) of sub-section (2) of section 14;
 - (d) the form of annual statement of accounts to be maintained by the Authority under sub-section (1) of section 17;
 - (e) the form and the manner in which and the time within which returns and statements and particulars are to be furnished to the Central Government under sub-section (l) of section 20;
 - (f) the matters under sub-section (5) of section 25 on which the Insurance Advisory Committee

shall advise the Authority;

- (g) any other matter which is required to be, or may be, prescribed, or in respect of which provision is to be or may be made by rules.

Establishment of Insurance Advisory Committee [Section 25]

- (1) The Authority may, by notification, establish with effect from such date as it may specify in such notification, a Committee to be known as the Insurance Advisory Committee.
- (2) The Insurance Advisory Committee shall consist of not more than twenty-five members excluding ex officio members to represent the interests of commerce, industry, transport, agriculture, consumer fora, surveyors, agents, intermediaries, organisations engaged in safety and loss prevention, research bodies and employees' association in the insurance sector.
- (3) The Chairperson and the members of the Authority shall be the ex officio Chairperson and ex officio members of the Insurance Advisory Committee.
- (4) The objects of the Insurance Advisory Committee shall be to advise the Authority on matters relating to the making of the regulations under section 26.
- (5) Without prejudice to the provisions of sub-section (4), the Insurance Advisory Committee may advise the Authority on such other matters as may be A prescribed.

Power to make regulations [Section 26]

- (1) The Authority may, in consultation with the Insurance Advisory Committee, by notification, make regulations consistent with this Act and the rules made thereunder to carry out the purposes of this Act.
- (2) In particular, and without prejudice to the generality of the foregoing power, such regulations may provide for all or any of the following matters, namely: -
 - (a) the time and places of meetings of the Authority and the procedure to be followed at such meetings including the quorum necessary for the transaction of business under sub-section (1) of section 10;
 - (b) the transaction of business at its meetings under sub -section (4) of section 10;
 - (c) the terms and other conditions of service of officers and other employees of the Authority under sub-section (2) of section 12;
 - (d) the powers and functions which may be delegated to Committees of the members under sub-section (2) of section 23; and
 - (e) any other matter which is required to be, or may be, specified by regulations or in respect of which provision is to be or may be made by regulations.

Rules and regulations to be laid before Parliament [Section 27]

Every rule and every regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or regulation or both Houses agree that the rule or regulation should not be made, the rule or regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule or regulation.

Application of other laws not barred [Section 28]



The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

Power to remove difficulties [Section 29]

- (1) *If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order published in the Official Gazette, make such provisions not inconsistent with the provisions of this Act as may appear to be necessary for removing the difficulty:*

Provided that no order shall be made under this section after the expiry of two years from the appointed day.

- (2) Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

Amendment of Act 4 of 1938 [Section 30]

The Insurance Act, 1938 shall be amended in the manner specified in the First Schedule to this Act.

Amendment of Act 31 of 1956 [Section 31]

The Life Insurance Corporation Act, 1956 shall be amended in the manner specified in the Second Schedule to this Act.

Amendment of Act 57 of 1972 [Section 32]

The General Insurance Business (Nationalisation) Act, 1972 shall be amended in the manner specified in the Third Schedule to this Act.

CONCEPT ON BASEL - I

OBJECTIVES

After going through this Chapter, the student would have some understanding of the following-

- The Basel Accord 1988 (Base I)
- Definition/Clarification of 'Bank' for the purpose of Basel accord, Commercial banks and Universal banks
- Shift from a 'Credit risk only' position which existed during 1988-1998
- Market risk - Recognition of the need for capital - Amendment of Basel I in 1996
- Commercial Banks & Securities firms - Universal Banks
- Segregation of Banking book & Trading book for holding Capital
- Banks to have independent Risk Management function and satisfy the 'Regulator' regarding its risk management practices

INTRODUCTION

As on date the provisions of Basel Accord of 1988 has undergone a number of changes made year after year. Though Basel II accord has become operational some of the covenants of Basel I (1988) are still relevant. Under the 1988 accord, Banks and security firms have been given different treatment. In the ensuing paragraphs we will focus on these developments.

THE BASEL ACCORD (BASEL I)

In 1988, the Basel Committee published a set of minimal capital requirements for banks. These became law in G-10 countries in 1992, with Japanese banks being permitted an extended transition period. The requirements have come to be known as the 1988 Basel Accord.

What is a 'Bank' for the purpose of Basel accord: To understand the scope of the 1988 accord, we need to clarify what we mean by 'bank.' This is because, some jurisdictions distinguished between banks and securities firms, and the Basel accord (Basel I) applied only to the former.

Commercial Banks and Universal Banks - Glass Steagal Act, USA (1933-1999)

Under its Glass-Steagal Act, the United States had quite some time back made a distinction between commercial banks and securities firms (investment banks or broker-dealers). Following World War II, Japan adopted a similar legal distinction. The United Kingdom also distinguished between banks and securities firms, although this was more a matter of custom than law. By comparison, Germany had a tradition of universal banking, which made no distinction between banks and securities firms. Under German law, securities firms were banks and a single regulatory authority oversaw banks. France and the Scandinavian countries had similar regimes. The USA revoked the Glass Steagal Act in 1999.

Exclusive Focus on Credit Risk During 1988-1998

The 1988 Basel Accord -Basel I- primarily addressed banking in the sense of deposit taking and lending (commercial banking under US law), so its focus was credit risk. Under this dispensation, bank assets were assigned 'risk weights.' Generally, G-10 government debt was weighted 0 per cent, G-10 bank debt was weighted 20 per cent, and other debt was weighted 100 per cent. Following this the Government of India Securities were assigned zero risk weight. Having assigned and aggregated the risk, Banks were required to hold capital equal to 8 per cent of the risk weighted value of assets. Additional rules applied to contingent obligations, such as letters of credit or derivatives.

MARKET RISK - RECOGNITION OF THE NEED FOR CAPITAL - AMENDMENT OF BASEL I IN 1996

With banks increasingly taking market risks, in the early 1990s, the Basel Committee decided to update



the 1988 accord to include bank capital requirements for market risk. This would have implications for non-bank securities firms. Any capital requirements the Basel Committee adopted for banks' market risk were to be incorporated into future updates of Europe's Capital Adequacy Directive (CAD) and thereby apply to Britain's non-bank securities firms. If the same framework were extended to non-bank securities firms outside Europe, then market risk capital requirements for banks, and, securities firms could be harmonized globally. In 1991, the Basel Committee entered discussions with the International Organization of Securities Commissions (IOSCO) to jointly develop such a framework. The two organizations formed a technical committee, and work commenced in January 1992.

COMMERCIAL BANKS & SECURITIES FIRMS - UNIVERSAL BANKS

Glass Steagal Act revocation in 1999 by USA: Historically, capital requirements for banks and securities firms had served different purposes.

1. Banks

Banks were primarily exposed to credit risk. They, often held illiquid portfolios of loans supported by deposits. Such loans could be liquidated rapidly only at 'fire sale' prices. This placed banks at risk of 'runs.' If depositors feared that a bank might fail, they would withdraw their deposits. Forced to liquidate its loan portfolio, the bank would succumb to staggering losses on those sales.

Though Deposit insurance and lender-of-last-resort provisions implemented eliminated the risk of bank runs, they introduced a new problem. Depositors no longer had an incentive to consider a bank's financial viability before depositing funds. Without such marketplace discipline, regulators were forced to intervene often at huge cost to the exchequer. One solution was to impose minimum capital requirements on banks. Because of the high cost of liquidating a bank, such requirements were generally based upon the value of a bank as a going concern.

Securities Firms

The primary objective behind stipulation of capital requirements for securities firms was to protect clients who might have funds or securities on deposit with a firm. Securities firms were primarily exposed to market risk. They held liquid portfolios of marketable securities supported by secured financing such as repos. A troubled firm's portfolio could be unwound quickly at market prices. For this reason, capital requirements were based upon the liquidation value of a firm.

Capital for Banks & Securities Firms

In a nutshell, banks entailed systemic risk. It was thought then that Securities firms did not. Regulators would strive to keep a troubled bank afloat but would gladly unwind a troubled securities firm. Banks needed long-term capital in the form of equity or long-term subordinated debt. Securities firms could operate with more transient capital, including short-term subordinated debt.

SEGREGATION OF BANKING BOOK & TRADING BOOK FOR HOLDING CAPITAL

In April 1993, the Basel Committee released a package of proposed amendments to the 1988 accord. This included a document proposing minimum capital requirements for banks' market risk.

- *Banks would be required to identify a trading book and hold capital for market risk under trading book and organization-wide foreign exchange exposures.*
- *Capital charges for the trading book would be based upon a crude value-at-risk (VaR) measure broadly consistent with a 10-day 95 per cent VaR metric. Similar to a VaR measure used by Europe's CAD, this partially recognized hedging effects but ignored diversification effects.*
- *Later VaR measure was changed modestly from the 1993 proposal, still reflecting a 10-day 95 per cent VaR metric. Market risk capital requirements were set equal to the greater of either the previous day's VaR, or the average VaR over the previous six days, multiplied by 3.*

BANKS TO HAVE INDEPENDENT RISK MANAGEMENT FUNCTION AND SATISFY THE REGULATOR REGARDING ITS RISK MANAGEMENT PRACTICES

The Basel Committee's new proposal was adopted in 1996 as an amendment to the 1988 accord. It is known as the 1996 amendment. It went into effect in 1998.

Let Us Sum Up

The Basel Committee published a set of minimal capital requirements for banks and distinguished between banks and securities firms. Bank assets were assigned 'risk weights'. The primary purpose of capital requirements for securities firms was to protect clients who might have funds or securities on deposit with a firm.

Keywords

International Organization, of Securities Commissions (TOSCO), Basel 1, Glass Steagall Act, Security firm, credit risk, market risk, risk weights, capital adequacy directive (CAD), deposit insurance, lender of last resort, Repos, trading book, value at risk (VaR), risk management practices

Check Your Progress

1. *In the case of Value at Risk (VaR), the -*
 - (a) *VaR at 95 per cent confidence level, implies a 5 per cent probability of incurring the loss*
 - (b) *VaR at 95 per cent confidence level, implies a 95 per cent probability of incurring the loss*
 - (c) *It is the part of investment which is at risk*
 - (d) *None of the above*

Ans. [a]
2. *'The Banking Book' includes assets and liabilities subjected to interest rate risk on their Maturities/ re-pricing.*
 - (a) *True*
 - (b) *False*

Ans. [a]
3. *The Trading Book includes all the assets that are held with intention of trading that are marketable:*
 - (a) *True*
 - (b) *False*

Ans. [a]
4. *'Run' in banking terms means*
 - (a) *Banks running for deposits*
 - (b) *If depositors feared a bank might fail, they would withdraw their deposits*
 - (c) *Depositors running after banks for best price for their investment*
 - (d) *None of the above*

Ans. [b]
5. *Security firms are primarily exposed to*
 - (a) *credit risks*
 - (b) *market risks*
 - (c) *both the above*
 - (d) *None of the above*

Ans. [b]



CONCEPT ON BASEL - II

OBJECTIVES

The objectives of this unit are to familiarize the readers with:

- *Pillar I - Minimum Capital requirement for Credit risk, Market risk and Operational risk*
- *Pillar II - Supervisory review process - Capital adequacy assessment*
- *Pillar III - Market discipline [Transparency and Disclosure requirement by banks]*

INTRODUCTION

The Basel Committee replaced the 1988 accord (amended in 1996 and adopted in 1998) in April 2006. This has been dubbed Basel II. It includes more sophisticated treatment of credit risk. Basel II also addressed 'Operational risk', among other things.

BASEL I WAS BASED ON UNIFORM ASSESSMENT METHODOLOGY FOR CAPITAL ADEQUACY

Basel II is based on 3 pillars as mentioned below: Pillar - I Minimum Capital requirements

Pillar - II Supervisory Review Process

Pillar - III Market Discipline

PILLAR - I MINIMUM CAPITAL REQUIREMENTS

A bank will have to determine the proportion of its capital that it must keep in reserve based on this calculation:

$$\frac{\text{Total Capital (Unchanged)}}{\text{Credit Risk+Market Risk+Operational Risk}} = \text{The Bank's Capital Ratio nor} = 8\%$$

[9% for India]

Credit risk capital is for 'Banking book'.

Market risk Capital is for 'Trading book'.

Operational risk - New rules introduced for Basel II

Market Risk Capital is for 'Trading book'.

Operational risk- New rules introduced for Basel II

PILLAR - II SUPERVISORY REVIEW PROCESS

Pillar II seeks to enhance the link between institution's [bank's] risk profile, its risk management and risk mitigation systems and its capital

Banks must ensure that they have a process in place to make sure that they hold adequate capital consistent with their risk profile and strategy.

The Internal Capital Adequacy Assessment Process [ICAAP] is the responsibility of the bank and they should own, develop and manage their risk management processes.

PILLAR - III MARKET DISCIPLINE [TRANSPARENCY & DISCLOSURES]

This sets out the 'minimum disclosure requirements for external reporting. A bank is expected to be transparent. It should disclose various information relating to its financial aspects including its risks at periodical intervals.

COMPARISON BETWEEN BASEL I AND BASEL

Introduction: In the previous paragraphs we have given the highlights of Basel I and Basel II. In this chapter we compare the two for better understanding.

Comparison between Basel I and Basel II

Basel - I (1988 and amended in 1996) – Based on Methodology for Capital Adequacy Basel - II (to be in place by 2006 in G-10)	Basel - II (to be in place by 2006 in G-10 countries and in India in 2008) - Basel II based on 3 pillars
1. Capital adequacy based on 'Risk Weighted Assets'	1. Capital adequacy based on 'Risk Weighted Assets'
2. Not risk sensitive. Prescriptive.	2. Risk sensitive.
3. All credit exposures carried risk weight of 100 per cent - except for some sovereign exposures and mortgages	3. Credit exposures carry risk weights based on credit qualities.
4. Risk Capital = Credit exposure * Risk Weights * 8 per cent	4. Risk capital: Similar to Basel I. But efficient Banks can have lesser capital than others
Implications were • Every bank had to maintain same 8 per cent capital. Thus Banks with good quality assets had no incentives. As a result credit quality had to be lowered to increase returns • Low rated exposures were subsidized by high rated exposures • No provision for economic pricing by banks	Implications are • Banks with good quality assets have incentives because they can manage with lower capital • Better quality assets requires lesser capital • Risk pricing can be done by banks based on credit risk perception • Provision exists for economic pricing by banks

Let Us Sum Up

Basel II introduced in 2006 brought in a new concept - 'Operational risk'. Basel II also introduced the idea of 3 pillars for assessing and ensuring capital adequacy of banks.

Basel II was implemented from 2006 in G-10 countries. It was implemented in India in 2008.

Keywords

Pillars, Operational risk, minimum capital requirement, Transparency, Capital Ratio, Internal Capital Adequacy Assessment Process [ICAAP], Capital adequacy, Risk weighted assets, Risk capital.

Check Your Progress

- Basel II is based on 3 pillars. The 3 pillars are
 - Minimum Capital requirements, Supervisory Review Process and Market Discipline
 - Transparency, minimum disclosures and financial aspects
 - Banks. Credit risk. Operational risk
 - None of the above

Ans. [a]



2. The minimum capital adequacy ratio for India is

- (a) Higher than prescribed by Basel H
- (b) Same as for other countries
- (c) Lower than suggested by Basel II
- (d) None of the above

Ans. [a]

3. 1CAAP is a Supervisory review process for Capital adequacy assessment. This process is to be periodically done by

- (a) The Central Bank of a country
- (b) The Bank itself which is required to ensure its own capital adequacy
- (c) The auditors

Ans. [b]

4. Credit exposures carry risk weights based on credit quality as per

- (a) Basel I
- (b) Basel II

Ans. [b]

Study Note - 7

LAWS RELATED TO POWER SECTOR



This Study Note includes

7.1 The Indian Electricity Act, 1910

7.1 THE INDIAN ELECTRICITY ACT 1910

ABSTRACT

The Indian Electricity Sector has gone through a lot of metamorphosis. The three major acts concerning the electricity sector were the Indian Electricity Act, 1910, the Electricity (Supply) Act, 1948 and the Electricity Regulatory Commissions Act, 1998. With the changing times many of the acts had become passé and thus had to be reviewed. The Electricity Act 2003, enacted by the Parliament of India, received the President's assent on 26 May 2003 and came in to force on June 10, 2003. The main aim of the Act was to consolidate the laws relating to generation, transmission, distribution, trading and use of electricity and generally for taking measures conducive to development of electricity industry, promoting competition therein, protecting interest of consumers and supply of electricity to all areas, rationalisation of electricity tariff, ensuring transparent policies regarding subsidies, promotion of efficient and environmentally benign policies constitution of Central Electricity Authority, Regulatory Commissions and establishment of Appellate Tribunal and for matters connected therewith or incidental thereto. However even after many deliberations there are some major issues that were overlooked. They need to be addressed promptly so that the power sector can be truly the engine of growth for the Indian Economy. This paper will briefly try to point out the troublesome issues and will try to suggest remedial measures.

Introduction:

Electricity is one of the key inputs for the overall socio-economic development of the country. The basic responsibility of the power supply industry is to provide adequate electricity at economic cost, while ensuring reliability and quality of the supply. Despite significant progress in capacity addition since Independence, the demand for electricity continues to outstrip the supply with the result that energy and peaking shortages continue to plague the economy. With the increasing pace of economic development facilitated by the reforms initiated by the Government, the demand for power in both rural and urban areas is likely to increase rapidly in the coming years. The major task of the power sector will, therefore, be to ensure that the anticipated demand is met adequately and in a reliable and cost-effective manner.

The power sector is currently witnessing a critical phase. State Electricity Boards (SEBs) are responsible for providing electricity to the people. Most of the SEBs are cash strapped. They are not even able to earn a minimum Rate of Return (RoR) of 3% on their net fixed assets in servicing after providing for depreciation and interest charges in accordance with Section 59 of the Electricity (Supply) Act, 1948. The power sector in the country has accumulated a huge deficit, due to Central Power Generating Companies because of the deteriorating financial performance. The structure of the electricity industry in independent India was laid down by the Electricity (Supply) Act, 1948 that created the State Electricity Boards (SEBs). In their initial years, the SEBs performed yeomen service in carrying electric power everywhere, but over the years they have become unsustainable, thanks to their mismanagement and politicisation coupled with the economic and technological developments

of the past decade. It is high time that the electricity industry is denationalised, and restructured on commercial principles. Even though, the legal framework was amended in 1998 to facilitate private investment in generation and transmission, respectively, it enabled private entities to sell or transmit power only through long-term contracts with state-owned entities. Such contract-driven privatisation through state-owned monopolies can have little chance of enduring success. Similarly, the setting up of regulatory commissions under the 1998 Act, though a welcome move, only had a limited impact on the state-owned monopolies. It should surprise no one that these piecemeal changes in the name of reform have not been able to arrest the deterioration of this industry.

To overcome these teething problems that the sector faces, The Electricity Act, 2003 (referred to as The Act from here on) was introduced in the Indian parliament after a lot of political debate. The Act came into force (except for section 121) on June 10, 2003 is stated to be the 'distilled wisdom' of a series of commissioned international and national consultancy studies and seminars and conferences held at the all-India level during the last three years. It replaces the three existing legislations, namely, Indian Electricity Act, 1910, the Electricity (Supply) Act, 1948 and the Electricity Regulatory Commissions Act, 1998. The objectives of the Act are to consolidate the laws relating to generation, transmission, distribution, trading and use of electricity and generally for taking measures conducive to development of electricity industry, promoting competition therein, protecting interest of consumers and supply of electricity to all areas, rationalization of electricity tariff, ensuring transparent policies regarding subsidies, promotion of efficient and environmentally benign policies, constitution of Central Electricity Authority, Regulatory Commissions and establishment of Appellate Tribunal. It is acclaimed to be the roadmap for the electricity industry, which will help hasten the pace of economic reforms in the country. When the Bill on this subject was under consideration of the standing committee of parliament, a number of issues deserved closer examination. Several of these remain unattended. The Act, which is a halfway house, raises a number of new issues, which are likely to pose serious problems in the coming years.

The new Act seeks to free up distribution, the main stumbling block in the development of India's power sector. The Act brings together laws on generation, transmission, distribution, trading and use of electricity, liberalising generation, transmission and distribution and providing for penal action for theft of power or default on payment for power consumed. Captive plants have far greater freedom under the Act. Consumers are allowed to form bulk-purchasing groups and buy power directly from generating companies, traders or distribution companies. Non-government organisations, local bodies and user organisations too can distribute power in non-urban areas, purchasing power from the supplier of their choice. Open access has been permitted in transmission. Additional, limited open access has been provided for in the case of distribution as well, although the extent of actual competition in distribution will depend on the quality of state level regulation. The Act also seeks to set up an appellate tribunal to hear complaints against the central and state level regulatory commissions and to exercise general supervision and control over these bodies.

The present paper will identify the major features of the act and will point out the major shortcomings of the Act. The first section is the introduction. The Second section deals with power generation scenario, which will look at the major development in the electricity sector over the years. The third section looks at the salient features of the act. The fourth section will look at the regulation aspect and point out some of its shortcomings in the act. The fifth section is divided in two parts wherein the first section i.e. 5.1 will look at the Open Access. The second section i.e. 5.2 will look at the implications of the act for the electricity sector. The last section is the conclusion, which will summarise the paper and put forward some issues that need to be addressed.

THE ELECTRICITY ACT, 2003

An Act to consolidate the laws relating to generation, transmission, distribution, trading and use of electricity and generally for taking measures conducive to development of electricity industry, promoting competition therein, protecting interest of consumers and supply of electricity to all areas, rationalisation of electricity tariff, ensuring transparent policies regarding subsidies, promotion of efficient and environmentally benign policies constitution of Central Electricity Authority, Regulatory



Commissions and establishment of Appellate Tribunal and for matters connected therewith or incidental thereto.

Be it enacted by Parliament in the Fifty- fourth Year of the Republic of India as follows: -

Short title, extent and commencement [Section 1]

- (1) This Act may be called the Electricity (Amendment) Act, 2007.
- (2) It extends to the whole of India except the State of Jammu and Kashmir.
- (3) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint.

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

Definitions [Section 2]

In this Act, unless the context otherwise requires,

- (1) "Appellate Tribunal" means the Appellate Tribunal for Electricity established under section 110;
- (2) "appointed date" means such date as the Central Government may, by notification, appoint;
- (3) "area of supply" means the area within which a distribution licensee is authorised by his licence to supply electricity;
- (4) "Appropriate Commission" means the Central Regulatory Commission referred to in sub-section (1) of section 76 or the State Regulatory Commission referred to in section 82 or the Joint Commission referred to in section 83, as the case may be ;
- (5) "Appropriate Government" means, -
 - (a) the Central Government, -
 - (i) in respect of a generating company wholly or partly owned by it;
 - (ii) in relation to any inter-State generation, transmission, trading or supply of electricity and with respect to any mines, oil-fields, railways, national highways, airports, telegraphs, broadcasting stations and any works of defence, dockyard, nuclear power installations;
 - (iii) in respect of National Load Despatch Centre; and Regional Load Despatch Centre;
 - (iv) in relation to any works or electric installation belonging to it or under its control ;
 - (b) in any other case, the State Government, having jurisdiction under this Act;
- (6) "Authority "means the Central Electricity Authority referred to in sub-section (1) of section 70;
- (7) "Board" means, a State Electricity Board, constituted before the commencement of this Act, under sub-section (1) of section 5 of the 3 commencement of this Act, under sub-section (1) of section 5 of the Electricity (Supply) Act, 1948;
- (8) "Captive generating plant" means a power plant set up by any person to generate electricity primarily for his own use and includes a power plant set up by any co-operative society or association of persons for generating electricity primarily for use of members of such cooperative society or association;
- (9) "Central Commission" means the Central Electricity Regulatory Commission referred to in sub-section (1) of section 76;

- (10) "Central Transmission Utility" means any Government company which the Central Government may notify under sub-section (1) of section 38;
- (11) "Chairperson" means the Chairperson of the Authority or Appropriate Commission or the Appellate Tribunal as the case may be;
- (12) "Cogeneration" means a process which simultaneously produces two or more forms of useful energy (including electricity);
- (13) "company" means a company formed and registered under the Companies Act, 1956 and includes anybody corporate under a Central, State or Provincial Act;
- (14) "Conservation" means any reduction in consumption of electricity as a result of increase in the efficiency in supply and use of electricity;
- (15) "consumer" means any person who is supplied with electricity for his own use by a licensee or the Government or by any other person engaged in the business of supplying electricity to the public under this Act or any other law for the time being in force and includes any person whose premises are for the time being connected for the purpose of receiving electricity with the works of a licensee, the Government or such other person, as the case may be;
- (16) "Dedicated Transmission Lines " means any electric supply line for point to point transmission which are required for the purpose of connecting electric lines or electric plants of a captive generating plant referred to in section 9 or generating station referred to in section 10 to any transmission lines or sub-stations or generating stations or the load centre, as the case may be;
- (17) "Distribution licensee" means a licensee authorised to operate and maintain a distribution system for supplying electricity to the consumers in his area of supply;
- (18) "distributing main" means the portion of any main with which a service line is, or is intended to be, immediately connected;
- (19) "distribution system" means the system of wires and associated facilities between the delivery points on the transmission lines or the generating station connection and the point of connection to the installation of the consumers;
- (20) "Electric line" means any line which is used for carrying electricity for any purpose and includes
 - (a) any support for any such line, that is to say, any structure, tower, pole or other thing in, on, by or from which any such line is, or may be, supported, carried or suspended; and
 - (b) any apparatus connected to any such line for the purpose of carrying electricity;
- (21) "Electrical Inspector" means a person appointed as such by the Appropriate Government under sub-section (1) of section 162 and also includes Chief Electrical Inspector;
- (22) "electrical plant" means any plant, equipment, apparatus or appliance or any part thereof used for, or connected with, the generation, transmission, distribution or supply of electricity but does not include-
 - (a) An electric line; or
 - (b) A meter used for ascertaining the quantity of electricity supplied to any premises; or
 - (c) An electrical equipment, apparatus or appliance under the control of a consumer;
- (23) "Electricity" means electrical energy-
 - (a) Generated, transmitted, supplied or traded for any purpose; or
 - (b) Used for any purpose except the transmission of a message; 1 of 1956
- (24) "Electricity Supply Code" means the Electricity Supply Code specified under section 50;



- (25) "electricity system" means a system under the control of a generating company or licensee, as the case may be, having one or more -
- (a) Generating stations; or
 - (b) Transmission lines; or
 - (c) Electric lines and sub-stations; and when used in the context of a State or the Union, the entire electricity system within the territories thereof;
- (26) "Electricity trader" means a person who has been granted a licence to undertake trading in electricity under section 12;
- (27) "franchisee" means a person authorised by a distribution licensee to distribute electricity on its behalf in a particular area within his area of supply;
- (28) "generating company" means any company or body corporate or association or body of individuals, whether incorporated or not, or artificial juridical person, which owns or operates or maintains a generating station;
- (29) "generate" means to produce electricity from a generating station for the purpose of giving supply to any premises or enabling a supply to be so given;
- (30) "generating station" or "station" means any station for generating electricity, including any building and plant with step-up transformer, switch yard, switch-gear, cables or other appurtenant equipment, if any used for that purpose and the site thereof, a site intended to be used for a generating station, and any building used for housing the operating staff of a generating station, and where electricity is generated by water-power, includes penstocks, head and tail works, main and regulating reservoirs, dams and other hydraulic works, but does not in any case include any sub-station;
- (31) "Government company" shall have the meaning assigned to it in section 617 of the Companies Act, 1956;
- (32) "grid" means the high voltage backbone system of inter-connected transmission lines, sub-stations and generating plants;
- (33) "Grid Code" means the Grid Code specified by the Central Commission under clause (h) of sub-section (1) of section 79;
- (34) "Grid Standards" means the Grid Standards specified under clause (d) of section 73 by the Authority;
- (35) "high voltage line" means an electric line or cable of a nominal voltage as may be specified by the Authority from time to time;
- (36) "inter-State transmission system" includes -
- (i) any system for the conveyance of electricity by means of main transmission line from the territory of one State to another State;
 - (ii) the conveyance of electricity across the territory of an intervening State as well as conveyance within the State which is incidental to such inter-State transmission of electricity;
 - (iii) The transmission of electricity within the territory of a State on a system built, owned, operated, maintained or controlled by Central Transmission Utility.
- (37) "intra-State transmission system" means any system for transmission of electricity other than an inter-State transmission system ;
- (38) "licence" means a licence granted under section 14;

- (39) “ licensee “ means a person who has been granted a licence under section 14;
- (40) “line” means any wire, cable, tube , pipe, insulator, conductor or other similar thing (including its casing or coating) which is designed or adapted for use in carrying electricity and includes any line which surrounds or supports, or is surrounded or supported by or is installed in close proximity to, or is supported, carried or suspended in association with, any such line;
- (41) “local authority” means any Nagar Panchayat, Municipal Council, municipal corporation, panchayat constituted at the village, intermediate and district levels, body or port commissioners or other authority legally entitled to, or entrusted by the Union or any State Government with, the control or management of any area or local fund;
- (42) “main” means any electric supply-`` line through which electricity is, or is intended to be, supplied ;
- (43) “Member” means the Member of the Appropriate Commission or Authority or Joint Commission, or the Appellate Tribunal, as the case may be, and includes the Chairperson of such Commission or 6 may be, and includes the Chairperson of such Commission or Authority or appellate tribunal;
- (44) “National Electricity Plan” means the National Electricity Plan notified under sub-section (4) of section 3;
- (45) “National Load Despatch Centre” means the Centre established under sub-section (1) of section 26;
- (46) “notification” means notification published in the Official Gazette and the expression “ notify” shall be construed accordingly;
- (47) “open access” means the non-discriminatory provision for the use of transmission lines or distribution system or associated facilities with such lines or system by any licensee or consumer or a person engaged in generation in accordance with the regulations specified by the Appropriate Commission;
- (48) “overhead line” means an electric line which is placed above the ground and in the open air but does not include live rails of a traction system;
- (49) “person” shall include any company or body corporate or association or body of individuals, whether incorporated or not, or artificial juridical person;
- (50) “power system” means all aspects of generation, transmission, distribution and supply of electricity and includes one or more of the following, namely:-
 - (a) generating stations;
 - (b) transmission or main transmission lines;
 - (c) sub-stations;
 - (d) tie-lines;
 - (e) load despatch activities;
 - (f) mains or distribution mains;
 - (g) electric supply-lines;
 - (h) overhead lines;
 - (i) service lines;
 - (j) works;
- (51) “premises” includes any land, building or structure;



- (52) "prescribed" means prescribed by rules made by the Appropriate Government under this Act; 7
- (53) "public lamp" means an electric lamp used for the lighting of any street;
- (54) "real time operation" means action to be taken at a given time at which information about the electricity system is made available to the concerned Load Despatch Centre;
- (55) "Regional Power Committee" means a committee established by resolution by the Central Government for a specified region for facilitating the integrated operation of the power systems in that region;
- (56) "Regional Load Despatch Centre" means the centre established under sub-section (1) of section 27;
- (57) "regulations" means regulations made under this Act;
- (58) "repealed laws" means the Indian Electricity Act, 1910, the Electricity (Supply) Act, 1948 and the Electricity Regulatory Commissions Act, 1998 repealed by section 185;
- (59) "rules " means rules made under this Act;
- (60) "schedule" means the schedule to this Act;
- (61) "service-line" means any electric supply line through which electricity is, or is intended to be, supplied -
 - (a) to a single consumer either from a distributing main or immediately from the Distribution Licensee's premises; or
 - (b) from a distributing main to a group of consumers on the same premises or on contiguous premises supplied from the same point of the distributing main;
- (62) "specified" means specified by regulations made by the Appropriate Commission or the Authority, as the case may be, under this Act;
- (63) "stand alone system" means the electricity system set up to generate power and distribute electricity in a specified area without connection to the grid;
- (64) "State Commission" means the State Electricity Regulatory Commission constituted under sub-section (1) of section 82 and includes a Joint Commission constituted under sub-section (1) of section 83;
- (65) "State Grid Code" means the State Grid Code referred under clause (h) of sub-section (1) of section 86;
- (66) "State Load Despatch Centre" means the centre established under subsection (1) of section 31;
- (67) "State Transmission Utility" means the Board or the Government company specified as such by the State Government under sub-section (1) of section 39;
- (68) "street" includes any way, road, lane, square, court, alley, passage or open space, whether a thoroughfare or not, over which the public have a right of way, and also the roadway and footway over any public bridge or causeway;
- (69) "sub-station" means a station for transforming or converting electricity for the transmission or distribution thereof and includes transformers, converters, switchgears, capacitors, synchronous condensers, structures, cable and other appurtenant equipment and any buildings used for that purpose and the site thereof;
- (70) "supply", in relation to electricity, means the sale of electricity to a licensee or consumer;
- (71) "trading" means purchase of electricity for resale thereof and the expression "trade" shall be construed accordingly;

- (72) "transmission lines" means all high pressure cables and overhead lines (not being an essential part of the distribution system of a licensee) transmitting electricity from a generating station to another generating station or a sub-station, together with any step-up and step-down transformers, switch-gear and other works necessary to and used for the control of such cables or overhead lines, and such buildings or part thereof as may be required to accommodate such transformers, switchgear and other works;
- (73) "transmission licensee" means a licensee authorised to establish or operate transmission lines;
- (74) "transmit" means conveyance of electricity by means of transmission lines and the expression "transmission" shall be construed accordingly;
- (75) "utility" means the electric lines or electrical plant, and includes all lands, buildings, works and materials attached thereto belonging to any person acting as a generating company or licensee under the provisions of this Act;
- (76) "wheeling" means the operation whereby the distribution system and associated facilities of a transmission licensee or distribution licensee, as the case may be, are used by another person for the conveyance of electricity on payment of charges to be determined under section 62;
- (77) "works" includes electric line, and any building, plant, machinery, apparatus and any other thing of whatever description required to transmit, distribute or supply electricity to the public and to carry into effect the objects of a licence or sanction granted under this Act or any other law for the time being in force.

NATIONAL ELECTRICITY POLICY AND PLAN

National Electricity policy and plan [Section 3]

- (1) The Central Government shall, from time to time, prepare the national electricity policy and tariff policy, in consultation with the State Governments and the Authority for development of the power system based on optimal utilisation of resources such as coal, natural gas, nuclear substances or materials, hydro and renewable sources of energy.
- (2) The Central Government shall publish National Electricity Policy and tariff policy from time to time.
- (3) The Central Government may, from time to time, in consultation with the State Governments and the Authority, review or revise, the National Electricity Policy and tariff policy referred to in sub-section (1).
- (4) The Authority shall prepare a National Electricity Plan in accordance with the National Electricity Policy and notify such plan once in five years:

Provided that the Authority in preparing the National Electricity Plan shall publish the draft National Electricity Plan and invite suggestions and objections thereon from licensees, generating companies and the public within such time as may be prescribed:

Provided further that the Authority shall -

- (a) notify the plan after obtaining the approval of the Central Government;
 - (b) revise the plan incorporating therein the directions, if any, given by the Central Government while granting approval under clause (a).
- (5) The Authority may review or revise the National Electricity Plan in accordance with the National Electricity Policy.

National policy on standalone systems for rural areas and non-conventional energy systems [Section 4]

The Central Government shall, after consultation with the State Governments, prepare and notify a national policy, permitting stand alone systems (including those based on renewable sources of energy and non-conventional sources of energy) for rural areas.



National policy on electrification and local distribution in rural areas [Section 5]

The Central Government shall also formulate a national policy, in consultation with the State Governments and the State Commissions, for rural electrification and for bulk purchase of power and management of local distribution in rural areas through Panchayat Institutions, users' associations, co-operative societies, non- Governmental organisations or franchisees.

Joint responsibility of State Government and Central Government in rural electrification [Section 6]

The concerned State Government and the Central Government shall jointly endeavour to provide access to electricity to all areas including villages and hamlets through rural electricity infrastructure and electrification of households.

Generation Company and requirement for setting up of generating station [Section 7]

Any generating company may establish, operate and maintain a generating station without obtaining a licence under this Act if it complies with the technical standards relating to connectivity with the grid referred to in clause (b) of section 73.

Hydro- electric generation [Section 8]

- (1) Notwithstanding anything contained in section 7, any generating company intending to set-up a hydro-generating station shall prepare and submit to the Authority for its concurrence, a scheme estimated to involve a capital expenditure exceeding such sum, as may be fixed by the Central Government, from time to time, by notification.
- (2) The Authority shall, before concurring in any scheme submitted to it under sub-section (1) have particular regard to, whether or not in its opinion,-
 - (a) the proposed river-works will prejudice the prospects for the best ultimate development of the river or its tributaries for power generation, consistent with the requirements of drinking water, irrigation, navigation, flood-control, or other public purposes, and for this purpose the Authority shall satisfy itself, after consultation with the State Government, the Central Government, or such other agencies as it may deem appropriate, that an adequate study has been made of the optimum location of dams and other river-works;
 - (b) the proposed scheme meets, the norms regarding dam design and safety.
- (3) Where a multi-purpose scheme for the development of any river in any region is in operation, the State Government and the generating company shall co-ordinate their activities with the activities of the person responsible for such scheme in so far as they are inter-related.

Captive Generation [Section 9]

- (1) Notwithstanding anything contained in this Act, a person may construct, maintain or operate a captive generating plant and dedicated transmission lines:

Provided that the supply of electricity from the captive generating plant through the grid shall be regulated in the same manner as the generating station of a generating company.

Provided further that no licence shall be required under this Act for supply of electricity generated from a captive generating plant to any licensee in accordance with the provisions of this Act and the rules and regulations made thereunder and to any consumer subject to the regulations made under sub-section (2) of section 42.
- (2) Every person, who has constructed a captive generating plant and maintains and operates such plant, shall have the right to open access for the purposes of carrying electricity from his captive generating plant to the destination of his use:

Provided that such open access shall be subject to availability of adequate transmission facility and such availability of transmission facility shall be determined by the Central Transmission Utility or the State Transmission Utility, as the case may be:

Provided further that any dispute regarding the availability of transmission facility shall be adjudicated upon by the Appropriate Commission.

Duties of Generating Companies [Section 10]

- (1) Subject to the provisions of this Act, the duties of a generating company shall be to establish, operate and maintain generating stations, tie-lines, sub-stations and dedicated transmission lines connected therewith in accordance with the provisions of this Act or the rules or regulations made thereunder.
- (2) A generating company may supply electricity to any licensee in accordance with this Act and the rules and regulations made thereunder and may, subject to the regulations made under sub-section (2) of section 42, supply electricity to any consumer.
- (3) Every generating company shall -
 - (a) submit technical details regarding its generating stations to the Appropriate Commission and the Authority;
 - (b) co-ordinate with the Central Transmission Utility or the State Transmission Utility, as the case may be, for transmission of the electricity generated by it.

Direction to generating companies [Section 11]

- (1) The Appropriate Government may specify that a generating company shall, in extraordinary circumstances operate and maintain any generating station in accordance with the directions of that Government.

Explanation.- For the purposes of this section, the expression “ extraordinary circumstances” means circumstances arising out of threat to security of the State, public order or a natural calamity or such other circumstances arising in the public interest.

- (2) The Appropriate Commission may offset the adverse financial impact of the directions referred to in sub-section (1) on any generating company in such manner as it considers appropriate.

Authorised persons to transmit, supply, etc., electricity [Section 12]

- (a) transmit electricity; or
- (b) distribute electricity; or
- (c) undertake trading in electricity,

unless he is authorised to do so by a licence issued under section 14, or is exempt under section 13.

Power to exempt [Section 13]

The Appropriate Commission may, on the recommendations, of the Appropriate Government, in accordance with the national policy formulated under section 5 and in public interest, direct, by notification that subject to such conditions and restrictions, if any, and for such period or periods, as may be specified in the notification, the provisions of section 12 shall not apply to any local authority, Panchayat Institution, users’ association, co-operative societies, nongovernmental organizations, or franchisees:

Grant of Licence [Section 14]

The Appropriate Commission may, on application made to it under section 15, grant any person licence to any person -

- (a) to transmit electricity as a transmission licensee; or
- (b) to distribute electricity as a distribution licensee; or



- (c) to undertake trading in electricity as an electricity trader, in any area which may be specified in the licence:

Provided that any person engaged in the business of transmission or supply of electricity under the provisions of the repealed laws or any Act specified in the Schedule on or before the appointed date shall be deemed to be a licensee under this Act for such period as may be stipulated in the licence, clearance or approval granted to him under the repealed laws or such Act specified in the Schedule, and the provisions of the repealed laws or such Act specified in the Schedule in respect of such licence shall apply for a period of one year from the date of commencement of this Act or such earlier period as may be specified, at the request of the licensee, by the Appropriate Commission and thereafter the provisions of this Act shall apply to such business:

Provided further that the Central Transmission Utility or the State Transmission Utility shall be deemed to be a transmission licensee under this Act:

Provided also that in case an Appropriate Government transmits electricity or distributes electricity or undertakes trading in electricity, whether before or after the commencement of this Act, such Government shall be deemed to be a licensee under this Act, but shall not be required to obtain a licence under this Act:

Provided also that the Damodar Valley Corporation, established under sub-section (1) of section 3 of the Damodar Valley Corporation Act, 1948, shall be deemed to be a licensee under this Act but shall not be required to obtain a licence under this Act and the provisions of the Damodar Valley Corporation Act, 1948, in so far as they are not inconsistent with the provisions of this Act, shall continue to apply to that Corporation:

Provided also that the Government company or the company referred to in sub-section (2) of section 131 of this Act and the company or companies created in pursuance of the Acts specified in the Schedule, shall be deemed to be a licensee under this Act:

Provided also that the Appropriate Commission may grant a licence to two or more persons for distribution of electricity through their own distribution system within the same area, subject to the conditions that the applicant for grant of licence within the same area shall, without prejudice to the other conditions or requirements under this Act, comply with the additional requirements (including the capital adequacy, credit-worthiness, or code of conduct) as may be prescribed by the Central Government, and no such applicant who complies with all the requirements for grant of licence, shall be refused grant of licence on the ground that there already exists a licensee in the same area for the same purpose:

Provided also that in a case where a distribution licensee proposes to undertake distribution of electricity for a specified area within his area of supply through another person, that person shall not be required to obtain any separate licence from the concerned State Commission and such distribution licensee shall be responsible for distribution of electricity in his area of supply:

Provided also that where a person intends to generate and distribute electricity in a rural area to be notified by the State Government, such person shall not require any licence for such generation and distribution of electricity, but he shall comply with the measures which may be specified by the Authority under section 53:

Provided also that a distribution licensee shall not require a licence to undertake trading in electricity.

Procedure for Grant of Licence [Section 15]

- (1) Every application under section 14 shall be made in such form and in such manner as may be specified by the Appropriate Commission and shall be accompanied by such fee as may be prescribed.
- (2) Any person who has made an application for grant of licence shall, within seven days after

making such application, publish a notice of his application with such particulars and in such manner as may be specified and a licence shall not be granted -

- (i) until the objections, if any, received by the Appropriate Commission in response to publication of the application have been considered by it:

Provided that no objection shall be so considered unless it is received before the expiration of thirty days from the date of the publication of such notice as aforesaid;

- (ii) until, in the case of an application for a licence for an area including the whole or any part of any cantonment, aerodrome, fortress, arsenal, dockyard or camp or of any building or place in the occupation of the Government for defence purposes, the Appropriate Commission has ascertained that there is no objection to the grant of the licence on the part of the Central Government.

- (3) A person intending to act as a transmission licensee shall, immediately on making the application, forward a copy of such application to the Central Transmission Utility or the State Transmission Utility, as the case may be.

- (4) The Central Transmission Utility or the State Transmission Utility, as the case may be, shall, within thirty days after the receipt of the copy of the application referred to in sub-section (3), send its recommendations, if any, to the Appropriate Commission:

Provided that such recommendations shall not be binding on the Commission.

- (5) Before granting a licence under section 14, the Appropriate Commission shall

- (a) publish a notice in two such daily newspapers, as that Commission may consider necessary, stating the name of the person to whom it proposes to issue the licence;
- (b) consider all suggestions or objections and the recommendations, if any, of the Central Transmission Utility or State Transmission Utility, as the case may be.

- (6) Where a person makes an application under sub-section (1) of section 14 to act as a licensee, the Appropriate Commission shall, as far as practicable, within ninety days after receipt of such application, -

- (a) issue a licence subject to the provisions of this Act and the rules and regulations made thereunder; or
- (b) reject the application for reasons to be recorded in writing if such application does not conform to the provisions of this Act or the rules and regulations made thereunder or the provisions of any other law for the time being in force:

Provided that no application shall be rejected unless the applicant has been given an opportunity of being heard.

- (7) The Appropriate Commission shall, immediately after issue of licence, forward a copy of the licence to the Appropriate Government, Authority, local authority, and to such other person as the Appropriate Commission considers necessary.

- (8) A licence shall continue to be in force for a period of twenty five years unless such licence is revoked.

Conditions of licence [Section 16]

The Appropriate Commission may specify any general or specific conditions which shall apply either to a licensee or class of licensees and such conditions shall be deemed to be conditions of such licence:

Provided that the Appropriate Commission shall, within one year from the appointed date, specify any general or specific conditions of licence applicable to the licensees referred to in the first, second,



third, fourth and fifth provisos to section 14 after the expiry of one year from the commencement of this Act.

Licensee not to do certain things [Section 17]

- (1) No licensee shall, without prior approval of the Appropriate Commission, -
 - (a) undertake any transaction to acquire by purchase or takeover or otherwise, the utility of any other licensee; or
 - (b) merge his utility with the utility of any other licensee:
Provided that nothing contained in this sub-section shall apply if the utility of the licensee is situate in a State other than the State in which the utility referred to in clause (a) or clause (b) is situate.
- (2) Every licensee shall, before obtaining the approval under subsection (1), give not less than one month's notice to every other licensee who transmits or distributes, electricity in the area of such licensee who applies for such approval.
- (3) No licensee shall at any time assign his licence or transfer his utility, or any part thereof, by sale, lease, exchange or otherwise without the prior approval of the Appropriate Commission.
- (4) Any agreement relating to any transaction specified in subsection (1) or sub-section (3), unless made with, the prior approval of the Appropriate Commission, shall be void.

Amendment of licence [Section 18]

- (1) Where in its opinion the public interest so permits, the Appropriate Commission, may, on the application of the licensee or otherwise, make such alterations and amendments in the terms and conditions of a licence as it thinks fit:
Provided that no such alterations or amendments shall be made except with the consent of the licensee unless such consent has, in the opinion of the Appropriate Commission, been unreasonably withheld.
- (2) Before any alterations or amendments in the licence are made under this section, the following provisions shall have effect, namely: -
 - (a) where the licensee has made an application under sub-section (1) proposing any alteration or modifications in his licence, the licensee shall publish a notice of such application with such particulars and in such manner as may be specified;
 - (b) in the case of an application proposing alterations or modifications in the area of supply comprising the whole or any part of any cantonment, aerodrome, fortress, arsenal, dockyard or camp or of any building or place in the occupation of the Government for defence purposes, the Appropriate Commission shall not make any alterations or modifications except with the consent of the Central Government;
 - (c) where any alterations or modifications in a licence are proposed to be made otherwise than on the application of the licensee, the Appropriate Commission shall publish the proposed alterations or modifications with such particulars and in such manner as may be specified;
 - (d) the Appropriate Commission shall not make any alterations or modification unless all suggestions or objections received within thirty days from the date of the first publication of the notice have been considered.

Revocation of licence [Section 19]

- (1) If the Appropriate Commission, after making an enquiry, is satisfied that public interest so requires, it may revoke a licence in any of the following cases, namely: -

- (a) where the licensee, in the opinion of the Appropriate Commission, makes wilful and prolonged default in doing anything required of him by or under this Act or the rules or regulations made thereunder;
 - (b) where the licensee breaks any of the terms or conditions of his licence the breach of which is expressly declared by such licence to render it liable to revocation;
 - (c) where the licensee fails, within the period fixed in this behalf by his licence, or any longer period which the Appropriate Commission may have granted therefor –
 - (i) to show, to the satisfaction of the Appropriate Commission, that he is in a position fully and efficiently to discharge the duties and obligations imposed on him by his licence; or and obligations imposed on him by his licence; or
 - (ii) to make the deposit or furnish the security, or pay the fees or other charges required by his licence;
 - (d) where in the opinion of the Appropriate Commission the financial position of the licensee is such that he is unable fully and efficiently to discharge the duties and obligations imposed on him by his licence.
- (2) Where in its opinion the public interest so requires, the Appropriate Commission may, on application, or with the consent of the licensee, revoke his licence as to the whole or any part of his area of distribution or transmission or trading upon such terms and conditions as it thinks fit.
 - (3) No licence shall be revoked under sub-section (1) unless the Appropriate Commission has given to the licensee not less than three months' notice, in writing, stating the grounds on which it is proposed to revoke the licence, and has considered any cause shown by the licensee within the period of that notice, against the proposed revocation.
 - (4) The Appropriate Commission may, instead of revoking a licence under sub-section (1), permit it to remain in force subject to such further terms and conditions as it thinks fit to impose, and any further terms or conditions so imposed shall be binding upon and be observed by the licensee and shall be of like force and effect as if they were contained in the licence.
 - (5) Where the Commission revokes a licence under this section, it shall serve a notice of revocation upon the licensee and fix a date on which the revocation shall take effect.
 - (6) Where an Appropriate Commission has given notice for revocation of licence under sub-section (5), without prejudice to any penalty which may be imposed or prosecution proceeding which may be initiated under this Act, the licensee may, after prior approval of that Commission, sell his utility to any person who is found eligible by that Commission for grant of licence.

Sale of utilities of licensees [Section 20]

- (1) Where the Appropriate Commission revokes under section 19 the licence of any licensee, the following provisions shall apply, namely:-
 - (a) the Appropriate Commission shall invite applications for acquiring the utility of the licensee whose licence has been revoked and determine which of such applications should be accepted, primarily on the basis of the highest and best price offered for the utility;
 - (b) the Appropriate Commission may, by notice in writing, require the licensee to sell his utility and thereupon the licensee shall sell his utility to the person (hereafter in this section referred to as the " purchaser") whose application has been accepted by that Commission;
 - (c) all the rights, duties, obligations and liabilities of the licensee, on and from the date of revocation of licence or on and from the date, if earlier, on which the utility of the licensee is sold to a purchaser, shall absolutely cease except for any liabilities which have accrued prior to that date;



- (d) the Appropriate Commission may make such interim arrangements in regard to the operation of the utility as may be considered appropriate including the appointment of Administrators;
 - (e) The Administrator appointed under clause (d) shall exercise such powers and discharge such functions as the Appropriate Commission may direct.
- (2) Where a utility is sold under sub-section (1), the purchaser shall pay to the licensee the purchase price of the utility in such manner as may be agreed upon.
 - (3) Where the Appropriate Commission issues any notice under subsection (1) requiring the licensee to sell the utility, it may, by such notice, require the licensee to deliver the utility, and thereupon the licensee shall deliver on a date specified in the notice, the utility to the designated purchaser on payment of the purchase price thereof.
 - (4) Where the licensee has delivered the utility referred to in subsection (3) to the purchaser but its sale has not been completed by the date fixed in the notice issued under that sub-section, the Appropriate Commission may, if it deems fit, permit the intending purchaser to operate and maintain the utility system pending the completion of the sale.

Vesting of utility in purchaser [Section 21]

Where a utility is sold under section 20 or section 24, then, upon completion of the sale or on the date on which the utility is delivered to the intending purchaser, as the case may be, whichever is earlier-

- (a) the utility shall vest in the purchaser or the intending purchaser, as the case may be, free from any debt, mortgage or similar obligation of the licensee or attaching to the utility:
Provided that any such debt, mortgage or similar obligation shall attach to the purchase money in substitution for the utility; and
- (b) the rights, powers, authorities, duties and obligations of the licensee under his licence shall stand transferred to the purchaser and such purchaser shall be deemed to be the licensee.

Provisions where no purchase takes place [Section 22]

- (1) If the utility is not sold in the manner provided under section 20 or section 24, the Appropriate Commission may, to protect the interest of consumers or in public interest, issue such directions or formulate such scheme as it may deem necessary for operation of the utility.
- (2) Where no directions are issued or scheme is formulated by the Appropriate Commission under sub-section (1), the licensee referred to in section 20 or section 24 may dispose of the utility in such manner as it may deem fit:

Provided that, if the licensee does not dispose of the utility, within a period of six months from the date of revocation under section 20 or section 24, the Appropriate Commission may cause the works of the licensee in, under, over, along, or across any street or public land to be removed and every such street or public land to be reinstated, and recover the cost of such removal and reinstatement from the licensee.

Directions to licensees [Section 23]

If the Appropriate Commission is of the opinion that it is necessary or expedient so to do for maintaining the efficient supply, securing the equitable distribution of electricity and promoting competition, it may, by order, provide for regulating supply, distribution, consumption or use thereof.

Suspension of distribution licence and sale of utility [Section 24]

- (1) If at any time the Appropriate Commission is of the opinion that a distribution licensee –
 - (a) has persistently failed to maintain uninterrupted supply of electricity conforming to standards regarding quality of electricity to the consumers; or

- (b) is unable to discharge the functions or perform the duties imposed on it by or under the provisions of this Act; or
- (c) has persistently defaulted in complying with any direction given by the Appropriate Commission under this Act; or
- (d) has broken the terms and conditions of licence,

and circumstances exist which render it necessary for it in public interest so to do, the Appropriate Commission may, for reasons to be recorded in writing, suspend, for a period not exceeding one year, the licence of the distribution licensee and appoint an Administrator to discharge the functions of the distribution licensee in accordance with the terms and conditions of licence:

Provided that before suspending a licence under this section, the Appropriate Commission shall give a reasonable opportunity to the distribution licensee to make representations against the proposed suspension of license and shall consider the representations, if any, of the distribution licensee.

- (2) Upon suspension of license under sub-section (1) the utilities of the distribution licensee shall vest in the Administrator for a period not exceeding one year or up to the date on which such utility is sold in accordance with the provisions contained in section 20, whichever is later.
- (3) The Appropriate Commission shall, within one year of appointment of the Administrator under sub-section (1) either revoke the licence in accordance with the provisions contained in section 19 or revoke suspension of the licence and restore the utility to the distribution licensee whose licence had been suspended, as the case may be.
- (4) In case where the Appropriate Commission revokes the licence under sub-section (3), the utility of the distribution licensee shall be sold within a period of one year from the date of revocation of the licence in accordance with the provisions of section 20 and the price after deducting the administrative and other expenses on sale of utilities be remitted to the distribution licensee.

Inter-State, regional and Inter-Regional transmission [Section 25]

For the purposes of this Part, the Central Government may, make regionwise demarcation of the country, and, from time to time, make such modifications therein as it may consider necessary for the efficient, economical and integrated transmission and supply of electricity, and in particular to facilitate voluntary interconnections and co-ordination of facilities for the inter-State, regional and interregional generation and transmission of electricity.

National Load Despatch centre [Section 26]

- (1) The Central Government may establish a centre at the national level, to be known as the National Load Despatch Centre for optimum scheduling and despatch of electricity among the Regional Load Despatch Centres.
- (2) The constitution and functions of the National Load Despatch Centre shall be such as may be prescribed by the Central Government:

Provided that the National Load Despatch Centre shall not engage in the business of trading in electricity.

- (3) The National Load Despatch Centre shall be operated by a Government company or any authority or corporation established or constituted by or under any Central Act, as may be notified by the Central Government.

Constitution of Regional Load Despatch Centre [Section 27]

- (1) The Central Government shall establish a centre for each region to be known as the Regional Load Despatch Centre having territorial jurisdiction as determined by the Central Government in



accordance with section 25 for the purposes of exercising the powers and discharging the power and discharging the functions under this Part.

- (2) The Regional Load Despatch Centre shall be operated by a Government Company or any authority or corporation established or constituted by or under any Central Act, as may be notified by the Central Government:

Provided that until a Government company or authority or corporation referred to in this sub-section is notified by the Central Government, the Central Transmission Utility shall operate the Regional Load Despatch Centre: Provided further that no Regional Load Despatch Centre shall engage in the business of generation of electricity or trading in electricity.

Functions of Regional Load Despatch Centre [Section 28]

- (1) The Regional Load Despatch Centre shall be the apex body to ensure integrated operation of the power system in the concerned region.
- (2) The Regional Load Despatch Centre shall comply with such principles, guidelines and methodologies in respect of the wheeling and optimum scheduling and despatch of electricity as the Central Commission may specify in the Grid Code.
- (3) The Regional Load Despatch Centre shall -
 - (a) be responsible for optimum scheduling and despatch of electricity within the region, in accordance with the contracts entered into with the licensees or the generating companies operating in the region;
 - (b) monitor grid operations;
 - (c) keep accounts of the quantity of electricity transmitted through the regional grid;
 - (d) exercise supervision and control over the inter-State transmission system; and
 - (e) be responsible for carrying out real time operations for grid control and despatch of electricity within the region through secure and economic operation of the regional grid in accordance with the Grid Standards and the Grid Code.
- (4) The Regional Load Despatch Centre may levy and collect such fee and charges from the generating companies or licensees engaged in inter-State transmission of electricity as may be specified by the Central Commission.

Compliance of directions [Section 29]

- (1) The Regional Load Despatch Centre may give such directions and exercise such supervision and control as may be required for ensuring stability of grid operations and for achieving the maximum economy and efficiency in the operation of the power system in the region under its control.
- (2) Every licensee, generating company, generating station, substation and any other person connected with the operation of the power system shall comply with the direction issued by the Regional Load Despatch Centres under sub-section (1).
- (3) All directions issued by the Regional Load Despatch Centres to any transmission licensee of State transmission lines or any other licensee of the State or generating company (other than those connected to inter State transmission system) or sub-station in the State shall be issued through the State Load Despatch Centre and the State Load Despatch Centres shall ensure that such directions are duly complied with the licensee or generating company or sub-station.
- (4) The Regional Power Committee in the region may, from time to time, agree on matters concerning the stability and smooth operation of the integrated grid and economy and efficiency in the operation of the power system in that region.

- (5) If any dispute arises with reference to the quality of electricity or safe, secure and integrated operation of the regional grid or in relation to any direction given under sub-section (1), it shall be referred to the Central Commission for decision :

Provided that pending the decision of the Central Commission, the directions of the Regional Load Despatch Centre shall be complied with by the State Load Despatch Centre or the licensee or the generating company, as the case may be.

- (6) If any licensee, generating company or any other person fails to comply with the directions issued under sub-section (2) or sub-section (3), he shall be liable to penalty not exceeding rupees fifteen lacs.

INTRA-STATE TRANSMISSION

Transmission within a State [Section 30]

The State Commission shall facilitate and promote transmission, wheeling and inter-connection arrangements within its territorial jurisdiction for the transmission and supply of electricity by economical and efficient utilisation of the electricity.

Constitution of state Load Despatch Centres [Section 31]

- (1) The State Government shall establish a Centre to be known as the State Load Despatch Centre for the purposes of exercising the powers and discharging the functions under this Part.
- (2) The State Load Despatch Centre shall be operated by a Government company or any authority or corporation established or constituted by or under any State Act, as may be notified by the State Government.

Provided that until a Government company or any authority or corporation is notified by the State Government, the State Transmission Utility shall operate the State Load Despatch Centre:

Provided further that no State Load Despatch Centre shall engage in the business of trading in electricity.

Functions of state Load Despatch Centres [Section 32]

- (1) The State Load Despatch Centre shall be the apex body to ensure integrated operation of the power system in a State.
- (2) The State Load Despatch Centre shall -
 - (a) be responsible for optimum scheduling and despatch of electricity within a State, in accordance with the contracts entered into with the licensees or the generating companies operating in that State;
 - (b) monitor grid operations;
 - (c) keep accounts of the quantity of electricity transmitted through the State grid;
 - (d) exercise supervision and control over the intra-state transmission system; and
 - (e) be responsible for carrying out real time operations for grid control and despatch of electricity within the State through secure and economic operation of the State grid in accordance with the Grid Standards and the State Grid Code.
- (3) The State Load Despatch Centre may levy and collect such fee and charges from the generating companies and licensees engaged in intra-State transmission of electricity as may be specified by the State Commission.

Compliance of directions [Section 33]

- (1) The State Load Despatch Centre in a State may give such directions and exercise such supervision



and control as may be required for ensuring the integrated grid operations and for achieving the maximum economy and efficiency in the operation of power system in that State.

- (2) Every licensee, generating company, generating station, substation and any other person connected with the operation of the power system shall comply with the direction issued by the State Load Despatch Centre under subsection (1).
- (3) The State Load Despatch Centre shall comply with the directions of the Regional Load Despatch Centre.
- (4) If any dispute arises with reference to the quality of electricity or safe, secure and integrated operation of the State grid or in relation to any direction given under sub-section (1) , it shall be referred to the State Commission for decision:

Provided that pending the decision of the State Commission, the direction of the State Load Despatch Centre shall be complied with by the licensee or generating company.

- (5) If any licensee, generating company or any other person fails to comply with the directions issued under sub-section(1), he shall be liable to penalty not exceeding rupees five lacs.

Other provisions relating to transmission

Grid Standards [Section 34]

Every transmission licensee shall comply with such technical standards, of operation and maintenance of transmission lines, in accordance with the Grid Standards, as may be specified by the Authority.

Intervening transmission facilities [Section 35]

The Appropriate Commission may, on an application by any licensee, by order require any other licensee owning or operating intervening transmission facilities to provide the use of such facilities to the extent of surplus capacity available with such licensee.

Provided that any dispute regarding the extent of surplus capacity available with the licensee, shall be adjudicated upon by the Appropriate Commission.

Charges for intervening transmission facilities [Section 36]

- (1) Every licensee shall, on an order made under section 35, provided his intervening transmission facilities at rates, charges and terms and conditions as may be mutually agreed upon :

Provided that the Appropriate Commission may specify rates, charges and terms and conditions if these cannot be mutually agreed upon by the licensees.

- (2) The rates, charges and terms and conditions referred to in subsection (1) shall be fair and reasonable, and may be allocated in proportion to the use of such facilities.

Explanation. - For the purposes of section 35 and 36, the expression “ intervening transmission facilities” means the electric lines owned or operated by a licensee where such electric lines can be utilised for transmitting electricity for and on behalf of another licensee at his request and on payment of a tariff or charge.

Direction by appropriate Government [Section 37]

The Appropriate Government may issue directions to the Regional Load Despatch Centres or State Load Despatch Centres, as the case may be, to take such measures as may be necessary for maintaining smooth and stable transmission and supply of electricity to any region or State.

Central Transmission Utility and functions [Section 38]

- (1) The Central Government may notify any Government company as the Central Transmission Utility:

Provided that the Central Transmission Utility shall not engage in the business of generation of electricity or trading in electricity:

Provided further that, the Central Government may transfer, and vest any property, interest in property, rights and liabilities connected with, and personnel involved in transmission of electricity of such Central Transmission Utility, to a company or companies to be incorporated under the Companies Act, 1956 to function as a transmission licensee, through a transfer scheme to be effected in the manner specified under Part XIII and such company or companies shall be deemed to be transmission licensees under this Act.

(2) The functions of the Central Transmission Utility shall be -

- (a) to undertake transmission of electricity through inter-State transmission system;
- (b) to discharge all functions of planning and co-ordination relating to inter-state transmission system with -
 - (i) State Transmission Utilities;
 - (ii) Central Government;
 - (iii) State Governments;
 - (iv) generating companies;
 - (v) Regional Power Committees;
 - (vi) Authority;
 - (vii) licensees;
 - (viii) any other person notified by the Central Government in this behalf;
- (c) to ensure development of an efficient, co-ordinated and economical system of inter-State transmission lines for smooth flow of electricity from generating stations to the load centres;
- (d) to provide non-discriminatory open access to its transmission system for use by-
 - (i) any licensee or generating company on payment of the transmission charges; or
 - (ii) any consumer as and when such open access is provided by the State Commission under sub-section (2) of section 42, on payment of the transmission charges and a surcharge thereon, as may be specified by the Central Commission:

Provided that such surcharge shall be utilised for the purpose of meeting the requirement of current level cross-subsidy:

Provided further that such surcharge and cross subsidies shall be progressively reduced in the manner as may be specified by the Central Commission:

Provided also that the manner of payment and utilisation of the surcharge shall be specified by the Central Commission:

Provided also that such surcharge shall not be leviable in case open access is provided to a person who has established a captive generating plant for carrying the electricity to the destination of his own use.

State Transmission Utility and functions [Section 39]

(1) The State Government may notify the Board or a Government company as the State Transmission Utility:

Provided that the State Transmission Utility shall not engage in the business of trading in electricity:

Provided further that the State Government may transfer, and vest any property, interest



in property, rights and liabilities connected with, and personnel involved in transmission of electricity, of such State Transmission Utility, to a company or companies to be incorporated under the Companies Act, 1956 to function as transmission licensee through a transfer scheme to be effected in the manner specified under Part XIII and such company or companies shall be deemed to be transmission licensees under this Act.

(2) The functions of the State Transmission Utility shall be -

- (a) to undertake transmission of electricity through intra-State transmission system;
- (b) to discharge all functions of planning and co-ordination relating to intra-state transmission system with -
 - (i) Central Transmission Utility;
 - (ii) State Governments;
 - (iii) generating companies;
 - (iv) Regional Power Committees;
 - (v) Authority;
 - (vi) licensees;
 - (vii) any other person notified by the State Government in this behalf;
- (c) to ensure development of an efficient, co-ordinated and economical system of intra-State transmission lines for smooth flow of electricity from a generating station to the load centres;
- (d) to provide non-discriminatory open access to its transmission system for use by-
 - (i) any licensee or generating company on payment of the transmission charges ; or
 - (ii) any consumer as and when such open access is provided by the State Commission under sub-section (2) of section 42, on payment of the transmission charges and a surcharge thereon, as may be specified by the State Commission:

Provided that such surcharge shall be utilised for the purpose of meeting the requirement of current level cross-subsidy:

Provided further that such surcharge and cross subsidies shall be progressively reduced in the manner as may be specified by the State Commission:

Provided also that the manner of payment and utilisation of the surcharge shall be specified by the State Commission.

Provided also that such surcharge shall not be leviable in case open access is provided to a person who has established a captive generating plant for carrying the electricity to the destination of his own use.

Duties of Transmission licensees [Section 40]

It shall be the duty of a transmission licensee -

- (a) to build, maintain and operate an efficient, co-ordinated and economical inter-State transmission system or intra-State transmission system, as the case may be;
- (b) to comply with the directions of the Regional Load Despatch Centre and the State Load Despatch Centre as the may be;
- (c) to provide non-discriminatory open access to its transmission system for use by-
 - (i) any licensee or generating company on payment of the transmission charges; or

- (ii) any consumer as and when such open access is provided by the State Commission under sub-section (2) of section 42, on payment of the transmission charges and a surcharge thereon, as may be specified by the State Commission:

Provided that such surcharge shall be utilised for the purpose of meeting the requirement of current level cross-subsidy:

Provided further that such surcharge and cross subsidies shall be progressively reduced in the manner as may be specified by the Appropriate Commission:

Provided also that the manner of payment and utilisation of the surcharge shall be specified by the Appropriate Commission:

Provided also that such surcharge shall not be leviable in case open access is provided to a person who has established a captive generating plant for carrying the electricity to the destination of his own use.

Other business of Transmission Licensee [Section 41]

A transmission licensee may, with prior intimation to the Appropriate Commission, engage in any business for optimum utilisation of its assets:

Provided that a proportion of the revenues derived from such business shall, as may be specified by the Appropriate Commission, be utilised for reducing its charges for transmission and wheeling:

Provided further that the transmission licensee shall maintain separate accounts for each such business undertaking to ensure that transmission business neither subsidises in any way such business undertaking nor encumbers its transmission assets in any way to support such business:

Provided also that no transmission licensee shall enter into any contract or otherwise engage in the business to in trading electricity.

Provisions with respect to distribution licensees

Duties of distribution Licensee and open access [Section 42]

- (1) It shall be the duty of a distribution licensee to develop and maintain an efficient, co-ordinated and economical distribution system in his area of supply and to supply electricity in accordance with the provisions contained in this Act.
- (2) The State Commission shall introduce open access in such phases and subject to such conditions, (including the cross subsidies, and other operational constraints) as may be specified within one year of the appointed date by it and in specifying the extent of open access in successive phases and in determining the charges for wheeling, it shall have due regard to all relevant factors including such cross subsidies, and other operational constraints:

Provided that such open access shall be allowed on payment of a surcharge in addition to the charges for wheeling as may be determined by the State Commission :

Provided further that such surcharge shall be utilised to meet the requirements of current level of cross subsidy within the area of supply of the distribution licensee :

Provided also that such surcharge and cross subsidies shall be progressively reduced in the manner as may be specified by the State Commission:

Provided also that such surcharge shall not be leviable in case open access is provided to a person who has established a captive generating plant for carrying the electricity to the destination of his own use.

- (3) Where any person, whose premises are situated within the area of supply of a distribution licensee, (not being a local authority engaged in the business of distribution of electricity before



the appointed date) requires a supply of electricity from a generating company or any licensee other than such distribution licensee, such person may, by notice, require the distribution licensee for wheeling such electricity in accordance with regulations made by the State Commission and the duties of the distribution licensee with respect to such supply shall be of a Common carrier providing non-discriminatory open access.

- (4) Where the State Commission permits a consumer or class of consumers to receive supply of electricity from a person other than the distribution licensee of his area of supply, such consumer shall be liable to pay an additional surcharge on the charges of wheeling, as may be specified by the State Commission, to meet the fixed cost of such distribution licensee arising out of his obligation to supply.
- (5) Every distribution licensee shall, within six months from the appointed date or date of grant of licence, whichever is earlier, establish a forum for redressal of grievances of the consumers in accordance with the guidelines as may be specified by the State Commission.
- (6) Any consumer, who is aggrieved by non-redressal of his grievances under sub-section (5), may make a representation for the redressal of his grievance to an authority to be known as Ombudsman to be appointed or designated by the State Commission.
- (7) The Ombudsman shall settle the grievance of the consumer within such time and in such manner as may be specified by the State Commission.
- (8) The provisions of sub-sections (5), (6) and (7) shall be without prejudice to right which the consumer may have apart from the rights conferred upon him by those sub-sections.

Duty to supply on request [Section 43]

- (1) Save as Otherwise provided in this Act, every distribution licensee, shall, on an application by the owner or occupier of any premises, give supply of electricity to such premises, within one month after receipt of the application requiring such supply:

Provided that where such supply requires extension of distribution mains, or commissioning of new sub-stations, the distribution licensee shall supply the electricity to such premises immediately after such extension or commissioning or within such period as may be specified by the Appropriate commissioning or within such period as may be specified by the Appropriate Commission.

Provided further that in case of a village or hamlet or area wherein no provision for supply of electricity exists, the Appropriate Commission may extend the said period as it may consider necessary for electrification of such village or hamlet or area.

Explanation.-For the purposes of this sub-section, "application" means the application complete in all respects in the appropriate form, as required by the distribution licensee, along with documents showing payment of necessary charges and other compliances.

- (2) It shall be the duty of every distribution licensee to provide, if required, electric plant or electric line for giving electric supply to the premises specified in sub-section (1) :

Provided that no person shall be entitled to demand, or to continue to receive, from a licensee a supply of electricity for any premises having a separate supply unless he has agreed with the licensee to pay to him such price as determined by the Appropriate Commission .

- (3) If a distribution licensee fails to supply the electricity within the period specified in sub-section (1), he shall be liable to a penalty which may extend to one thousand rupees for each day of default.

Exceptions from duty to supply electricity [Section 44]

Nothing contained in section 43 shall be taken as requiring a distribution licensee to give supply of electricity to any premises if he is prevented from doing so by cyclone, floods, storms or other occurrences beyond his control.

Power to recover charges [Section 45]

- (1) Subject to the provisions of this section, the prices to be charged by a distribution licensee for the supply of electricity by him in pursuance of section 43 shall be in accordance with such tariffs fixed from time to time and conditions of his licence.
- (2) The charges for electricity supplied by a distribution licensee shall be -
 - (a) fixed in accordance with the methods and the principles as may be specified by the concerned State Commission ;
 - (b) published in such manner so as to give adequate publicity for such charges and prices.
- (3) The charges for electricity supplied by a distribution licensee may include -
 - (a) a fixed charge in addition to the charge for the actual electricity supplied;
 - (b) a rent or other charges in respect of any electric meter or electrical plant provided by the distribution licensee.
- (4) Subject to the provisions of section 62, in fixing charges under this section a distribution licensee shall not show undue preference to any person or class of persons or discrimination against any person or class of persons.
- (5) The charges fixed by the distribution licensee shall be in accordance with the provisions of this Act and the regulations made in this behalf by the concerned State Commission.

Power to recover expenditure [Section 46]

The State Commission may, by regulations, authorise a distribution licensee to charge from a person requiring a supply of electricity in pursuance of section 43 any expenses reasonably incurred in providing any electric line or electrical plant used for the purpose of giving that supply.

Power to require security [Section 47]

- (1) Subject to the provisions of this section, a distribution licensee may require any person, who requires a supply of electricity in pursuance of section 43, to give him reasonable security, as determined by regulations, for the payment to him of all monies which may become due to him -
 - (a) in respect of the electricity supplied to such persons; or
 - (b) where any electric line or electrical plant or electric meter is to be provided for supplying electricity to person, in respect of the provision of such line or plant or meter,
and if that person fails to give such security, the distribution licensee may, if he thinks fit, refuse to give the supply or to provide the line or plant or meter for the period during which the failure continues.
- (2) Where any person has not given such security as is mentioned in subsection (1) or the security given by any person has become invalid or insufficient, the distribution licensee may, by notice, require that person, within thirty days after the service of the notice, to give him reasonable security for the payment of all monies which may become due to him in respect of the supply of electricity or provision of such line or plant or meter.
- (3) If the person referred to in sub-section(2) fails to give such security, the distribution licensee may, if he thinks fit, discontinue the supply of electricity for the period during which the failure continues.
- (4) The distribution licensee shall pay interest equivalent to the bank rate or more, as may be specified by the concerned State Commission, on the security referred to in sub-section (1) and refund such security on the request of the person who gave such security.
- (5) A distribution licensee shall not be entitled to require security in pursuance of clause (a) of sub-



section (1) if the person requiring the supply is prepared to take the supply through a pre-payment meter.

Additional terms of supply [Section 48]

A distribution licensee may require any person who requires a supply of electricity in pursuance of section 43 to accept -

- (a) any restrictions which may be imposed for the purpose of enabling the distribution licensee to comply with regulations made under section 53;
- (b) any terms restricting any liability of the distribution licensee for economic loss resulting from negligence of the person to whom the electricity is supplied.

Agreements with respect to supply or purchase of electricity [Section 49]

Where the Appropriate Commission has allowed open access to certain consumers under section 42, such consumers notwithstanding the provisions contained in clause (d) of sub-section (1) of section 62, may enter into an agreement with any person for supply or purchase of electricity on such terms and conditions (including tariff) as may be agreed upon by them.

The Electricity Supply Code [Section 50]

The State Commission shall specify an electricity supply code to provide for recovery of electricity charges, intervals for billing of electricity charges, disconnection of supply of electricity for non-payment thereof, restoration of supply of electricity, measures for preventing tampering, distress or damage to electrical plant or electrical line or meter, entry of distribution licensee or any person acting on his behalf for disconnecting supply and removing the meter, entry for replacing, altering or maintaining electric lines or electrical plants or meter and such other matters.

Provisions with respect to electricity trader [Section 52]

- (1) Without prejudice to the provisions contained in clause (c) of section 12, the Appropriate Commission may, specify the technical requirement, capital adequacy requirement and credit worthiness for being an electricity trader.
- (2) Every electricity trader shall discharge such duties, in relation to supply and trading in electricity, as may be specified by the Appropriate Commission.

Provisions relating to safety and electricity supply [Section 53]

- (1) The Authority may in consultation with the State Government, specify suitable measures for—
 - (a) protecting the public (including the persons engaged in the generation, transmission or distribution or trading) from dangers arising from the generation, transmission or distribution or trading of electricity, or use of electricity supplied or installation, maintenance or use of any electric line or electrical plant;
 - (b) eliminating or reducing the risks of personal injury to any person, or damage to property of any person or interference with use of such property ;
 - (c) prohibiting the supply or transmission of electricity except by means of a system which conforms to the specification as may be specified;
 - (d) giving notice in the specified form to the Appropriate Commission and the Electrical Inspector, of accidents and failures of supplies or transmissions of electricity;
 - (e) keeping by a generating company or licensee the maps, plans and sections relating to supply or transmission of electricity;
 - (f) inspection of maps, plans and sections by any person authorized by it or by Electrical Inspector or by any person on payment of specified fee;

- (g) specifying action to be taken in relation to any electric line or electrical plant, or any electrical appliance under the control of a consumer for the purpose of eliminating or reducing a risk of personal injury or damage to property or interference with its use;

Control of transmission and use of electricity [Section 54]

- (1) Save as otherwise exempted under this Act, no person other than Central Transmission Utility or a State Transmission Utility, or a licensee shall transmit or use electricity at a rate exceeding two hundred and fifty watts and one hundred volts –

- (a) in any street, or

- (b) in any place,-

- (i) in which one hundred or more persons are ordinarily likely to be assembled; or

- (ii) which is a factory within the meaning of the Factories Act, 1948 or a mine within the meaning of the Mines Act, 1952; or

- (iii) to which the State Government, by general or special order, declares the provisions of this sub-section to apply, without giving, before the commencement of transmission or use of electricity, not less than seven days' notice in writing of his intention to the Electrical Inspector and to the District Magistrate, or the Commissioner of Police, as the case may be, containing particulars of the electrical installation and plant, if any, the nature and the purpose of supply and complying with such of the provisions of Part XI of this Act, as may be applicable:

Provided that nothing in this section shall apply to electricity used for the public carriage of passengers, animals or goods, on, or for the lighting or ventilation of the rolling stock of any railway or tramway subject to the provisions of the Railways Act, 1989.

- (2) Where any difference or dispute arises as to whether a place is or is not one in which one hundred or more persons are ordinarily likely to be assembled, the matter shall be referred to the State Government, and the decision of the State Government thereon shall be final.

- (3) The provisions of this section shall be binding on the Government.

Use, etc., of meters [Section 55]

- (1) No licensee shall supply electricity, after the expiry of two years from the appointed date, except through installation of a correct meter in accordance with regulations to be made in this behalf by the Authority:

Provided that the licensee may require the consumer to give him security for the price of a meter and enter into an agreement for the hire thereof, unless the consumer elects to purchase a meter:

Provided further that the State Commission may, by notification extend the said period of two years for a class or classes of persons or for such area as may be specified in that notification.

- (2) For proper accounting and audit in the generation, transmission and distribution or trading of electricity, the Authority may direct the installation of meters by a generating company or licensee at such stages of generation, transmission or distribution or trading of electricity and at such locations of generation, transmission or distribution or trading , as it may deem necessary.
- (3) If a person makes default in complying with the provisions contained in this section or regulations made under sub-section (1), the Appropriate Commission may make such order as it thinks fit for requiring the default to be made good by the generating company or licensee or by any officers of a company or other association or any other person who is responsible for its default.



Disconnection of supply in default of payment [Section 56]

- (1) Where any person neglects to pay any charge for electricity or any sum other than a charge for electricity due from him to a licensee or the generating company in respect of supply, transmission or distribution or wheeling of electricity to him, the licensee or the generating company may, after giving not less than fifteen clear days notice in writing, to such person and without prejudice to his rights to recover such charge or other sum by suit, cut off the supply of electricity and for that purpose cut or disconnect any electric supply line or other works being the property of such licensee or the generating company through which electricity may have been supplied, transmitted, distributed or wheeled and may discontinue the supply until such charge or other sum, together with any expenses incurred by him in cutting off and reconnecting the supply, are paid, but no longer:

Provided that the supply of electricity shall not be cut off if such person deposits , under protest, -

- (a) an amount equal to the sum claimed from him, or
 - (b) the electricity charges due from him for each month calculated on the basis of average charge for electricity paid by him during the preceding six months, whichever is less, pending disposal of any dispute between him and the licensee.
- (2) Notwithstanding anything contained in any other law for the time being in force, no sum due from any consumer, under this section shall be recoverable after the period of two years from the date when such sum became first due unless such sum has been shown continuously as recoverable as arrear of charges for electricity supplied and the licensee shall not cut off the supply of the electricity:

Standard of performance of licensee [Section 57]

- (1) The Appropriate Commission may, after consultation with the licensees and persons likely to be affected, specify standards of performance of a licensee or a class of licensees.
- (2) If a licensee fails to meet the standards specified under subsection (1), without prejudice to any penalty which may be imposed or prosecution be initiated, he shall be liable to pay such compensation to the person affected as may be determined by the Appropriate Commission: Provided that before determination of compensation, the concerned licensee shall be given a reasonable opportunity of being heard.
- (3) The compensation determined under sub-section (2) shall be paid by the concerned licensee within ninety days of such determination.

Different Standards of performance by licensee [Section 58]

The Appropriate Commission may specify different standards under subsection (1) of section 57 for a class or classes of licensee.

Information with respect to levels of performance [Section 59]

- (1) Every licensee shall, within the period specified by the Appropriate Commission, furnish to the Commission the following information, namely:-
 - (a) the level of performance achieved under sub-section (1) of the section 57;
 - (b) the number of cases in which compensation was made under subsection (2) of section 57 and the aggregate amount of the compensation.
- (2) The Appropriate Commission shall at least once in every year arrange for the publication, in such form and manner as it considers appropriate, of such of the information furnished to it under sub-section (1).

Market destination [Section 60]

The Appropriate Commission may such issue directions as it considers appropriate to a licensee or a generating company if such licensee or generating company enters into any agreement or abuses its dominant position or enters into a combination which is likely to cause or causes an adverse effect on competition in electricity industry.

TARIFF

Tariff Regulations [Section 61]

The Appropriate Commission shall, subject to the provisions of this Act, specify the terms and conditions for the determination of tariff, and in doing so, shall be guided by the following, namely:-

- (a) the principles and methodologies specified by the Central Commission for determination of the tariff applicable to generating companies and transmission licensees;
- (b) the generation, transmission, distribution and supply of electricity are conducted on commercial principles;
- (c) the factors which would encourage competition, efficiency, economical use of the resources, good performance and optimum investments;
- (d) safeguarding of consumers' interest and at the same time, recovery of the cost of electricity in a reasonable manner;
- (e) the principles rewarding efficiency in performance;
- (f) multi year tariff principles;
- (g) that the tariff progressively reflects the cost of supply of electricity and also, reduces cross-subsidies in the manner specified by the Appropriate Commission;
- (h) the promotion of co-generation and generation of electricity from renewable sources of energy;
- (i) the National Electricity Policy and tariff policy:

Provided that the terms and conditions for determination of tariff under the Electricity (Supply) Act, 1948, the Electricity Regulatory Commission Act, 1998 and the enactments specified in the Schedule as they stood immediately before the appointed date, shall continue to apply for a period of one year or until the terms and conditions for tariff are specified under this section, whichever is earlier.

Determination of Tariff [Section 62]

- (1) The Appropriate Commission shall determine the tariff in accordance with provisions of this Act for –
 - (a) supply of electricity by a generating company to a distribution licensee:

Provided that the Appropriate Commission may, in case of shortage of supply of electricity, fix the minimum and maximum ceiling of tariff for sale or purchase of electricity in pursuance of an agreement, entered into between a generating company and a licensee or between licensees, for a period not exceeding one year to ensure reasonable prices of electricity;
 - (b) transmission of electricity ;
 - (c) wheeling of electricity;
 - (d) retail sale of electricity.

Provided that in case of distribution of electricity in the same area by two or more distribution licensees, the Appropriate Commission may, for promoting competition among distribution licensees, fix only maximum ceiling of tariff for retail sale of electricity.



- (2) The Appropriate Commission may require a licensee or a generating company to furnish separate details, as may be specified in respect of generation, transmission and distribution for determination of tariff.
- (3) The Appropriate Commission shall not, while determining the tariff under this Act, show undue preference to any consumer of electricity but may differentiate according to the consumer's load factor, power factor, voltage, total consumption of electricity during any specified period or the time at which the supply is required or the geographical position of any area, the nature of supply and the purpose for which the supply is required.
- (4) No tariff or part of any tariff may ordinarily be amended more frequently than once in any financial year, except in respect of any changes expressly permitted under the terms of any fuel surcharge formula as may be specified.
- (5) The Commission may require a licensee or a generating company to comply with such procedures as may be specified for calculating the expected revenues from the tariff and charges which he or it is permitted to recover.
- (6) If any licensee or a generating company recovers a price or charge exceeding the tariff determined under this section, the excess amount shall be recoverable by the person who has paid such price or charge along with interest equivalent to the bank rate without prejudice to any other liability incurred by the licensee.

Determination of tariff by bidding process [Section 63]

Notwithstanding anything contained in section 62, the Appropriate Commission shall adopt the tariff if such tariff has been determined through transparent process of bidding in accordance with the guidelines issued by the Central Government.

Procedure for tariff order [Section 64]

- (1) An application for determination of tariff under section 62 shall be made by a generating company or licensee in such manner and accompanied by such fee, as may be determined by regulations.
- (2) Every applicant shall publish the application, in such abridged form and manner, as may be specified by the Appropriate Commission.
- (3) The Appropriate Commission shall, within one hundred and twenty days from receipt of an application under sub-section (1) and after considering all suggestions and objections received from the public,-
 - (a) issue a tariff order accepting the application with such modifications or such conditions as may be specified in that order;
 - (b) reject the application for reasons to be recorded in writing if such application is not in accordance with the provisions of this Act and the rules and regulations made thereunder or the provisions of any other law for the time being in force:

Provided that an applicant shall be given a reasonable opportunity of being heard before rejecting his application.
- (4) The Appropriate Commission shall, within seven days of making the order, send a copy of the order to the Appropriate Government, the Authority, and the concerned licensees and to the person concerned.
- (5) Notwithstanding anything contained in Part X, the tariff for any inter-State supply, transmission or wheeling of electricity, as the case may be, involving the territories of two States may, upon application made to it by the parties intending to undertake such supply, transmission or wheeling,

be determined under this section by the State Commission having jurisdiction in respect of the licensee who intends to distribute electricity and make payment therefore:

- (6) A tariff order shall, unless amended or revoked, shall continue to be in force for such period as may be specified in the tariff order.

Provision of subsidy by State Government [Section 65]

If the State Government requires the grant of any subsidy to any consumer or class of consumers in the tariff determined by the State Commission under section 62, the State Government shall, notwithstanding any direction which may be given under section 108, pay, within in advance in the manner as may be specified, by the State Commission the amount to compensate the person affected by the grant of subsidy in the manner the State Commission may direct, as a condition for the licence or any other person concerned to implement the subsidy provided for by the State Government:

Provided that no such direction of the State Government shall be operative if the payment is not made in accordance with the provisions contained in this section and the tariff fixed by State Commission shall be applicable from the date of issue of orders by the Commission in this regard.

Development of market [Section 66]

The Appropriate Commission shall endeavour to promote the development of a market (including trading) in power in such manner as may be specified and shall be guided by the National Electricity Policy referred to in section 3 in this regard..

WORKS

Works of licensees

Provision as to opening up of streets, railways etc. [Section 67]

- (1) A licensee may, from time to time but subject always to the terms and conditions of his licence, within his area of supply or transmission or when permitted by the terms of his licence to lay down or place electric supply lines without the area of supply, without that area carry out works such as -
- (a) to open and break up the soil and pavement of any street, railway or tramway;
 - (b) to open and break up any sewer, drain or tunnel in or under any street, railway or tramway;
 - (c) to alter the position of any line or works or pipes, other than a main sewer pipe;
 - (d) to lay down and place electric lines, electrical plant and other works;
 - (e) to repair, alter or remove the same;
 - (f) to do all other acts necessary for transmission or supply of electricity.
- (2) The Appropriate Government may, by rules made by it in this behalf, specify, -
- (a) the cases and circumstances in which the consent in writing of the Appropriate Government, local authority, owner or occupier, as the case may be, shall be required for carrying out works;
 - (b) the authority which may grant permission in the circumstances where the owner or occupier objects to the carrying out of works;
 - (c) the nature and period of notice to be given by the licensee before carrying out works;
 - (d) the procedure and manner of consideration of objections and suggestion received in accordance with the notice referred to in clause (c);
 - (e) the determination and payment of compensation or rent to the persons affected by works under this section;



- (f) the repairs and works to be carried out when emergency exists;
 - (g) the right of the owner or occupier to carry out certain works under this section and the payment of expenses therefor;
 - (h) the procedure for carrying out other works near sewers, pipes or other electric lines or works;
 - (i) the procedure for alteration of the position of pipes, electric lines, electrical plant, telegraph lines, sewer lines, tunnels, drains, etc.;
 - (j) the procedure for fencing, guarding, lighting and other safety measures relating to works on streets, railways, tramways, sewers, drains or tunnels and immediate reinstatement thereof;
 - (k) the avoidance of public nuisance, environmental damage and unnecessary damage to the public and private property by such works;
 - (1) the procedure for undertaking works which are not reparable by the Appropriate Government, licensee or local authority;
 - (m) the manner of deposit of amount required for restoration of any railways, tramways, waterways, etc.;
 - (n) the manner of restoration of property affected by such works and maintenance thereof;
 - (o) the procedure for deposit of compensation payable by the licensee and furnishing of security; and
 - (p) such other matters as are incidental or consequential to the construction and maintenance of works under this section.
- (3) A licensee shall, in exercise of any of the powers conferred by or under this section and the rules made thereunder, cause as little damage, detriment and inconvenience as may be, and shall make full compensation for any damage, detriment or inconvenience caused by him or by any one employed by him.
- (4) Where any difference or dispute [including amount of compensation under sub-section (3)] arises under this section, the matter shall be determined by the Appropriate Commission.
- (5) The Appropriate Commission, while determining any difference or dispute arising under this section in addition to any compensation under sub-section (3), may impose a penalty not exceeding the amount of compensation payable under that sub-section.

Provisions relating to overhead lines

Overhead lines [Section 68]

- (1) An overhead line shall, with prior approval of the Appropriate Government, be installed or kept installed above ground in accordance with the provisions of sub-section (2).
- (2) The provisions contained in sub-section (1) shall not apply-
 - (a) in relation to an electric line which has a nominal voltage not exceeding 11 kilovolts and is used or intended to be used for supplying to a single consumer;
 - (b) in relation to so much of an electric line as is or will be within premises in the occupation or control of the person responsible for its installation; or
 - (c) in such other cases as may be prescribed.
- (3) The Appropriate Government shall, while granting approval under sub-section (1), impose such conditions (including conditions as to the ownership and operation of the line) as appear to it to be necessary

- (4) The Appropriate Government may vary or revoke the approval at any time after the end of such period as may be stipulated in the approval granted by it.
- (5) Where any tree standing or lying near an overhead line or where any structure or other object which has been placed or has fallen near an overhead line subsequent to the placing of such line, interrupts or interferes with, or is likely to interrupt or interfere with, the conveyance or transmission of electricity or the accessibility of any works, an Executive Magistrate or authority specified by the Appropriate Government may, on the application of the licensee, cause the tree, structure or object to be removed or otherwise dealt with as he or it thinks fit.
- (6) When disposing of an application under sub-section (5), an Executive Magistrate or authority specified under that sub-section shall, in the case of any tree in existence before the placing of the overhead line, award to the person interested in the tree such compensation as he thinks reasonable, and such person may recover the same from the licensee.

Explanation. - For purposes of this section, the expression "tree" shall be deemed to include any shrub, hedge, jungle growth or other plant.

Notice to telegraph authority [Section 69]

- (1) A licensee shall, before laying down or placing, within ten meters of any telegraph line, electric line, electrical plant or other works, not being either service lines, or electric lines or electrical plant, for the repair, renewal or amendment of existing works of which the character or position is not to be altered,-
 - (a) submit a proposal in case of a new installation to an authority to be designated by the Central Government and such authority shall take a decision on the proposal within thirty days;
 - (b) give not less than ten days' notice in writing to the telegraph authority in case of repair, renewal or amendment of existing works, specifying-
 - (i) the course of the works or alterations proposed ;
 - (ii) the manner in which the works are to be utilised ;
 - (iii) the amount and nature of the electricity to be transmitted;
 - (iv) the extent to, and the manner in which (if at all), earth returns are to be used, and the licensee shall conform to such reasonable requirements, either general or special, as may be laid down by the telegraph authority within that period for preventing any telegraph line from being injuriously affected by such works or alterations:

Provided that in case of emergency (which shall be stated by the licensee in writing to the telegraph authority) arising from defects in any of the electric lines or electrical plant or other works of the licensee, the licensee shall be required to give only such notice as may be possible after the necessity for the proposed new works or alterations has arisen.
- (2) Where the works of the laying or placing of any service line is to be executed the licensee shall, not less than forty-eight hours before commencing the work, serve upon the telegraph authority a notice in writing of his intention to execute such works.

Constitution and functions of Authority

Constitution, etc., of Central Electricity Authority [Section 70]

- (1) There shall be a body to be called the Central Electricity Authority to exercise such functions and perform such duties as are assigned to it under this Act.
- (2) The Central Electricity Authority, established under section 3 of the Electricity (Supply) Act, 1948



and functioning as such immediately before the appointed date, shall be the Central Electricity Authority for the purposes of this Act and the Chairperson, Members, Secretary and other officers and employees thereof shall be deemed to have been appointed under this Act and they shall continue to hold office on the same terms and conditions on which they were appointed under the Electricity (Supply) Act, 1948.

- (3) The Authority shall consist of not more than fourteen Members (including its Chairperson) of whom not more than eight shall be full-time Members to be appointed by the Central Government.
- (4) The Central Government may appoint any person, eligible to be appointed as Member of the Authority, as the Chairperson of the Authority, or, designate one of the full time Members as the Chairperson of the Authority.
- (5) The Members of the Authority shall be appointed from amongst persons of ability, integrity and standing who have knowledge of, and adequate experience and capacity in, dealing with problems relating to engineering, finance, commerce, economics or industrial matters, and at least one Member shall be appointed from each of the following categories, namely:-
 - (a) engineering with specialisation in design, construction, operation and maintenance of generating stations;
 - (b) engineering with specialisation in transmission and supply of electricity;
 - (c) applied research in the field of electricity;
 - (d) applied economics, accounting, commerce or finance.
- (6) The Chairperson and all the Members of the Authority shall hold office during the pleasure of the Central Government.
- (7) The Chairperson shall be the Chief Executive of the Authority.
- (8) The head quarters of the Authority shall be at Delhi.
- (9) The Authority shall meet at the head office or any other place at such time as the Chairperson may direct, and shall observe such rules of procedure in regard to the transaction of business at its meetings (including the quorum at its meetings) as it may specify.
- (10) The Chairperson, or if he is unable to attend a meeting of the Authority, any other Member nominated by the Chairperson in this behalf and in the absence of such nomination or where there is no Chairperson, any Member chosen by the Members present from among themselves shall preside at the meeting.
- (11) All questions which come up before any meeting of the Authority shall be decided by a majority of votes of the Members present and voting, and in the event of an equality of votes, the Chairperson or the person presiding shall have the right to exercise a second or casting vote.
- (12) All orders and decisions of the Authority shall be authenticated by the Secretary or any other officer of the Authority duly authorised by the Chairperson in this behalf.
- (13) No act or proceedings of the Authority shall be questioned or shall be invalidated merely on the ground of existence of any vacancy in, or any defect in, the constitution of, the Authority.
- (14) The Chairperson of the Authority and other full time Members shall receive such salary and allowances as may be determined by the Central Government and other Members shall receive such allowances and fees for attending the meetings of the Authority, as the Central Government may prescribe.
- (15) The other terms and conditions of service of the Chairperson and Members of the Authority including, subject to the provisions of sub-section (6), their terms of office shall be such as the Central Government may prescribe.

Members not to have certain interest [Section 71]

No Member of the Authority shall have any share or interest, whether in his own name or otherwise, in any company or other body corporate or an association of persons (whether incorporated or not), or a firm engaged in the business of generation, transmission, distribution and trading of electricity or fuel for the generation thereof or in the manufacture of electrical equipment.

Officers and staff of Authority [Section 72]

The Authority may appoint a Secretary and such other officers and employees as it considers necessary for the performance of its functions under this Act and on such terms as to salary, remuneration, fee, allowance, pension, leave and gratuity, as the authority may in consultation with the Central Government, fix:

Provided that the appointment of the Secretary shall be subject to the approval of the Central Government.

Functions and duties of Authority [Section 73]

The Authority shall perform such functions and duties as the Central Government may prescribe or direct, and in particular to -

- (a) advise the Central Government on the matters relating to the national electricity policy, formulate short-term and perspective plans for development of the electricity system and co-ordinate the activities of the planning agencies for the optimal utilisation of resources to subserve the interests of the national economy and to provide reliable and affordable electricity for all consumers;
- (b) specify the technical standards for construction of electrical plants, electric lines and connectivity to the grid;
- (c) specify the safety requirements for construction, operation and maintenance of electrical plants and electric lines;
- (d) specify the Grid Standards for operation and maintenance of transmission lines;
- (e) specify the conditions for installation of meters for transmission and supply of electricity;
- (f) promote and assist in the timely completion of schemes and projects for improving and augmenting the electricity system;
- (g) promote measures for advancing the skill of persons engaged in the electricity industry;
- (h) advise the Central Government on any matter on which its advice is sought or make recommendation to that Government on any matter if, in the opinion of the Authority, the recommendation would help in improving the generation, transmission, trading, distribution and utilisation of electricity;
- (i) collect and record the data concerning the generation, transmission, trading, distribution and utilisation of electricity and carry out studies relating to cost, efficiency, competitiveness and such like matters;
- (j) make public from time to time information secured under this Act, and provide for the publication of reports and investigations;
- (k) promote research in matters affecting the generation, transmission, distribution and trading of electricity;
- (l) carry out, or cause to be carried out, any investigation for the purposes of generating or transmitting or distributing electricity;
- (m) advise any State Government, licensees or the generating companies on such matters which shall enable them to operate and maintain the electricity system under their ownership or control



in an improved manner and where necessary, in co-ordination with any other Government, licensee or the generating company owning or having the control of another electricity system;

- (n) advise the Appropriate Government and the Appropriate Commission on all technical matters relating to generation, transmission and distribution of electricity; and
- (o) discharge such other functions as may be provided under this Act.

Certain powers and directions

Power to require statistics and returns [Section 74]

It shall be the duty of every licensee, generating company or person generating electricity for its or his own use to furnish to the Authority such statistics, returns or other information relating to generation, transmission, distribution, trading and use of electricity as it may require and at such times and in such form and manner as may be specified by the Authority.

Directions by Central Government to Authority [Section 75]

- (1) In the discharge of its functions, the Authority shall be guided by such directions in matters of policy involving public interest as the Central Government may give to it in writing.
- (2) If any question arises as to whether any such direction relates to a matter of policy involving public interest, the decision of the Central Government thereon shall be final.

REGULATORY COMMISSIONS

Constitution, powers and functions of Central Commission

Constitution of Central Commission [Section 76]

- (1) There shall be a Commission to be known as the Central Electricity Regulatory Commission to exercise the powers conferred on, and discharge the functions assigned to, it under this Act.
- (2) The Central Electricity Regulatory Commission, established under section 3 of the Electricity Regulatory Commissions Act, 1998 and functioning as such immediately before the appointed date, shall be deemed to be the Central Commission for the purposes of this Act and the Chairperson, the Central Commission for the purposes of this Act and the Chairperson, Members, Secretary, and other officers and employees thereof shall be deemed to have been appointed under this Act and they shall continue to hold office on the same terms and conditions on which they were appointed under the Electricity Regulatory Commissions Act, 1998.

Provided that the Chairperson and other Members of the Central Commission appointed, before the commencement of this Act, under the Electricity Regulatory Commissions Act, 1998, may, on the recommendations of the Selection Committee constituted under sub-section (1) of section 78, be allowed, to opt for the terms and conditions under this Act by the Central Government.

- (3) The Central Commission shall be a body corporate by the name aforesaid, having perpetual succession and a common seal with power to acquire, hold and dispose of property, both movable and immovable, and to contract and shall, by the said name, sue or be sued.
- (4) The head office of the Central Commission shall be at such place as the Central Government may, by notification, specify.
- (5) The Central Commission shall consist of the following Members namely:-
 - (a) a Chairperson and three other Members;
 - (b) the Chairperson of the Authority who shall be the Member, exofficio.
- (6) The Chairperson and Members of the Central Commission shall be appointed by the Central Government on the recommendation of the Selection Committee referred to in section 78.

Qualification for appointment of Members of Central Commission [Section 77]

- (1) The Chairperson and the Members of the Central Commission shall be persons having adequate knowledge of, or experience in, or shown capacity in, dealing with, problems relating to engineering, law, economics, commerce, finance or, management and shall be appointed in the following manner, namely:-
 - (a) one person having qualifications and experience in the field of engineering with specialisation in generation, transmission or distribution of electricity;
 - (b) one person having qualifications and experience in the field of finance;
 - (c) two persons having qualifications and experience in the field of economics, commerce, law or management:

Provided that not more than one Member shall be appointed under the same category under clause (c).
- (2) Notwithstanding anything contained in sub-section (1), the Central Government may appoint any person as the Chairperson from amongst persons who is, or has been, a Judge of the Supreme Court or the Chief Justice of a High Court:

Provided that no appointment under this sub-section shall be made except after consultation with the Chief Justice of India.
- (3) The Chairperson or any other Member of the Central Commission shall not hold any other office.
- (4) The Chairperson shall be the Chief Executive of the Central Commission.

Constitution of Selection Committee to recommend Members Commission [Section 78]

- (1) The Central Government shall, for the purposes of selecting the Members of the Appellate Tribunal and the Chairperson and Members of the Central Commission, constitute a Selection Committee consisting of –
 - (a) Member of the Planning Commission in charge of the energy sector Chairperson;
 - (b) Secretary-in-charge of the Ministry of the Central Government dealing with the Department of the Legal Affairs Member;
 - (c) Chairperson of the Public Enterprises Selection Board Member;
 - (d) a person to be nominated by the Central Government in accordance with sub-section (2) Member ;
 - (e) a person to be nominated by the Central Government in accordance with sub-section (3) Member ;
 - (f) Secretary-in-charge of the Ministry of the Central Government dealing with power Member.
- (2) For the purposes of clause (d) of sub-section (1), the Central Government shall nominate from amongst persons holding the post of chairperson or managing director, by whatever name called, of any public financial institution specified in section 4A of the Companies Act, 1956.
- (3) For the purposes of clause (e) of sub-section (1), the Central Government shall, by notification, nominate from amongst persons holding the post of director or the head of the institution, by whatever name called, of any research, technical or management institution for this purpose.
- (4) Secretary-in-charge of the Ministry of the Central Government dealing with Power shall be the Convenor of the Selection Committee.



- (5) The Central Government shall, within one month from the date of occurrence of any vacancy by reason of death, resignation or removal of a Member of the Appellate Tribunal or the Chairperson or a Member of the Central Commission and six months before the superannuation or end of tenure of the Member of the Appellate Tribunal or Member of the Central Commission, make a reference to the Selection Committee for filling up of the vacancy.
- (6) The Selection Committee shall finalise the selection of the Chairperson and Members referred to in sub-section (5) within three month from the date on which the reference is made to it.
- (7) The Selection Committee shall recommend a panel of two names for every vacancy referred to it.
- (8) Before recommending any person for appointment as Member of the Appellate Tribunal or the Chairperson or other Member of the Central Commission, the Selection Committee shall satisfy itself that such person does not have any financial or other interest which is likely to affect prejudicially his functions as the Chairperson or Member.
- (9) No appointment of the Chairperson or other Member shall be invalid merely by reason of any vacancy in the Selection Committee:

Provided that nothing contained in this section shall apply to the appointment of a person as the Chairperson of the Central Commission where such person is, or has been , a Judge of the Supreme Court or the Chief Justice of a High Court.

Functions of Central Commission [Section 79]

- (1) The Central Commission shall discharge the following functions, namely:-
 - (a) to regulate the tariff of generating companies owned or controlled by the Central Government;
 - (b) to regulate the tariff of generating companies other than those owned or controlled by the Central Government specified in clause (a), if such generating companies enter into or otherwise have a composite scheme for generation and sale of electricity in more than one State;
 - (c) to regulate the inter-State transmission of electricity ;
 - (d) to determine tariff for inter-State transmission of electricity;
 - (e) to issue licenses to persons to function as transmission licensee and electricity trader with respect to their inter-State operations.
 - (f) to adjudicate upon disputes involving generating companies or transmission licensee in regard to matters connected with clauses (a) to (d) above and to refer any dispute for arbitration;
 - (g) to levy fees for the purposes of this Act;
 - (h) to specify Grid Code having regard to Grid Standards;
 - (i) to specify and enforce the standards with respect to quality, continuity and reliability of service by licensees.
 - (j) to fix the trading margin in the inter-State trading of electricity, if considered, necessary;
 - (k) to discharge such other functions as may be assigned under this Act.
- (2) The Central Commission shall advise the Central Government on all or any of the following matters, namely :-
 - (a) Advise the Central Government on all or any of the following matters, namely:-

- (i) formulation of National electricity Policy and tariff policy;
 - (ii) promotion of competition, efficiency and economy in activities of the electricity industry;
 - (iii) promotion of investment in electricity industry;
 - (iv) any other matter referred to the Central Commission by that Government.
- (3) The Central Commission shall ensure transparency while exercising its powers and discharging its functions.
- (4) In discharge of its functions, the Central Commission shall be guided by the National Electricity Policy, National Electricity Plan and tariff policy published under section 3.

Central Advisory Committee [Section 80]

- (1) The Central Commission may, by notification, establish with effect from such date as it may specify in such notification, a Committee to be known as the Central Advisory Committee.
- (2) The Central Advisory Committee shall consist of not more than thirty-one members to represent the interests of commerce, industry, transport, agriculture, labour, consumers, non-governmental organisations and academic and research bodies in the electricity sector.
- (3) The Chairperson of the Central Commission shall be the exofficio Chairperson of the Central Advisory Committee and the Members of that Commission and Secretary to the Government of India in charge of the Ministry or Department of the Central Government dealing with Consumer Affairs and Public Distribution System shall be the ex-officio Members of the Committee.

Objects of Central Advisory Committee [Section 81]

The objects of the Central Advisory Committee shall be to advise the Central Commission on:--

- (i) major questions of policy;
- (ii) matters relating to quality, continuity and extent of service provided by the licensees;
- (iii) compliance by the licensees with the conditions and requirements of their licence;
- (iv) protection of consumer interest;
- (v) electricity supply and overall standards of performance by utilities.

Constitution, powers and functions of the State Commissions

Constitution of State Commission [Section 82]

- (1) Every State Government shall, within six months from the appointed date, by notification, constitute for the purposes of this Act, a Commission for the State to be known as the (name of the State) Electricity Regulatory Commission:

Provided that the State Electricity Regulatory Commission, established by a State Government under section 17 of the Electricity Regulatory Commissions Act, 1998 and the enactments specified in the Schedule, and functioning as such immediately before the appointed date shall be the State Commission for the purposes of this Act and the Chairperson, Members, Secretary, and other officers and other employees thereof shall continue to hold office, on the same terms and conditions on which they were appointed under those Acts.

Provided further that the Chairperson and other Members of the State Commission appointed before the commencement of this Act under the Electricity Regulatory Commissions Act, 1998 or under the enactments specified in the Schedule, may on the recommendations of the Selection Committee constituted under sub-section (1) of Section 85 be allowed to opt for the terms and conditions under this Act by the concerned State Government.



- (2) The State Commission shall be a body corporate by the name aforesaid, having perpetual succession and a common seal, with power to acquire, hold and dispose of property, both movable and immovable, and to contract and shall, by the said name, sue or be sued.
- (3) The head office of the State Commission shall be at such place as the State Government may, by notification, specify.
- (4) The State Commission shall consist of not more than three Members, including the Chairperson.
- (5) The Chairperson and Members of the State Commission shall be appointed by the State Government on the recommendation of a Selection Committee referred to in section 85.

Joint Commission [Section 83]

- (1) Notwithstanding anything to the contrary contained in section 82, a Joint Commission may be constituted by an agreement to be entered into -
 - (a) by two or more Governments of States; or
 - (b) by the Central Government, in respect of one or more Union territories, and one or more Governments of States, and shall be in force for such period and shall be subject to renewal for each further period, if any, as may be stipulated in the agreement:

Provided that the Joint Commission, constituted under section 21 A of Electricity Regulatory Commissions Act, 1998 and functioning as such immediately before the appointed day, shall be the Joint Commission for the purposes of this Act and the Chairperson, members, Secretary and other officers and employees thereof shall be deemed to have been appointed as such under this Act and they shall continue to hold office, on the same terms and conditions on which they were appointed under the Electricity Regulatory Commissions Act, 1998.

- (2) The Joint Commission shall consists of 1 Member from each of the participating States and Union Territories and the Chairperson shall be appointed from amongst the Members by consensus, failing which by rotation.
- (3) An agreement under sub-section (1) shall contain provisions as to the name of the Joint Commission, the manner in which the participating States may be associated in the selection of the Chairperson and Members of the Joint Commission, manner of appointment of Members and appointment of Chairperson by rotation or consensus, places at which the Commission shall sit, apportionment among the participating States of the expenditure in connection with the Joint Commission, manner in which the differences of opinion between the Joint Commission and the State Government concerned would be resolved and may also contain such other supplemental, incidental and consequential provisions not inconsistent with this Act as may be deemed necessary or expedient for giving effect to the agreement.
- (4) The Joint Commission shall determine tariff in respect of the participating States or Union Territories separately and independently.
- (5) Notwithstanding anything contained in this section, the Central Government may, if so authorised by all the participating States, constitute a Joint Commission and may exercise the powers in respect of all or any of the matters specified under sub-section (3) and specifically so authorized by the participating States.

Qualifications of appointment of Chairperson and Members of State Commission [Section 84]

- (1) The Chairperson and the Members of the State Commission shall be persons of ability, integrity and standing who have adequate knowledge of, and have shown capacity in, dealing with problems relating to engineering, finance, commerce, economics, law or management.
- (2) Notwithstanding anything contained in sub-section (1), the State Government may appoint any

person as the Chairperson from amongst persons who is, or has been, a Judge of a High Court: is, or has been, a Judge of a High Court:

Provided that no appointment under this sub-section shall be made except after consultation with the Chief Justice of that High Court.

- (3) The Chairperson or any other Member of the State Commission shall not hold any other office.
- (4) The Chairperson shall be the Chief Executive of the State Commission.

Constitution of Selection Committee to select Members of State Commission [Section 85]

- (1) The State Government shall, for the purposes of selecting the Members of the State Commission, constitute a Selection Committee consisting of –
 - (a) a person who has been a Judge of the High Court.... Chairperson;
 - (b) the Chief Secretary of the concerned State... ..Member;
 - (c) the Chairperson of the Authority or the Chairperson of the Central Commission Member:

Provided that nothing contained in this section shall apply to the appointment of a person as the Chairperson who is or has been a Judge of the High Court.

- (2) The State Government shall, within one month from the date of occurrence of any vacancy by reason of death, resignation or removal of the Chairperson or a Member and six months before the superannuation or end of tenure of the Chairperson or Member, make a reference to the Selection Committee for filling up of the vacancy.
- (3) The Selection Committee shall finalise the selection of the Chairperson and Members within three month from the date on which the reference is made to it.
- (4) The Selection Committee shall recommend a panel of two names for every vacancy referred to it.
- (5) Before recommending any person for appointment as the Chairperson or other Member of the State Commission, the Selection Committee shall satisfy itself that such person does not have any financial or other interest which is likely to affect prejudicially his functions as Chairperson or Member, as the case may be.
- (6) No appointment of Chairperson or other Member shall be invalid merely by reason of any vacancy in the Selection Committee.

Functions of State Commission [Section 86]

- (1) The State Commission shall discharge the following functions, namely: -
 - (a) determine the tariff for generation, supply, transmission and wheeling of electricity, wholesale, bulk or retail, as the case may be, within the State:

Providing that where open access has been permitted to a category of consumers under section 42, the State Commission shall determine only the wheeling charges and surcharge thereon, if any, for the said category of consumers;
 - (b) regulate electricity purchase and procurement process of distribution licensees including the price at which electricity shall be procured from the generating companies or licensees or from other sources through agreements for purchase of power for distribution and supply within the State;
 - (c) facilitate intra-state transmission and wheeling of electricity;



- (d) issue licences to persons seeking to act as transmission licensees, distribution licensees and electricity traders with respect to their operations within the State;
 - (e) promote congeneration and generation of electricity from renewable sources of energy by providing suitable measures for connectivity with the grid and sale of electricity to any person, and also specify, for purchase of electricity from such sources, a percentage of the total consumption of electricity in the area of a distribution licence;
 - (f) adjudicate upon the disputes between the licensees, and generating companies and to refer any dispute for arbitration;
 - (g) levy fee for the purposes of this Act;
 - (h) specify State Grid Code consistent with the Grid Code specified under clause (h) of sub-section (1) of section 79;
 - (i) specify or enforce standards with respect to quality, continuity and reliability of service by licensees;
 - (j) fix the trading margin in the intra-State trading of electricity, if considered, necessary; and
 - (k) discharge such other functions as may be assigned to it under this Act.
- (2) The State Commission shall advise the State Government on all or any of the following matters, namely :-
- (i) promotion of competition, efficiency and economy in activities of the electricity industry;
 - (ii) promotion of investment in electricity industry;
 - (iii) reorganization and restructuring of electricity industry in the State;
 - (iv) matters concerning generation, transmission , distribution and trading of electricity or any other matter referred to the State Commission by that Government.
- (3) The State Commission shall ensure transparency while exercising its powers and discharging its functions.
- (4) In discharge of its functions the State Commission shall be guided by the National Electricity Policy, National Electricity Plan and tariff policy published under section 3.

State Advisory Committee [Section 87]

- (1) The State Commission may, by notification, establish with effect from such date as it may specify in such notification, a Committee to be known as the State Advisory Committee.
- (2) The State Advisory Committee shall consist of not more than twenty-one members to represent the interests of commerce, industry, transport, agriculture, labour, consumers, non-governmental organisations and academic and research bodies in the electricity sector.
- (3) The Chairperson of the State Commission shall be the ex-officio Chairperson of the State Advisory Committee and the Members of the State Commission and the Secretary to State Government in charge of the Ministry or Commission and the Secretary to State Government in charge of the Ministry or Department dealing with Consumer Affairs and Public Distribution System shall be the ex-officio Members of the Committee.

Objects of State Advisory Committee [Section 88]

The objects of the State Advisory Committee shall be to advise the Commission on –

- (i) major questions of policy;
- (ii) matters relating to quality, continuity and extent of service provided by the licensees;

- (iii) compliance by licensees with the conditions and requirements of their licence:
- (iv) protection of consumer interest; and
- (v) electricity supply and overall standards of performance by utilities.

Appropriate Commission – Other Provisions

Term of office and conditions of service of members [Section 89]

- (1) The Chairperson or other Member shall hold office for a term of five years from the date he enters upon his office;

Provided that the Chairperson or other Member in the Central Commission or the State Commission shall not be eligible for re-appointment in the same capacity as the Chairperson or a Member in that Commission in which he had earlier held office as such :

Provided further that no Chairperson or Member shall hold office as such after he has attained the age of sixty-five years.

- (2) The salary, allowances and other terms and conditions of service of the Chairperson and Members shall be such as may be prescribed by the Appropriate Government.

Provided that the salary, allowances and other terms and conditions of service of the Members, shall not be varied to their disadvantage after appointment.

- (3) Every Member shall, before entering upon his office, make and subscribe to an oath of office and secrecy in such form and in such manner and before such authority as may be prescribed.
- (4) Notwithstanding anything contained in sub-section (1), a Member may-
 - (a) Relinquish his office by giving in writing to the Appropriate Government a notice of not less than three months; or
 - (b) be removed from his office in accordance with the provisions of section 90.
- (5) Any member ceasing to hold office as such shall –
 - (a) not accept any commercial employment for a period of two years from the date he ceases to hold such office; and
 - (b) not represent any person before the Central Commission or any State Commission in any manner.

Explanation. - For the purposes of this sub-section “commercial employment” means employment in any capacity in any organisation which has been a party to the proceedings before the Appropriate Commission or employment in any capacity under, or agency of, a person engaged in trading, commercial, industrial or financial business in electricity industry and includes a director of a company or partner of a firm or setting up practice either independently or as partner of a firm or as an advisor or a consultant.

Removal of member [Section 90]

- (1) No Member shall be removed from office except in accordance with the provisions of this section.
- (2) The Central Commission, in the case of a Member of the Central Commission, and the State Government, in the case of a Member of the State Commission, may by order remove from office any Member, if he-
 - (a) has been adjudged an insolvent;
 - (b) has been convicted of an offence which, in the opinion of the Appropriate Government, involves moral turpitude;



- (c) has become physically or mentally incapable of acting as a Member;
- (d) has acquired such financial or other interest as is likely to affect prejudicially his functions as a Member;
- (e) has so abused his position as to render his continuance in office prejudicial to the public interest; or
- (f) has been guilty of proved misbehaviour:

Provided that no Member shall be removed from his office on any ground specified in clauses (d), (e) and (f) unless the Chairperson of the Appellate Tribunal on a reference being made to him in this behalf by the Central Government, or the State Government, as the case may be, has, on an inquiry, held by him in accordance with such procedure as may be prescribed by the Central Government, reported that the Member ought on such ground or grounds to be removed.

- (3) The Central Government or the State Government, as the case may be, may, in consultation with the Chairperson of the Appellate Tribunal suspend any Member of the Appropriate Commission in respect of whom a reference has been made to the Chairperson of the Appellate Tribunal, under sub-section (2) until the Central Government or the State Government, as the case may be, has passed orders on receipt of the report of the Chairperson of the Appellate Tribunal, on such reference :

Provided that nothing contained in this section shall apply to the Chairperson of the Appropriate Commission who, at the time of his appointment as such is a sitting Judge of the Supreme court or the chief Justice of a High Court or a Judge of a High Court.

Proceedings and powers of the Appropriate Commission

Secretary Officers and other employees of Appropriate Commission [Section 91]

- (1) The Appropriate Commission may appoint a Secretary to exercise such powers and perform such duties as may be specified. Such powers and perform such duties as may be specified.
- (2) The Appropriate Commission may, with the approval of the Appropriate Government, specify the numbers, nature and categories of other officers and employees.
- (3) The salaries and allowances payable to, and other term and conditions of service of, the Secretary, officers and other employees shall be such as may be specified with the approval of the Appropriate Government.
- (4) The Appropriate Commission may appoint consultants required to assist that Commission in the discharge of its functions on the terms and conditions as may be specified.

Proceedings of Appropriate Commission [Section 92]

- (1) The Appropriate Commission shall meet at the head office or any other place at such time as the Chairperson may direct, and shall observe such rules of procedure in regard to the transaction of business at its meetings (including the quorum at its meetings) as it may specify.
- (2) The Chairperson, or if he is unable to attend a meeting of the Appropriate Commission, any other Member nominated by the Chairperson in this behalf and, in the absence of such nomination or where there is no Chairperson, any Member chosen by the Members present from among themselves, shall preside at the meeting.
- (3) All questions which come up before any meeting of the Appropriate Commission shall be decided by a majority of votes of the Members present and voting, and in the event of an equality of votes, the Chairperson or in his absence, the person presiding shall have a second or casting vote.

- (4) Save as otherwise provided in sub-section (3), every Member shall have one vote.
- (5) All orders and decisions of the Appropriate Commission shall be authenticated by its Secretary or any other officer of the Commission duly authorised by the Chairperson in this behalf.

Vacancies, etc., not to invalidate proceedings [Section 93]

No act or proceedings of the Appropriate Commission shall be questioned or shall be invalidated merely on the ground of existence of any vacancy or defect in the constitution of the Appropriate Commission.

Powers of Appropriate Commission [Section 94]

- (1) The Appropriate Commission shall, for the purposes of any inquiry or proceedings under this Act, have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 in respect of the following matters, namely: -
 - (a) summoning and enforcing the attendance of any person and examining him on oath;
 - (b) discovery and production of any document or other material object producible as evidence;
 - (c) receiving evidence on affidavits;
 - (d) requisitioning of any public record;
 - (e) issuing commission for the examination of witnesses;
 - (f) reviewing its decisions, directions and orders;
 - (g) any other matter which may be prescribed.
- (2) The Appropriate Commission shall have the powers to pass such interim order in any proceeding, hearing or matter before the Appropriate Commission, as that Commission may consider appropriate.
- (3) The Appropriate Commission may authorise any person, as it deems fit, to represent the interest of the consumers in the proceedings before it.

Proceedings before Commission [Section 95]

All proceedings before the Appropriate Commission shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code and the Appropriate Commission shall be deemed to be a civil court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 1973.

Powers of entry and seizure [Section 96]

The Appropriate Commission or any officer, not below the rank of a Gazetted Officer specially authorised in this behalf by the Commission, may enter any building or place where the Commission has reason to believe that any document relating to the subject matter of the inquiry may be found, and may seize any such document or take extracts or copies therefrom subject to the provisions of section 100 of the Code of Criminal Procedure, 1973, insofar as it may be applicable.

Delegation [Section 97]

The Appropriate Commission may, by general or special order in writing, delegate to any Member, Secretary officer of the Appropriate Commission or any other person subject to such conditions, if any, as may be specified in the order, such of its powers and functions under this Act (except the powers to adjudicate disputes under Section 79 and Section 86 and the powers to make regulations under section 178 or section 181) as it may deem necessary.



Grants, Fund, Accounts, Audit and Report

Grants and loans by Central Government [Section 98]

The Central Government may, after due appropriation made by Parliament in this behalf, make to the Central Commission grants and loans of such sums of money as that Government may consider necessary.

Establishment of Fund by Central Government [Section 99]

- (1) There shall be constituted a Fund to be called the Central Electricity Regulatory Commission Fund and there shall be credited thereto-
 - (a) any grants and loans made to the Central Commission by the Central Government under section 98;
 - (b) all fees received by the Central Commission under this Act;
 - (c) all sums received by the Central Commission from such other sources as may be decided upon by the Central Government.
- (2) The Fund shall be applied for meeting –
 - (a) the salary, allowances and other remuneration of Chairperson, Members, Secretary, officers and other employees of the Central Commission;
 - (b) the expenses of the Central Commission in discharge of its function under section 79;
 - (c) the expenses on objects and for purposes authorised by this Act.
- (3) The Central Government may, in consultation with the Comptroller and Auditor-General of India, prescribe the manner of applying the Fund for meeting the expenses specified in clause (b) or clause (c) of sub-section (2).

Accounts and Audit of Central Commission [Section 100]

- (1) The Central Commission shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor-General of India.
- (2) The accounts of the Central Commission shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Central Commission to the Comptroller and Auditor-General of India.
- (3) The Comptroller and Auditor-General of India and any person appointed by him in connection with the auditing of the accounts of the Central Commission under this Act shall have the same rights and privileges and authority in connection with such audit as the Comptroller and Auditor-General of India has in connection with the audit of the Government accounts and, in particular, shall have the right to demand the production of books, accounts, connected vouchers and other documents and papers and to inspect any of the offices of the Central Commission.
- (4) The accounts of the Central Commission, as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf, together with the audit report thereon, shall be forwarded annually to the Central Government and that Government shall cause the same to be laid, as soon as may be after it is received, before each House of Parliament.

Annual Report of Central Commission [Section 101]

- (1) The Central Commission shall prepare once every year, in such form and at such time as may be prescribed, an annual report giving a summary of its activities during the previous year and copies of the report shall be forwarded to the Central Government.

- (2) A copy of the report received under sub-section (1) shall be laid, as soon as may be after it is received, before each House of Parliament.

Grants and Loans by State Government [Section 102]

The State Government may, after due appropriation made by Legislature of a State in this behalf, make to the State Commission grants and loans of such sums of money as that Government may consider necessary.

Establishment of Fund by state Government [Section 103]

- (1) There shall be constituted a Fund to be called the State Electricity Regulatory Commission fund and there shall be credited thereto-
 - (a) any grants and loans made to the State Commission by the State Government under Section 102;
 - (b) all fees received by the State Commission under this Act;
 - (c) all sums received by the State Commission from such other sources as may be decided upon by the State Government.
- (2) The Fund shall be applied for meeting –
 - (a) the salary, allowances and other remuneration of Chairperson, Members, Secretary, officers and other employees of the State Commission;
 - (b) the expenses of the State Commission in discharge of its function under Section 86; and
 - (c) the expenses on objects and for purposes authorised by this Act.
- (3) The State Government may, in consultation with the Comptroller and Auditor-General of India, prescribe the manner of applying the Fund for meeting the expenses specified in clause (b) or clause (c) of sub-section (2).

Accounts and audit of State Commission [Section 104]

- (1) The State Commission shall maintain proper accounts and other relevant records and prepare annual statement of accounts in such forms as may be prescribed by the State Government in consultation with the Comptroller and Auditor-General of India.
- (2) The Accounts of the State Commission shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the State Commission to the Comptroller and Auditor-General of India.
- (3) The Comptroller and Auditor-General of India and any person appointed by him in connection with the audit of the accounts of the State Commission under this Act shall have the same rights and privileges and authority in connection with such audit as the Comptroller and Auditor-General of India generally has in connection with the audit of Government accounts and, in particular, shall have the right to demand the production of books, accounts, connected vouchers and other documents and papers and to inspect any of the offices of the State Commission.
- (4) The accounts of the State Commission, as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf, together with the audit report thereon shall be forwarded annually to the State Government and that Government shall cause the same to be laid, as soon as may be after it is received, before the State Legislature.

Annual report of State Commission [Section 105]

- (1) The State Commission shall prepare once every year in such form and at such time as may



be prescribed, an annual report giving a summary of its activities during the previous year and copies of the report shall be forwarded to the State Government.

- (2) A copy of the report received under sub-section (1) shall be laid, as soon as may be after it is received, before the State Legislature.

Budget of Appropriate Commission [Section 106]

The Appropriate Commission shall prepare, in such form and at such time in each financial year as may be prescribed, its budget for the next financial year, showing the estimated receipts and expenditure of that Commission and forward the same to the Appropriate Government.

Directions by Central Government [Section 107]

- (1) In the discharge of its functions, the Central Commission shall be guided by such directions in matters of policy involving public interest as the Central Government may give to it in writing.
- (2) If any question arises as to whether any such direction relates to a matter of policy involving public interest, the decision of the Central Government thereon shall be final.

Directions by State Government [Section 108]

- (1) In the discharge of its functions, the State Commission shall be guided by such directions in matters of policy involving public interest as the State Government may give to it in writing.
- (2) If any question arises as to whether any such direction relates to a matter of policy involving public interest, the decision of the State Government thereon shall be final.

Directions to Joint Commission [Section 109]

Notwithstanding anything contained in this Act, where any Joint Commission is established under section 83 –

- (a) the Government of the State, for which the Joint Commission is established, shall be competent to give any direction under this Act only in cases where such direction relates to matter within the exclusive territorial jurisdiction of the State;
- (b) the Central Government alone shall be competent to give any direction under this Act where such direction relates to a matter within the territorial jurisdiction of two or more States or pertaining to a Union territory if the participating Governments fail to reach an agreement or the participating States or majority of them request the Central Government to issue such directions.

Establishment of Appellate Tribunal [Section 110]

The Central Government shall, by notification, establish an Appellate Tribunal to be known as the Appellate Tribunal for Electricity to hear appeals against the orders of the adjudicating officer or the Appropriate Commission under this Act.

Appeal to Appellate Tribunal [Section 111]

- (1) Any person aggrieved by an order made by an adjudicating officer under this Act (except under section 127) or an order made by the Appropriate Commission under this Act may prefer an appeal to the Appellate Tribunal for Electricity:

Provided that any person appealing against the order of the adjudicating officer levying and penalty shall, while filling the appeal, deposit the amount of such penalty:

Provided further that where in any particular case, the Appellate Tribunal is of the opinion that the deposit of such penalty would cause undue hardship to such person, it may dispense with such deposit subject to such conditions as it may deem fit to impose so as to safeguard the realisation of penalty.

- (2) Every appeal under sub-section (1) shall be filed within a period of forty-five days from the date on which a copy of the order made by the adjudicating officer or the Appropriate Commission is received by the aggrieved person and it shall be in such form, verified in such manner and be accompanied by such fee as may be prescribed:

Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

- (3) On receipt of an appeal under sub-section (1), the Appellate Tribunal may, after giving the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.
- (4) The Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned adjudicating officer or the Appropriate Commission, as the case may be.
- (5) The appeal filed before the Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within one hundred and eighty days from the date of receipt of the appeal:

Provided that where any appeal could not be disposed off within the said period of one hundred and eighty days, the Appellate Tribunal shall record its reasons in writing for not disposing of the appeal within the said period.

- (6) The Appellate Tribunal may, for the purpose of examining the legality, propriety or correctness of any order made by the adjudicating officer or legality, propriety or correctness of any order made by the adjudicating officer or the Appropriate Commission under this Act, as the case may be, in relation to any proceeding, on its own motion or otherwise, call for the records of such proceedings and make such order in the case as it thinks fit.

Composition of Appellate Tribunal [Section 112]

- (1) The Appellate Tribunal shall consist of a Chairperson and three other Members.
- (2) Subject to the provisions of this Act,-
 - (a) the jurisdiction of the Appellate Tribunal may be exercised by Benches thereof;
 - (b) a Bench may be constituted by the Chairperson of the Appellate Tribunal with two or more Members of the Appellate Tribunal as the Chairperson of the Appellate Tribunal may deem fit:

Provided that every Bench constituted under this clause shall include at least one Judicial Member and one Technical Member;
 - (c) the Benches of the Appellate Tribunal shall ordinarily sit at Delhi and such other places as the Central Government may, in consultation with the Chairperson of the Appellate Tribunal, notify;
 - (d) the Central Government shall notify the areas in relation to which each Bench of the Appellate Tribunal may exercise jurisdiction.
- (3) Notwithstanding anything contained in sub-section (2), the Chairperson of the Appellate Tribunal may transfer a Member of the Appellate Tribunal from one Bench to another Bench.

Explanation.- For the purposes of this Chapter,-

- (i) "Judicial Member" means a Member of the Appellate Tribunal appointed as such under sub-clause (i) of clause (b) of sub-section (1) of section 113, and includes the Chairperson of the Appellate Tribunal;
- (ii) "Technical Member" means a Member of the Appellate Tribunal appointed as such under sub-clause (ii) or sub-clause (iii) of clause (b) of subsection (1) of section 113.



Qualifications for appointment of Chairperson and Member of the Appellate Tribunal [Section 113]

- (1) A person shall not be qualified for appointment as the Chairperson of the Appellate Tribunal or a Member of the Appellate Tribunal unless he-
 - (a) in the case of the Chairperson of the Appellate Tribunal, is, or has been, a judge of the Supreme Court or the Chief Justice of a High Court; and
 - (b) in the case of a Member of the Appellate Tribunal,-
 - (i) is, or has been, or is qualified to be, a Judge of a High Court; or
 - (ii) is, or has been, a Secretary for at least one year in the Ministry or Department of the Central Government dealing with economic affairs or matters or infrastructure; or
 - (iii) is, or has been, a person of ability and standing, having adequate knowledge or experience in dealing with the matters relating to electricity generation, transmission and distribution and regulation or economics, commerce, law or management.
- (2) The Chairperson of the Appellate Tribunal shall be appointed by the Central Government after consultation with the Chief Justice of India.
- (3) The Members of the Appellate Tribunal shall be appointed by the Central Government on the recommendation of the Selection Committee referred to in section 78.
- (4) Before appointing any person for appointment as Chairperson or other Member of the Appellate Tribunal, the Central Government shall satisfy itself that such person does not have any financial or other interest which is likely to affect prejudicially his functions as such Chairperson or Member.

Term of office [Section 114]

The Chairperson of the Appellate Tribunal or a Member of the Appellate Tribunal shall hold office as such for a term of three years from the date on which he enters upon his office:

Provided that such Chairperson or other Member shall be eligible for reappointment for a second term of three years:

Provided further that no Chairperson of the Appellate Tribunal or Member of the Appellate Tribunal shall hold office as such after he has attained,-

- (a) in the case of the Chairperson of the Appellate Tribunal, the age of seventy years;
- (b) in the case of a Member of the Appellate Tribunal, the age of sixty-five years.

Terms and conditions of service [Section 115]

The salary and allowances payable to, and the other terms and conditions of service of, the Chairperson of the Appellate Tribunal and Members of the Appellate Tribunal shall be such as may be prescribed by the Central Government :

Provided that neither the salary and allowances nor the other terms and conditions of service of the Chairperson of the Appellate Tribunal or a Member of the Appellate Tribunal shall be varied to his disadvantage after appointment.

Vacancies [Section 116]

If, for reason other than temporary absence, any vacancy occurs in the office of the Chairperson of the Appellate Tribunal or a Member of the Appellate Tribunal, the Central Government shall appoint another person in accordance with the provisions of this Act to fill the vacancy and the proceedings may be continued before the Appellate Tribunal from the stage at which the vacancy is filled.

Resignation and removal [Section 117]

- (1) The Chairperson of the Appellate Tribunal or a Member of the Appellate Tribunal may, by notice in writing under his hand addressed to the Central Government, resign his office:

Provided that the Chairperson of the Appellate Tribunal or a Member of the Appellate Tribunal 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 term of office, whichever is the earliest.

- (2) The Chairperson of the Appellate Tribunal or a Member of the Appellate Tribunal shall not be removed from his office except by an order by the Central Government on the ground of proved misbehaviour or incapacity after an inquiry made by a judge of the Supreme Court as the Central Government may appoint for this purpose in which the Chairperson or a Member of the Appellate Tribunal concerned has been informed of the charges against him and given a reasonable opportunity of being heard in respect of such charges.

Member to act as Chairperson in certain circumstances [Section 118]

- (1) In the event of the occurrence of any vacancy in the office of the Chairperson of the Appellate Tribunal by reason of his death, resignation or otherwise, the senior-most Member of the Appellate Tribunal shall act as the Chairperson of the Appellate Tribunal until the date on which a new Chairperson, appointed in accordance with the provisions of this Act to fill such vacancy, enters upon his office.
- (2) When the Chairperson of the Appellate Tribunal is unable to discharge his functions owing to absence, illness or any other cause, the senior most Member of the Appellate Tribunal shall discharge the functions of the Chairperson of the Appellate Tribunal until the date on which the Chairperson of the Appellate Tribunal resumes his duties.

Officers and other employees of Appellate Tribunal [Section 119]

- (1) The Central Government shall provide the Appellate Tribunal with such officers and other employees as it may deem fit.
- (2) The officers and other employees of the Appellate Tribunal shall discharge their functions under the general superintendence of the Chairperson of the Appellate Tribunal.
- (3) The salaries and allowances and other terms and conditions of service of the officers and other employees of the Appellate Tribunal shall be such as may be prescribed by the Central Government.

Procedure and powers of Appellate Tribunal [Section 120]

- (1) The Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act, the Appellate Tribunal shall have powers to regulate its own procedure.
- (2) The Appellate Tribunal shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:-
 - (a) summoning and enforcing the attendance of any person and examining him on oath;
 - (b) requiring the discovery and production of documents;
 - (c) receiving evidence on affidavits;
 - (d) subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872, requisitioning any public record or document or copy of such record or document from any office;



- (e) issuing commissions for the examination of witnesses or documents;
 - (f) reviewing its decisions;
 - (g) dismissing a representation of default or deciding it ex parte;
 - (h) setting aside any order of dismissal or any representation for default or any order passed by it ex parte;
 - (i) any other matter which may be prescribed by the Central Government.
- (3) An order made by the Appellate Tribunal under this Act shall be executable by the Appellate Tribunal as a decree of civil court and, for this purpose, the Appellate Tribunal shall have all the powers of a civil court.
- (4) Notwithstanding anything contained in sub-section (3), the Appellate Tribunal may transmit any order made by it to a civil court having local jurisdiction and such civil court shall execute the order as if it were a decree made by that court.
- (5) All proceedings before the Appellate Tribunal shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code and the Appellate Tribunal shall be deemed to be a civil court for the purposes of section 345 and 346 of the Code of Criminal Procedure, 1973.

Power of Chairperson of Appellate Tribunal [Section 121]

The Chairperson of the Appellate Tribunal shall exercise general power of super-intendence and control over the Appellate Commission.

Distribution of business amongst Benches and transfer of cases from one Bench to another Bench [Section 122]

- (1) Where Benches are constituted, the Chairperson of the Appellate Tribunal may, from time to time, by notification, make provisions as to the distribution of the business of the Appellate Tribunal amongst the Benches and also provide for the matters which may be dealt with by each Bench.
- (2) On the application of any of the parties and after notice to the parties, and after hearing such of them as he may desire to be heard, or on his own motion without such notice, the Chairperson of the Appellate Tribunal may transfer any case pending before one Bench, for disposal, to any other Bench.

Decision to be by majority [Section 123]

If the Members of the Appellate Tribunal of a Bench consisting of two Members differ in opinion on any point, they shall state the point or points on which they differ, and make a reference to the Chairperson of the Appellate Tribunal who shall either hear the point or points himself or refer the case for hearing on such point or points by one or more of the other Members of the Appellate Tribunal and such point or points shall be decided according to the opinion of the majority of the Members of the Appellate Tribunal who have heard the case, including those who first heard it.

Right of appellant to take assistance of legal practitioner and of Appellate Commission to appoint presenting officers [Section 124]

- (1) A person preferring an appeal to the Appellate Tribunal under this Act may either appear in person or take the assistance of a legal practitioner of his choice to present his case before the Appellate Tribunal, as the case may be.
- (2) The Appellate Commission may authorise one or more legal practitioners or any of its officers to act as presenting officers and every person so authorised may present the case with respect to any appeal before the Appellate Tribunal, as the case may be.

Appeal to Supreme Court [Section 125]

Any person aggrieved by any decision or order of the Appellate Tribunal, may, file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal, to him, on any one or more of the grounds specified in section 100 of the Code of Civil Procedure, 1908:

Provided that the Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

INVESTIGATION AND ENFORCEMENT

Assessment [Section 126]

- (1) If on an inspection of any place or premises or after inspection of the equipments, gadgets, machines, devices found connected or used, or after inspection of records maintained by any person, the assessing officer comes to the conclusion that such person is indulging in unauthorized use of electricity, he shall provisionally assess to the best of his judgement the electricity charges payable by such person or by any other person benefited by such use.
- (2) The order of provisional assessment shall be served upon the person in occupation or possession or in charge of the place or premises in such manner as may be prescribed.
- (3) The person, on whom an order has been served under sub-section (2), shall be entitled to file objections, if any, against the provisional assessment before the assessing officer, who shall, after affording a reasonable opportunity of hearing to such person, pass a final order of assessment within thirty days from the date of service of such order of provisional assessment, of the electricity charges payable by such person.
- (4) Any person served with the order of provisional assessment, may, accept such assessment and deposit the assessed amount with the licensee within seven days of service of such provisional assessment order upon him.
- (5) If the assessing officer reaches to the conclusion that unauthorised use of electricity has taken place, the assessment shall be made for the entire period during which such unauthorised use of electricity has taken place and if, however, the period during which such unauthorised use of electricity has taken place cannot be ascertained, such period shall be limited to a period of twelve months immediately preceding the date of inspection.
- (6) The assessment under this section shall be made at a rate equal to twice the tariff rates applicable for the relevant category of services specified in sub-section (5).

Explanation.- For the purposes of this section,-

- (a) "assessing officer" means an officer of a State Government or Board or licensee, as the case may be, designated as such by the State Government;
- (b) "unauthorised use of electricity" means the usage of electricity –
 - (i) by any artificial means; or
 - (ii) by a means not authorised by the concerned person or authority or licensee; or
 - (iii) through a tampered meter; or
 - (iv) for the purpose other than for which the usage of electricity was authorized; or
 - (v) for the premises or areas other than those for which the supply of electricity was authorised.



Appeal to Appellate Authority [Section 127]

- (1) Any person aggrieved by a final order made under section 126 may, within thirty days of the said order, prefer an appeal in such form, verified in such manner and be accompanied by such fee as may be specified by the State Commission, to an appellate authority as may be prescribed.
- (2) No appeal against an order of assessment under sub-section (1) shall be entertained unless an amount equal to half of the assessed amount is deposited in cash or by way of bank draft with the licensee and documentary evidence of such deposit has been enclosed along with the appeal.
- (3) The appellate authority referred to in sub-section (1) shall dispose of the appeal after hearing the parties and pass appropriate order and send copy of the order to the assessing officer and the appellant.
- (4) The order of the appellate authority referred to in sub-section (1) passed under sub-section (3) shall be final.
- (5) No appeal shall lie to the appellate authority referred to in subsection (1) against the final order made with the consent of the parties.
- (6) When a person default in making payment of assessed amount, he, in addition to the assessed amount shall be liable to pay, on the expiry of thirty days from the date of order of assessment, an amount of interest at the rate of sixteen per cent per annum compounded every six months.

Investigation of certain matters [Section 128]

- (1) The Appropriate Commission may, on being satisfied that a licensee has failed to comply with any of the conditions of licence or a generating company or a licensee has failed to comply with any of the provisions of this Act or rules or regulations made there under, at any time, by order in writing, direct any person (hereafter in this section referred to as " Investigating Authority") specified in the order to investigate the affairs of any generating company or licensee and to report to that Commission on any investigation made by such Investigating Authority:

Provided that the Investigating Authority may, wherever necessary, employ any auditor or any other person for the purpose of assisting him in any investigation under this section.

- (2) Notwithstanding anything to the contrary contained in section 235 of the Companies Act, 1956, the Investigating Authority may, at any time, and shall, on being directed so to do by the Appropriate Commission, cause an inspection to be made, by one or more of his officers, of any licensee or generating company and his books of account; and the Investigating Authority shall supply to the licensee or generating company, as the case may be, a copy of his report on such inspection.
- (3) It shall be the duty of every manager, managing director or other officer of the licensee or generating company, as the case may be, to produce before the Investigating Authority directed to make the investigation under subsection (1), or inspection under sub-section (2), all such books of account, registers and other documents in his custody or power and to furnish him with any statement and information relating to the affairs of the licensee or generating company, as the case may be, as the said Investigating Authority may require of him within such time as the said Investigating Authority may specify.
- (4) Any Investigating Authority, directed to make an investigation under sub-section (1), or inspection under sub-section (2), may examine on oath any manager, managing director or other officer of the licensee or generating company, as the case may be, in relation to his business and may administer oaths accordingly.
- (5) The Investigating Authority, shall, if it has been directed by the Appropriate Commission to cause an inspection to be made, and may, in any other case, report to the Appropriate Commission on any inspection made under this section.

- (6) On receipt of any report under sub-section (1) or sub-section (5), the Appropriate Commission may, after giving such opportunity to the licensee or generating company, as the case may be, to make a representation in connection with the report as in the opinion of the Appropriate Commission, seems reasonable, by order in writing—
 - (a) require the licensee or the generating company to take such action in respect of any matter arising out of the report as the Appropriate Commission may think fit; or
 - (b) cancel the licence; or
 - (c) direct the generating company to cease to carry on the business of generation of electricity.
- (7) The Appropriate Commission may, after giving reasonable notice to the licensee or the generating company, as the case may be, publish the report submitted by the Investigating Authority under sub-section (5) or such portion thereof as may appear to it to be necessary.
- (8) The Appropriate Commission may specify the minimum information to be maintained by the licensee or the generating company in their books, the manner in which such information shall be maintained, the checks and other verifications to be adopted by licensee or the generating company in that connection and all other matters incidental thereto as are, in its opinion, necessary to enable the Investigating Authority to discharge satisfactorily its functions under this section.

Explanation. - For the purposes of this section, the expression “licensee or the generating company” shall include in the case of a licensee incorporated in India—

 - (a) all its subsidiaries formed for the purpose of carrying on the business of generation or transmission or distribution or trading of electricity exclusively outside India; and
 - (b) all its branches whether situated in India or outside India.
- (9) All expenses of, and incidental to, any investigation made under this section shall be defrayed by the licensee or generating company, as the case may be, and shall have priority over that debts due from the licensee or the generating company and shall be recoverable as an arrear of land revenue.

Orders for securing compliance [Section 129]

- (1) Where the Appropriate Commission, on the basis of material in its possession, is satisfied that a licensee is contravening, or is likely to contravene, any of the conditions mentioned in his licence or conditions for grant of exemption or the licensee or the generating company has contravened or is likely to contravene any of the provisions of this Act, it shall, by an order, give such directions as may be necessary for the purpose of securing compliance with that condition or provision.
- (2) While giving direction under sub-section (1), the Appropriate Commission shall have due regard to the extent to which any person is likely to sustain loss or damage due to such contravention.

Procedure for issuing directions by Appropriate Commission [Section 130]

The Appropriate Commission, before issuing any direction under section 129, shall--

- (a) serve notice in the manner as may be specified to the concerned licensee or generating company;
- (b) publish the notice in the manner as may be specified for the purpose of bringing the matters to the attention of persons, likely to be affected, or affected;
- (c) Consider suggestions and objections from the concerned licensee or generating company and the persons, likely to be affected, or affected.



REORGANISATION OF BOARD

Vesting of property of Board in State Government [Section 131]

- (1) With effect from the date on which a transfer scheme, prepared by the State Government to give effect to the objects and purposes of this Act, is published or such further date as may be stipulated by the State Government (hereafter in this Part referred to as the effective date), any property, interest in property, rights and liabilities which immediately before the effective date belonged to the State Electricity Board (hereafter referred to as the Board) shall vest in the State Government on such terms as may be agreed between the State Government and the Board.
- (2) Any property, interest in property, rights and liabilities vested in the State Government under sub-section (1) shall be re-vested by the State Government in a Government company or in a company or companies, in accordance with the transfer scheme so published along with such other property, interest in property, rights and liabilities of the State Government as may be stipulated in such scheme, on such terms and conditions as may be agreed between the State Government and such company or companies being State Transmission Utility or generating company or transmission licensee or distribution licensee, as the case may be :

Provided that the transfer value of any assets transferred hereunder shall be determined, as far as may be, based on the revenue potential of such assets at such terms and conditions as may be agreed between the State Government and the State Transmission Utility or generating company or transmission licensee or distribution licensee, as the case may be.

- (3) Notwithstanding anything contained in this section, where,-
 - (a) the transfer scheme involves the transfer of any property or rights to any person or undertaking not wholly owned by the State Government, the scheme shall give effect to the transfer only for fair value to be paid by the transferee to the State Government;
 - (b) a transaction of any description is effected in pursuance of a transfer scheme, it shall be binding on all persons including third parties and even if such persons or third parties have not consented to it.
- (4) The State Government may, after consulting the Government company or company or companies being State Transmission Utility or generating company or transmission licensee or distribution licensee, referred to in sub-section (2) (hereinafter referred to as the transferor), require such transferor to draw up a transfer scheme to vest in a transferee being any other generating company or transmission licensee or distribution licensee, the property, interest in property, rights and liabilities which have been vested in the transferor under this section, and publish such scheme as statutory transfer scheme under this Act.
- (5) A transfer scheme under this section may-
 - (a) provide for the formation of subsidiaries, joint venture companies or other schemes of division, amalgamation, merger, reconstruction or arrangements which shall promote the profitability and viability of the resulting entity, ensure economic efficiency, encourage competition and protect consumer interests;
 - (b) define the property, interest in property, rights and liabilities to be allocated -
 - (i) by specifying or describing the property, rights and liabilities in question; or
 - (ii) by referring to all the property, interest in property, rights and liabilities comprised in a described part of the transferor's undertaking; or
 - (iii) partly in one way and partly in the other;
 - (c) provide that any rights or liabilities stipulated or described in the scheme shall be enforceable by or against the transferor or the transferee;

- (d) impose on the transferor an obligation to enter into such written agreements with or execute such other instruments in favour of any other subsequent transferee as may be stipulated in the scheme;
 - (e) mention the functions and duties of the transferee;
 - (f) make such supplemental, incidental and consequential provisions as the transferor considers appropriate including provision stipulating the order as taking effect; and
 - (g) provide that the transfer shall be provisional for a stipulated period.
- (6) All debts and obligations incurred, all contracts entered into and all matters and things engaged to be done by the Board, with the Board or for the Board, or the State Transmission Utility or generating company or transmission licensee or distribution licensee, before a transfer scheme becomes effective shall, to the extent specified in the relevant transfer scheme, be deemed to have been incurred, entered into or done by the Board, with the Board or for the State Government or the transferee and all suits or other legal proceedings instituted by or against the Board or transferor, as the case may be, may be continued or instituted by or against the State Government or concerned transferee, as the case may be.
- (7) The Board shall cease to be charged with and shall not perform the functions and duties with regard to transfers made on and after the effective date.

Explanation. - For the purpose of this Part, -

- (a) "Government company" means a Government Company formed and registered under the Companies Act, 1956.
- (b) "company" means a company to be formed and registered under the Companies Act, 1956 to undertake generation or transmission or distribution in accordance with the scheme under this Part.

Use of proceeds of sale or transfer of the Board etc. [Section 132]

In the event that a Board or any utility owned or controlled by the Appropriate Government is sold or transferred in any manner to a person who is not owned or controlled by the Appropriate Government, the proceeds from such sale or transfer shall be utilised in priority to all other dues in the following order, namely :-

- (a) dues (including retirement benefits due) to the officers and employees of such Board or utility, who have been affected by the aforesaid sale or transfer;
- (b) payment of debt or other liabilities of the transferor as may be required by the existing loan covenants.

Provisions relating to officers and employees [Section 133]

- (1) The State Government may, by a transfer scheme, provide for the transfer of the officers and employees to the transferee on the vesting of properties, rights and liabilities in such transferee as provided under section 131.
- (2) Upon such transfer under the transfer scheme, the personnel shall hold office or service under the transferee on such terms and conditions as may be determined in accordance with the transfer scheme:

Provided that such terms and conditions on the transfer shall not in any way be less favourable than those which would have been applicable to them if there had been no such transfer under the transfer scheme:

Provided further that the transfer can be provisional for a stipulated period.



Explanation: - For the purposes of this section and the transfer scheme, the expression “officers and employees” shall mean all officers and employees who on the date specified in the scheme are the officers and employees of the Board or transferor, as the case may be.

Payment of compensation or damages on transfer [Section 134]

Notwithstanding anything contained in the Industrial Disputes Act, 1947 or any other law for the time being in force and except for the provisions made in this Act, the transfer of the employment of the officers and employees referred to in sub-section (1) of section 133 shall not entitle such officers and employees to any compensation or damages under this Act, or any other Central or State law, save as provided in the transfer scheme.

OFFENCES AND PENALTIES

Theft of Electricity [Section 135]

(1) Whoever, dishonestly, --

- (a) taps, makes or causes to be made any connection with overhead, underground or under water lines or cables, or service wires, or service facilities of a licensee or supplier, as the case may be; or
- (b) tampers a meter, installs or uses a tampered meter, current reversing transformer, loop connection or any other device or method which interferes with accurate or proper registration, calibration or metering of electric current or otherwise results in a manner whereby electricity is stolen or wasted; or
- (c) damages or destroys an electric meter, apparatus, equipment, or wire or causes or allows any of them to be so damaged or destroyed as to interfere with the proper or accurate metering of electricity; or
- (d) uses electricity through a tampered meter; or
- (e) uses electricity for the purpose other than for which the usage of electricity was authorised, so as to abstract or consume or use electricity shall be punishable with imprisonment for a term which may extend to three years or with fine or with both:

Provided that in a case where the load abstracted, consumed, or used or attempted abstraction or attempted consumption or attempted use -

- (i) does not exceed 10 kilowatt, the fine imposed on first conviction shall not be less than three times the financial gain on account of such theft of electricity and in the event of second or subsequent conviction the fine imposed shall not be less than six times the financial gain on account of such theft of electricity;
- (ii) exceeds 10 kilowatt, the fine imposed on first conviction shall not be less than three times the financial gain on account of such theft of electricity and in the event of second or subsequent conviction, the sentence shall be imprisonment for a term not less than six months, but which may extend to five years and with fine not less than six times the financial gain on account of such theft of electricity:

Provided further that in the event of second and subsequent conviction of a person where the load abstracted, consumed, or used or attempted abstraction or attempted consumption or attempted use exceeds 10 kilowatt, such person shall also be debarred from getting any supply of electricity for a period which shall not be less than three months but may extend to two years and shall also be debarred from getting supply of electricity for that period from any other source or generating station.

Provided also that if it is proved that any artificial means or means not authorised by the Board or licensee or supplier, as the case may be, exist for the abstraction, consumption or use of electricity by the consumer, it shall be presumed, until the contrary is proved, that any abstraction, consumption or use of electricity has been dishonestly caused by such consumer.

- (1A) Without prejudice to the provisions of this Act, the licensee or supplier, as the case may be, may, upon detection of such theft of electricity, immediately disconnect the supply of electricity:

Provided that only such officer of the licensee or supplier, as authorised for the purpose by the Appropriate Commission or any other officer of the licensee or supplier, as the case may be, of the rank higher than the rank so authorised shall disconnect the supply line of electricity:

Provided further that such officer of the licensee or supplier, as the case may be, shall lodge a complaint in writing relating to the commission of such offence in police station having jurisdiction within twenty-four hours from the time of such disconnection:

Provided also that the licensee or supplier, as the case may be, on deposit or payment of the assessed amount or electricity charges in accordance with the provisions of this Act, shall, without prejudice to the obligation to lodge the complaint as referred to in the second proviso to this clause, restore the supply line of electricity within forty-eight hours of such deposit or payment”;

- (2) Any officer of the licensee or supplier as the case may be, authorised in this behalf by the State Government may -
- (a) enter, inspect, break open and search any place or premises in which he has reason to believe that electricity has been, is being, or is likely to be, used unauthorisedly;
 - (b) search, seize and remove all such devices, instruments, wires and any other facilitator or article which has been, is being, or is likely to be, used for unauthorized use of electricity;
 - (c) examine or seize any books of account or documents which in his opinion shall be useful for or relevant to, any proceedings in respect of the offence under sub-section (1) and allow the person from whose custody such books of account or documents are seized to make copies thereof or take extracts therefrom in his presence.
- (3) The occupant of the place of search or any person on his behalf shall remain present during the search and a list of all things seized in the course of such search shall be prepared and delivered to such occupant or person who shall sign the list:
- Provided that no inspection, search and seizure of any domestic places or domestic premises shall be carried out between sunset and sunrise except in the presence of an adult male member occupying such premises.
- (4) The provisions of the Code of Criminal Procedure, 1973, relating to search and seizure shall apply, as far as may be, to searches and seizure under this Act.

Theft of electric lines and materials [Section 136]

- (1) Whoever, dishonestly --
- (a) cuts or removes or takes away or transfers any electric line, material or meter from a tower, pole, any other installation or place of installation or any other place, or site where it may be rightfully or lawfully stored, deposited, kept, stocked, situated or located including during transportation, without the consent of the licensee or the owner, as the case may be, whether or not the act is done for profit or gain; or
 - (b) stores, possesses or otherwise keeps in his premises, custody or control, any electric line, material or meter without the consent of the owner, whether or not the act is committed for profit or gain; or



- (c) loads, carries, or moves from one place to another any electric line, material or meter without the consent of its owner, whether or not the act is done for profit or gain,

is said to have committed an offence of theft of electric lines and materials, and shall be punishable with imprisonment for a term which may extend to three years or with fine or with both.

- (2) If a person, having been convicted of an offence punishable under sub-section (1) is again guilty of an offence punishable under that subsection, he shall be punishable for the second or subsequent offence for a term of imprisonment which shall not be less than six months but which may extend to five years and shall also be liable to fine which shall not be less than ten thousand rupees.

Punishment for receiving stolen property [Section 137]

Whoever, dishonestly receives any stolen electric lines or materials knowing or having reasons to believe the same to be stolen property, shall be punishable with imprisonment of either description for a term which may extend to three years or with fine or with both.

Interference with meters or works of licensee [Section 138]

- (1) Whoever, -
- (a) unauthorisedly connects any meter, indicator or apparatus with any electric line through which electricity is supplied by a licensee or disconnects the same from any such electric line; or
 - (b) unauthorisedly reconnects any meter, indicator or apparatus with any electric line or other works being the property of a licensee when the said electric line or other works has or have been cut or disconnected; or
 - (c) lays or causes to be laid, or connects up any works for the purpose of communicating with any other works belonging to a licensee; or
 - (d) maliciously injures any meter, indicator, or apparatus belonging to a licensee or willfully or fraudulently alters the index of any such meter, indicator or apparatus or prevents any such meter, indicator or apparatus from duly registering,

Shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to ten thousand rupees, or with both, and, in the case of a continuing offence, with a daily fine which may extend to five hundred rupees; and if it is proved that any means exist for making such connection as is referred to in clause (a) or such re-connection as is referred to in clause (b), or such communication as is referred to in clause (c), for causing such alteration or prevention as is referred to in clause (d), and that the meter, indicator or apparatus is under the custody or control of the consumer, whether it is his property or not, it shall be presumed, until the contrary is proved, that such connection, reconnection, communication, alteration, prevention or improper use, as the case may be, has been knowingly and willfully caused by such consumer.

Negligently wasting electricity or injuring works [Section 139]

Whoever, negligently causes electricity to be wasted or diverted or negligently breaks, injures, throws down or damages any material connected with the supply of electricity, shall be punishable with fine which may extend to ten thousand rupees.

Penalty for maliciously wasting electricity or injuring works [Section 140]

Whoever, maliciously causes electricity to be wasted or diverted, or, with intent to cut off the supply of electricity, cuts or injures, or attempts to cut or injure, any electric supply line or works, shall be punishable with fine which may extend to ten thousand rupees.

Extinguishing public lamps [Section 141]

Whoever, maliciously extinguishes any public lamp shall be punishable with fine which may extend to two thousand rupees.

Punishment for non-compliance of directions by Appropriate Commission [Section 142]

In case any complaint is filed before the Appropriate Commission by any person or if that Commission is satisfied that any person has contravened any provisions of this Act or rules or regulations made thereunder, or any direction issued by the Commission, the Appropriate Commission may after giving such person an opportunity of being heard in the matter, by order in writing, direct that, without prejudice to any other penalty to which he may be liable under this Act, such person shall pay, by way of penalty, which shall not exceed one lakh rupees for each contravention and in case of a continuing failure with an additional penalty which may extend to six thousand rupees for every day during which the failure continues after contravention of the first such direction.

Power to adjudicate [Section 143]

- (1) For the purpose of adjudging under this Act, the Appropriate Commission shall appoint any of its Members to be an adjudicating officer for holding an inquiry in such manner as may be prescribed by the Appropriate Government, after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.
- (2) While holding an inquiry, the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or produce any document which in the opinion of the adjudicating officer, may be useful for or relevant to the subject-matter of the inquiry, and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of section 29 or section 33 or section 43, he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.

Factors to be taken into account by adjudicating officer [Section 144]

While adjudicating the quantum of penalty under section 29 or section 33 or section 43, the adjudicating officer shall have due regard to the following factors, namely:-

- (a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;
- (b) the repetitive nature of the default.

Civil court not to have jurisdiction [Section 145]

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which an assessing officer referred to in section 126 or an appellate authority referred to in section 127 or the adjudicating officer appointed under this Act is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

Punishment for non-compliance of orders or directions [Section 146]

Whoever, fails to comply with any order or direction given under this Act, within such time as may be specified in the said order or direction or contravenes or attempts or abets the contravention of any of the provisions of this Act or any rules or regulations made thereunder, shall be punishable with imprisonment for a term which may extend to three months or with fine, which may extend to one lakh rupees, or with both in respect of each offence and in the case of a continuing failure, with an additional fine which may extend to five thousand rupees for every day during which the failure continues after conviction of the first such offence.



Penalties not to affect other liabilities [Section 147]

The penalties imposed under this Act shall be in addition to, and not in derogation of, any liability in respect of payment of compensation or, in the case of a licensee, the revocation of his licence which the offender may have incurred.

Penalty where works belong to Government [Section 148]

The provisions of this Act shall, so far as they are applicable, be deemed to apply also when the acts made punishable thereunder are committed in the case of electricity supplied by or of works belonging to the Appropriate Government.

Offences by companies [Section 149]

- (1) Where an offence under this Act has been committed by a company, every person who at the time the offence was committed was in charge of and was responsible to the company for the conduct of the business of the company, as well as the company shall be deemed to be guilty of having committed the offence and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

- (2) Notwithstanding anything contained in sub-section (1), where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of or is attributable to any neglect on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of having committed such offence and shall be liable to be proceeded against and punished accordingly.

Explanation. - For the purpose of this section,-

- (a) "company" means a body corporate and includes a firm or other association of individuals; and
- (b) "director", in relation to a firm, means a partner in the firm.

Abatement [Section 150]

- (1) Whoever abets an offence punishable under this Act, shall, notwithstanding anything contained in the Indian Penal Code, be punished with the punishment provided for the offence.
- (2) Without prejudice to any penalty or fine which may be imposed or prosecution proceeding which may be initiated under Act or any other law for the time being in force, if any officer or other employee of the Board or the licensee enters into or acquiesces in any agreement to do, abstains from doing, permits, conceals or connives at any act or thing whereby any theft of electricity is committed, he shall be punishable with imprisonment for a term which may extend to three years, or with fine, or with both.
- (3) Notwithstanding anything contained in sub-section (1) of section 135, sub-section (1) of section 136, section 137 and section 138, the licence or certificate of competency or permit or such other authorisation issued under the rules made or deemed to have been made under this Act to any person who acting as an electrical contractor, supervisor or worker abets the commission of an offence punishable under sub-section (1) of section 135, sub-section (1) of section 136, section 137, or section 138, on his conviction for such abetment, may also be cancelled by the licensing authority:

Provided that no order of such cancellation shall be made without giving such person an opportunity of being heard.

Explanation.- For the purposes of this sub-section, "licensing authority" means the officer who for the time being in force is issuing or renewing such licence or certificate of competency or permit or such other authorisation.

Cognizance of offences [Section 151]

No court shall take cognizance of an offence punishable under this Act except upon a complaint in writing made by Appropriate Government or Appropriate Commission or any of their officer authorized by them or a Chief Electrical Inspector or an Electrical Inspector or licensee or the generating company, as the case may be, for this purpose.

Provided that the court may also take cognizance of an offence punishable under this Act upon a report of a police officer filed under section 173 of the Code of Criminal Procedure, 1973.

Provided further that a special court constituted under section 153 shall be competent to take cognizance of an offence without the accused being committed to it for trial."

Power of Police to investigate [Section 151A]

For the purposes of investigation of an offence punishable under this Act, the police officer shall have all the powers as provided in Chapter XII of the Code of Criminal Procedure, 1973.

Certain offences to be cognizable and non-bailable [Section 151B]

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, an offence punishable under sections 135 to 140 or section 150 shall be cognizable and non-bailable."

Cognizance of offences [Section 152]

- (1) Notwithstanding anything contained in the Code of Criminal Procedure 1973, the Appropriate Government or any officer authorized by it in this behalf may accept from any consumer or person who committed or who is reasonably suspected of having committed an offence of theft of electricity punishable under this Act, a sum of money by way of compounding of the offence as specified in the Table below:

Nature of Service	Rate at which the sum of money for Compounding to be collected per Kilowatt(KW)/Horse Power(HP) or part thereof for Low Tension (LT) supply and per Kilo Volt Ampere(KVA) of contracted demand for High Tension (HT)
(1)	(2)
1. Industrial Service	twenty thousand rupees;
2. Commercial Service	ten thousand rupees;
3. Agricultural Service	two thousand rupees;
4. Other Services	four thousand rupees:

Provided that the Appropriate Government may, by notification in the Official Gazette, amend the rates specified in the Table above.

- (2) On payment of the sum of money in accordance with sub-section (1), any person in custody in connection with that offence shall be set at liberty and no proceedings shall be instituted or continued against such consumer or person in any criminal court.
- (3) The acceptance of the sum of money for compounding an offence in accordance with sub-section (1) by the Appropriate Government or an officer authorised in this behalf empowered in this behalf shall be deemed to amount to an acquittal within the meaning of section 300 of the Code of Criminal Procedure, 1973.
- (4) The Compounding of an offence under sub-section (1) shall be allowed only once for any person or consumer.



SPECIAL COURTS

Constitution of Special Courts [Section 153]

- (1) The State Government may, for the purposes of providing speedy trial of offences referred to in sections 135 to 140 and section 150, by notification in the Official Gazette, constitute as many Special Courts as may be necessary for such area or areas, as may be specified in the notification.
- (2) A Special Court shall consist of a single Judge who shall be appointed by the State Government with the concurrence of the High Court.
- (3) A person shall not be qualified for appointment as a Judge of a Special Court unless he was, immediately before such appointment, an Additional District and Sessions Judge.
- (4) Where the office of the Judge of a Special Court is vacant, or such Judge is absent from the ordinary place of sitting of such Special Court, or he is incapacitated by illness or otherwise for the performance of his duties, any urgent business in the Special Court shall be disposed of –
 - (a) by a Judge, if any, exercising jurisdiction in the Special Court;
 - (b) where there is no such other Judge available, in accordance with the direction of District and Sessions Judge having jurisdiction over the ordinary place of sitting of Special Court, as notified under sub-section(1).

Procedure and power of Special Court [Section 154]

- (1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, every offence punishable under sections 135 to 140 and section 150 shall be triable only by the Special Court within whose jurisdiction such offence has been committed.
- (2) Where it appears to any court in the course of any inquiry or trial that an offence punishable under sections 135 to 140 and section 150 in respect of any offence that the case is one which is triable by a Special Court constituted under this Act for the area in which such case has arisen, it shall transfer such case to such Special Court, and thereupon such case shall be tried and disposed of by such Special Court in accordance with the provisions of this Act :

Provided that it shall be lawful for such Special Court to act on the evidence, if any, recorded by any court in the case of presence of the accused before the transfer of the case to any Special Court :

Provided further that if such Special Court is of opinion that further examination, cross-examination and re-examination of any of the witnesses whose evidence has already been recorded, is required in the interest of justice, it may resummon any such witness and after such further examination, cross-examination or re-examination, if any, as it may permit, the witness shall be discharged.

- (3) The Special Court may, notwithstanding anything contained in subsection (1) of section 260 or section 262 of the Code of Criminal Procedure, 1973, try the offence referred to in sections 135 to 140 and section 150 in a summary way in accordance with the procedure prescribed in the said Code and the provisions of sections 263 to 265 of the said Code shall, so far as may be, apply to such trial:

Provided that where in the course of a summary trial under this subsection, it appears to the Special Court that the nature of the case is such that it is undesirable to try such case in summary way, the Special Court shall recall any witness who may have been examined and proceed to re-hear the case in the manner provided by the provisions of the said Code for the trial of such offence: Provided further that in the case of any conviction in a summary trial under this section, it shall be lawful for a Special Court to pass a sentence of imprisonment for a term not exceeding five years.

- (4) A Special Court may, with a view to obtaining the evidence of any person supposed to have been directly or indirectly concerned in or privy to, any offence tender pardon to such person on condition of his making a full and true disclosure of the circumstances within his knowledge relating to the offence and to every other person concerned whether as principal or abettor in the commission thereof, and any pardon so tendered shall, for the purposes of section 308 of the Code of Criminal Procedure, 1973, be deemed to have been tendered under section 307 thereof.
- (5) The Special Court shall determine the civil liability against a consumer or a person in terms of money for theft of energy which shall not be less than an amount equivalent to two times of the tariff rate applicable for a period of twelve months preceding the date of detection of theft of energy or the exact period of theft if determined whichever is less and the amount of civil liability so determined shall be recovered as if it were a decree of civil court.
- (6) In case the civil liability so determined finally by the Special Court is less than the amount deposited by the consumer or the person, the excess amount so deposited by the consumer or the person, to the Board or licensee or the concerned person, as the case may be, shall be refunded by the Board or licensee or the concerned person, as the case may be, within a fortnight from the date of communication of the order of the Special Court together with interest at the prevailing Reserve Bank of India prime lending rate for the period from the date of such deposit till the date of payment.

Explanation. - For the purposes of this section, "civil liability" means loss or damage incurred by the Board or licensee or the concerned person, as the case may be, due to the commission of an offence referred to in sections 135 to 140 and section 150.

Special Court to have powers of court of session [Section 155]

Save as otherwise provided in this Act, the Code of Criminal Procedure, 1973, in so far as they are not inconsistent with the provisions of this Act, shall apply to the proceedings before the Special Court and for the purpose of the provisions of the said enactments, the Special Court shall be deemed to be a Court of Session and shall have all powers of a Court of Session and the person conducting a prosecution before the Special Court shall be deemed to be a Public Prosecutor.

Appeal and revision [Section 156]

The High Court may exercise, so far as may be applicable, all the powers conferred by Chapters XXIX and XXX of the Code of Criminal Procedure, 1973, as if the Special Court within the local limits of the jurisdiction of the High Court is a District Court, or as the case may be, the Court of Session, trying cases within the local limits of jurisdiction of the High Court.

Review [Section 157]

The Special Court may, on a petition or otherwise and in order to prevent miscarriage of justice, review its judgment or order passed under section 154, but no such review petition shall be entertained except on the ground that it was such order passed under a mistake of fact, ignorance of any material fact or any error apparent on the face of the record :

Provided that the Special Court shall not allow any review petition and set aside its previous order or judgment without hearing the parties affected.

Explanation.- For the purpose of this Part, "Special Courts" means the Special Courts constituted under sub-section (1) of section 153.

DISPUTE RESOLUTION

Arbitration [Section 158]

Where any matter is, by or under this Act, directed to be determined by arbitration, the matter shall, unless it is otherwise expressly provided in the licence of a licensee, be determined by such person



or persons as the Appropriate Commission may nominate in that behalf on the application of either party; but in all other respects the arbitration shall be subject to the provisions of the Arbitration and Conciliation Act, 1996.

OTHER PROVISION

Protection of railways, highways, airports and canals, docks, wharfs and piers [Section 159]

No person shall, in the generation, transmission, distribution, supply or use of electricity, in any way injure any railway, highway, airports, tramway, canal or water-way or any dock, wharf or pier vested in or controlled by a local authority, or obstruct or interfere with the traffic on any railway, airway, tramway, canal or water-way.

Protection of telegraphic, telephonic and electric signaling lines [Section 160]

- (1) Every person generating, transmitting, distributing, supplying or using electricity (hereinafter in this section referred to as the "operator") shall take all reasonable precautions in constructing, laying down and placing his electric lines, electrical plant and other works and in working his system, so as not injuriously to affect, whether by induction or otherwise, the working of any wire or line used for the purpose of telegraphic, telephone or electric signaling communication, or the currents in such wire or line.
- (2) Where any difference or dispute arises between the operator, and the telegraph authority as to whether the operator has constructed, laid down or placed his electric lines, electrical plant or other works, or worked his system, in contravention of sub-section (1), or as to whether the working of any wire, line or current is or is not injuriously affected thereby, the matter shall be referred to the Central Government and the Central Government, unless it is of opinion that the wire or line has been placed in unreasonable proximity to the electric lines, electrical plant or works of the operator after the construction of such lines, plant or works, may direct the operator to make such alterations in, or additions to, his system as may be necessary in order to comply with the provisions of this section, and the operator shall make such alterations or additions accordingly:

Provided that nothing in this sub-section shall apply to the repair, renewal or amendment of any electric line or electrical plant so long as the course of the electric line or electrical plant and the amount and nature of the electricity transmitted thereby are not altered.
- (3) Where the operator makes default in complying with the requirements of this section, he shall make full compensation for any loss or damage incurred by reason thereof, and, where any difference or dispute arises as to the amount of such compensation, the matter shall be determined by arbitration.

Explanation. - For the purposes of this section, a telegraph line shall be deemed to be injuriously affected if telegraphic, telephonic or electric signaling communication by means of such line is, whether through induction or otherwise, prejudicially interfered with by an electric line, electrical plant or other work or by any use made thereof.

Notice of accidents and inquiries [Section 161]

- (1) If any accident occurs in connection with the generation, transmission, distribution, supply or use of electricity in or in connection with, any part of the electric lines or electrical plant of any person and the accident results or is likely to have resulted in loss of human or animal life or in any injury to a human being or an animal, such person shall give notice of the occurrence and of any such loss or injury actually caused by the accident, in such form and within such time as may be prescribed, to the Electrical Inspector or such other person as aforesaid and to such other authorities as the Appropriate Government may by general or special order, direct.
- (2) The Appropriate Government may, if it thinks fit, require any Electrical Inspector, or any other person appointed by it in this behalf, to inquire and report-

- (a) as to the cause of any accident affecting the safety of the public, which may have been occasioned by or in connection with, the generation, transmission, distribution, supply or use of electricity, or
 - (b) as to the manner in, and extent to, which the provisions of this Act or rules and regulations made thereunder or of any licence, so far as those provisions affect the safety of any person, have been complied with.
- (3) Every Electrical Inspector or other person holding an inquiry under sub-section (2) shall have all the powers of a civil court under the Code of Civil Procedure, 1908 for the purpose of enforcing the attendance of witnesses and compelling the production of documents and material objects, and every person required by an Electrical Inspector be legally bound to do so within the meaning of section 176 of the Indian Penal Code.

Appointment of Chief Electrical Inspector and Electrical Inspector [Section 162]

- (1) The Appropriate Government may, by notification, appoint duly qualified persons to be Chief Electrical Inspector or Electrical Inspectors and every such Inspector so appointed shall exercise the powers and perform the functions of a Chief Electrical Inspector or an Electrical Inspector under this Act and exercise such other powers and perform such other functions as may be prescribed within such areas or in respect of such class of works and electric installations and subject to such restrictions as the Appropriate Government may direct.
- (2) In the absence of express provision to the contrary in this Act, or any rule made thereunder, an appeal shall lie from the decision of a Chief Electrical Inspector or an Electrical Inspector to the Appropriate Government or if the Appropriate Government, by general or special order so directs, to an Appropriate Commission.

Power for licensee to enter premises and to remove fittings or other apparatus of licensee [Section 163]

- (1) A licensee or any person duly authorised by a licence may, at any reasonable time, and on informing the occupier of his intention, enter any premises to which electricity is, or has been, supplied by him, of any premises or land, under, over, along, across, in or upon which the electric supply-lines or other works have been lawfully placed by him for the purpose of –
- (a) inspecting, testing, repairing or altering the electric supply lines, meters, fittings, works and apparatus for the supply of electricity belonging to the licensee; or
 - (b) ascertaining the amount of electricity supplied or the electrical quantity contained in the supply; or
 - (c) removing where a supply of electricity is no longer required, or where the licensee is authorised to take away and cut off such supply, any electric supply-lines, meters, fittings, works or apparatus belonging to the licensee.
- (2) A licensee or any person authorised as aforesaid may also, in pursuance of a special order in this behalf made by an Executive Magistrate and after giving not less than twenty-four hours notice in writing to the occupier, -
- (a) enter any premises or land referred to in sub-section (1) for any of the purposes mentioned therein;
 - (b) enter any premises to which electricity is to be supplied by him, for the purpose of examining and testing the electric wires fittings, works and apparatus for the use of electricity belonging to the consumer.
- (3) Where a consumer refuses to allow a licensee or any person authorised as aforesaid to enter his premises or land in pursuance of the provisions of sub-section (1) or, sub-section (2), when such licensee or person has so entered, refuses to allow him to perform any act which he is



authorised by those subsections to perform, or fails to give reasonable facilities for such entry or performance, the licensee may, after the expiry of twenty-four hours from the service of a notice in writing on the consumer, cut off the supply to the consumer for so long as such refusal or failure continues, but for no longer.

Exercise of powers of Telegraph Authority in certain cases [Section 164]

The Appropriate Government may, by order in writing, for the placing of electric lines or electrical plant for the transmission of electricity or for the purpose of telephonic or telegraphic communications necessary for the proper co-ordination of works, confer upon any public officer, licensee or any other person engaged in the business of supplying electricity under this Act, subject to such conditions and restrictions, if any, as the Appropriate Government may think fit to impose and to the provisions of the Indian Telegraph Act, 1885, any of the powers which the telegraph authority possesses under that Act with respect to the placing of telegraph authority possesses under that Act with respect to the placing of telegraph lines and posts for the purposes of a telegraph established or maintained, by the Government or to be so established or maintained.

Amendment of Sections 40 and 41 of Act 1 of 1894 [Section 165]

- (1) In section 40, sub-section (1) of clause (b) and section 41, subsection (5) of the Land Acquisition Act, 1894, the term "work" shall be deemed to include electricity supplied or to be supplied by means of the work to be constructed.
- (2) The Appropriate Government may, on recommendation of the Appropriate Commission in this behalf, if it thinks fit, on the application of any person, not being a company desirous of obtaining any land for its purposes, direct that he may acquire such land under the provisions of the Land Acquisition Act, 1894 in the same manner and on the same conditions as it might be acquired if the person were a company.

MISCELLANEOUS

Coordination Forum [Section 166]

- (1) The Central Government shall constitute a Coordination Forum consisting of the Chairperson of the Central Commission and Members thereof, the Chairperson of the Authority, representatives of generating companies and transmission licensees engaged in inter-State transmission of electricity for smooth and coordinated development of the power system in the country.
- (2) The Central Government shall also constitute a forum of regulators consisting of the Chairperson of the Central Commission and Chairpersons of the State Commissions.
- (3) The Chairperson of the Central Commission shall be the Chairperson of the Forum of regulators referred to in sub-section (2).
- (4) The State Government shall constitute a Coordination Forum consisting of the Chairperson of the State Commission and Members thereof representatives of the generating companies, transmission licensee and distribution licensees engaged in generation, transmission and distribution of electricity in that State for smooth and coordinated development of the power system in the State.
- (5) There shall be a committee in each district to be constituted by the Appropriate Government
 - (a) to coordinate and review the extension of electrification in each district;
 - (b) to review the quality of power supply and consumer satisfaction;
 - (c) to promote energy efficiency and its conservation.

Exemption of electric lines or electrical plants from attachment in certain cases [Section 167]

Where any electric lines or electrical plant, belonging to a licensee are placed in or upon any premises

or land not being in the possession of the licensee, such electric lines or electrical plant shall not be liable to be taken in execution under any process of any civil court or in any proceedings in insolvency against the person in whose possession the same may be.

Protection of action taken in good faith [Section 168]

No suit, prosecution or other proceeding shall lie against the Appropriate Government or Appellate Tribunal or the Appropriate Commission or any officer of Appropriate Government, or any Member, Officer or other employees of the Appellate Tribunal or any Members, officer or other employees of the Appropriate Commission or the assessing officer or any public servant for anything done or in good faith purporting to be done under this Act or the rules or regulations made thereunder.

Members, officers, etc., of Appellate Tribunal, Appropriate Commission to be public servants [Section 169]

The Chairperson, Members, officers and other employees of the Appellate Tribunal and the Chairperson, Members, Secretary, officers and other employees of the Appropriate Commission and the assessing officer referred to in section 126 shall be deemed, when acting or purporting to act in pursuance of any of the provisions of this Act to be public servants within the meaning of section 21 of the Indian Penal Code.

Recovery of penalty payable under Act [Section 170]

Any penalty payable by a person under this Act, if not paid, may be recovered as if it were an arrear of land revenue.

Service of notices, orders or documents [Section 171]

- (1) Every notice, order or document by or under this Act required, or authorised to be addressed to any person may be served on him by delivering the same after obtaining signed acknowledgement receipt therefor or by registered post or such means of delivery as may be prescribed -
 - (a) where the Appropriate Government is the addressee, at the office of such officer as the Appropriate Government may prescribe in this behalf;
 - (b) where the Appropriate Commission is the addressee, at the office of the Appropriate Commission;
 - (c) where a company is the addressee, at the registered office of the company or, in the event of the registered office of the company not being in India, at the head office of the company in India;
 - (d) where any other person is the addressee, at the usual or last known place of abode or business of the person.
- (2) Every notice, order or document by or under this Act required or authorised to be addressed to the owner or occupier of any premises shall be deemed to be properly addressed if addressed by the description of the owner or occupier of the premises (naming the premises), and may be served by delivering it, or a true copy thereof, to some person on the premises, or if there is no person on the premises to whom the same can with reasonable diligence be delivered, by affixing it on some conspicuous part of the premises.

Transitional provisions [Section 172]

Notwithstanding anything to the contrary contained in this Act,-

- (a) a State Electricity Board constituted under the repealed laws shall be deemed to be the State Transmission Utility and a licensee under the provisions of this Act for a period of one year from the appointed date or such earlier date as the State Government may notify, and shall perform the duties and functions of the State Transmission Utility and a licensee in accordance with the provisions of this Act and rules and regulations made thereunder:



Provided that the State Government may, by notification, authorise the State Electricity Board to continue to function as the State Transmission Utility or a licensee for such further period beyond the said period of one year as may be mutually decided by the Central Government and the State Government.

- (b) all licences, authorisations approvals, clearances and permissions granted under the provisions of the repealed laws may, for a period not exceeding one year from the appointed date or such earlier period; as may be notified by the Appropriate Government, continue to operate as if the repealed laws were in force with respect to such licence, authorisations, approvals, clearances and permissions, as the case may be, and thereafter such licences, authorisations, approvals, clearances and permissions shall be deemed to be licences, authorisation, approvals, clearances and permission under this Act and all provisions of this Act shall apply accordingly to such licences authorizations approvals, clearances and permissions.
- (c) the undertaking of the State Electricity Boards established under section 5 of the Electricity (Supply) Act, 1948 may after the expiry of the period specified in clause (a) be transferred in accordance with the provisions of Part XIII of this Act;
- (d) the State Government may, by notification, declare that any or all the provisions contained in this Act, shall not apply in that State for such period, not exceeding six months from the appointed date, as may be stipulated in the notification.

Inconsistency in laws [Section 173]

Nothing contained in this Act or any rule or regulation made thereunder or any instrument having effect by virtue of this Act, rule or regulation shall have effect in so far as it is inconsistent with any other provisions of the Consumer Protection Act, 1986 or the Atomic Energy Act, 1962 or the Railways Act, 1989.

Act to have overriding effect [Section 174]

Save as otherwise provided in section 173, the provisions of this Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or in any instrument having effect by virtue of any law other than this Act.

Provisions of this Act to be in addition to and not in derogation of other laws [Section 175]

The provisions of this Act are in addition to and not in derogation of any other law for the time being in force.

Power of Central Government to make rules [Section 176]

- (1) The Central Government may, by notification, make rules for carrying out the provisions of this Act.
- (2) In particular and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely: -
 - (a) the time within which the objection and suggestions on the draft National Electricity Plan to be invited by the Authority under the proviso to sub-section (4) of section 3;
 - (b) the additional requirements (relating to the capital adequacy, credit worthiness or code of conduct) under sixth proviso to section 14;
 - (c) the payment of fees for application for grant of licence under sub-section (l) of section 15;
 - (d) the constitution and functions of the National Load Despatch Centre under sub-section (2) of section 26;

- (e) the works of licensees affecting the property of owner or occupier under sub-section (2) of section 67;
- (f) such other works which may be prescribed under clause (c) of sub-section (2) of Section 68;
- (g) allowances and fees payable to others Members for attending the meetings of Authority under sub-section (14) of section 70.
- (h) other terms and conditions of service of the Chairperson and Members of the Authority under sub-section (15) of section 70;
- (i) the functions and duties of the Central Electricity Authority under section 73;
- (j) the salary, allowances and other conditions of service of Chairperson and Member of Central Commission under sub-section (2) of section 89;
- (k) the form and manner in which and the authority before whom oath of office and secrecy should be subscribed under sub-section (3) of section 89;
- (l) the procedure to be prescribed by the Central Commission under the proviso to sub-section (2) of section 90;
- (m) any other matter required to be prescribed under clause (g) of sub-section (1) of section 94;
- (n) the form in which the Central Commission shall prepare its annual statements of accounts under sub-section (1) of section 100;
- (o) the form in which and time at which the Central Commission shall prepare its annual report under sub-section (1) 101;
- (p) the form in which and time at which the Central Commission shall prepare its budget under section 106;
- (q) the form and the manner of verifying such form, and fee for filing appeal under sub-section (2) of section 111;
- (r) the salary and allowances payable to and the other terms and conditions of service of the Chairperson of the Appellate Tribunal and Members of the Appellate Tribunal under section 115;
- (s) the salary and allowances and other conditions of service of the officers and employees of the Appellate Tribunal under sub-section (3) of section 119;
- (t) the additional matters in respect of which the Appellate Tribunal may exercise the powers of a civil court under clause (i) of sub-section (2) of section 120;
- (u) the authority to whom the appeal shall be filed under sub-section (1) of section 127;
- (v) manner of holding inquiry by an adjudicating officer and subsection (1) of section 143;
- (w) the form in which and the time at which service of notices to any person or to the Central Government for the purpose under sub-section (1) of section 161;
- (x) the powers to be exercised and the functions to be performed by the Inspectors under sub-section (1) of section 162;
- (y) the manner of delivery of every notice, order or document to be served under sub-section (1) of section 171;
- (z) any other matter which is required to be, or may be, prescribed.



Powers of Authority to make regulations [Section 177]

- (1) The Authority may, by notification, make regulations consistent with this Act and the rules generally to carry out the provisions of this Act.
- (2) In particular and without prejudice to the generality of the power conferred in sub-section (1), such regulations may provide for all or any of the following matters, namely:--
 - (a) the Grid Standards under section 34;
 - (b) suitable measures relating to safety and electric supply under section 53;
 - (c) the installation and operation of meters under section 55;
 - (d) the rules of procedure for transaction of business under sub-section (9) of section 70;
 - (e) the technical standards for construction of electrical plants and electric lines and connectivity to the grid under clause (b) of section 73;
 - (f) the form and manner in which and the time at which the State Government and licensees shall furnish statistics, returns or other information under section 74.
 - (g) any other matter which is to be, or may be, specified;
- (3) All regulations made by the Authority under this Act shall be subject to the conditions of previous publication.

Powers of Central Commission to make regulations [Section 178]

- (1) The Central Commission may, by notification make regulations consistent with this Act and the rules generally to carry out the provisions of this Act.
- (2) In particular and without prejudice to the generality of the power contained in sub-section (1), such regulations may provide for all or any of following matters, namely:-
 - (a) period to be specified under the first proviso to section 14;
 - (b) the form and the manner of the application under sub-section (1) of section 15;
 - (c) the manner and particulars of notice under sub-section (2) of section 15;
 - (d) the conditions of licence under section 16;
 - (e) the manner and particulars of notice under clause (a) of sub-section(2) of section 18;
 - (f) publication of alterations or amendments to be made in the licence under clause(c) of sub-section (2) of section 18;
 - (g) Grid Code under sub-section (2) of section 28;
 - (h) levy and collection of fees and charge from generating companies or transmission utilities or licensees under sub-section (4) of section 28;
 - (i) rates, charges and terms and conditions in respect of intervening transmission facilities under proviso to section 36;
 - (j) payment of the transmission charges and a surcharge under-sub78 clause (ii) of clause (d) of sub-section (2) of section 38;
 - (k) reduction of surcharge and cross subsidies under second proviso to sub-clause (ii) of clause (d) of sub-section (2) of section 38;
 - (l) payment of transmission charges and a surcharge under sub-clause (ii) of clause(c) of section 40;

- (m) reduction of surcharge and cross subsidies under the second proviso to sub-clause (ii) of clause (c) of section 40;
 - (n) proportion of revenues from other business to be utilised for reducing the transmission and wheeling charges under proviso to section 41;
 - (o) duties of electricity trader under sub-section (2) of section 52;
 - (p) standards of performance of a licensee or class of licensees under sub-section (1) of section 57;
 - (q) the period within which information to be furnished by the licensee under sub-section (1) of section 59;
 - (r) the manner for reduction of cross-subsidies under clause (g) of section 61;
 - (s) the terms and conditions for the determination of tariff under section 61;
 - (t) details to be furnished by licensee or generating company under sub-section (2) of section 62;
 - (u) the procedures for calculating the expected revenue from tariff and charges under sub-section (5) of section 62;
 - (v) the manner of making an application before the Central Commission and the fee payable therefor under sub-section (1) of section 64;
 - (w) the manner of publication of draft tariff order under sub-section (3) of section 64;
 - (x) issue of tariff order with modifications or conditions under subsection (4) of section 64;
 - (y) the manner by which development of market in power including trading specified under section 66;
 - (z) the powers and duties of the Secretary of the Central Commission under sub-section (1) of section 91;
 - (za) the terms and conditions of service of the Secretary, officers and other employees of Central Commission under sub-section (3) of section 91; (zb) the rules of procedure for transaction of business under subsection (1) of section 92;
 - (zc) minimum information to be maintained by a licensee or the generating company and the manner of such information to be maintained under sub-section (8) of section 128; (zd) the manner of service and publication of notice under section 130;
 - (ze) any other matter which is to be, or may be, specified by regulations.
- (3) All regulations made by the Central Commission under this Act shall be subject to the conditions of previous publication.

Rules and regulations to be laid before Parliament [Section 179]

Every rule made by the Central Government, every regulation made by the Authority, and every regulation made by the Central Commission shall be laid, as soon as may be after it is made, before each House of the Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or regulation or agree that the rule or regulation should not be made, the rule or regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule or regulation.



Powers of State Governments to make rules [Section 180]

- (1) The State Government may, by notification, make rules for carrying out the provisions of this Act.
- (2) In particular and without prejudice to the generality of foregoing power, such rules may provide for all or any of the following matters, namely: -
 - (a) the payment of fees for application for grant of licence under subsection (1) of section 15;
 - (b) the works of licensees affecting the property of other persons under sub-section (2) of section 67;
 - (c) such other matters which may be prescribed under clause (c) of subsection (2) of section 68;
 - (d) the salary, allowances and other terms and conditions of service of the Chairperson and Members of the State Commission under sub-section (2) of section 89;
 - (e) the form and manner in which and the authority before whom oath of office and secrecy should be subscribed under sub-section (3) of section 89;
 - (f) any other matter required to be prescribed by the State Commission under clause (g) of sub-section (1) of section 94;
 - (g) the manner of applying the Fund under sub-section (3) of section 103;
 - (h) the form in which and time at which the State Commission shall prepare its annual accounts under sub-section (1) of section 104;
 - (i) the form in which and time at which the State Commission shall prepare its annual report under sub-section (1) of section 105;
 - (j) the form in which and time at which the State Commission shall prepare its budget under section 106;
 - (k) manner of service of provisional order of assessment under subsection (2) of section 126;
 - (l) manner of holding inquiry by an adjudicating officer under subsection (1) of section 143;
 - (m) the form in which and the time at which notice to the Electrical. Inspector under sub-section (1) of section 161;
 - (n) the manner of delivery of every notice, order or document under sub-section (1) of section 171; and
 - (o) any other matter which is required to be, or may be, prescribed.

Powers of State Commissions to make regulations [Section 181]

- (1) The State Commissions may, by notification, make regulations consistent with this Act and the rules generally to carry out the provisions of this Act.
- (2) In particular and without prejudice to the generality of the power contained in sub-section (1), such regulations may provide for all or any of the following matters, namely: -
 - (a) period to be specified under the first proviso of section 14;
 - (b) the form and the manner of application under sub-section (1) of section 15;
 - (c) the manner and particulars of application for licence to be published under sub-section (2) of section 15;
 - (d) the conditions of licence section 16;
 - (e) the manner and particulars of notice under clause (a) of subsection (2) of section 18;

- (f) publication of the alterations or amendments to be made in the licence under clause (c) of sub-section (2) of section 18;
- (g) levy and collection of fees and charges from generating companies or licensees under sub-section (3) of section 32;
- (h) rates, charges and the term and conditions in respect of intervening transmission facilities under proviso to section 36;
- (i) payment of the transmission charges and a surcharge under subclause (ii) of clause(d) of sub-section (2) of section 39;
- (j) reduction of surcharge and cross subsidies under second proviso to sub-clause (ii) of clause (d) of sub-section (2) of section 39;
- (k) manner and utilisation of payment and surcharge under the fourth proviso to sub-clause(ii) of clause (d) of sub-section (2) of section 39;
- (l) payment of the transmission charges and a surcharge under subclause(ii) of clause (c) of section 40;
- (m) reduction of surcharge and cross subsidies under second proviso to sub-clause (ii) of clause (c) of section 40;
- (n) the manner of payment of surcharge under the fourth proviso to sub-clause (ii) of clause (c) of section 40;
- (o) proportion of revenues from other business to be utilised for reducing the transmission and wheeling charges under proviso to section 41;
- (p) reduction of surcharge and cross-subsidies under the third proviso to sub-section (2) of section 42;
- (q) payment of additional charges on charges of wheeling under subsection (4) of section 42;
- (r) guidelines under sub-section (5) of section 42;
- (s) the time and manner for settlement of grievances under sub-section (7) of section 42;
- (t) the period to be specified by the State Commission under sub-section (1) of section 43;
- (u) methods and principles by which charges for electricity shall be fixed under sub-section (2) of section 45;
- (v) reasonable security payable to the distribution licensee under sub-section (1) of section 47;
- (w) payment of interest on security under sub-section (4) of section 47;
- (x) electricity supply code under section 50;
- (y) the proportion of revenues from other business to be utilised for reducing wheeling charges under proviso to section 51;
- (z) duties of electricity trader under sub-section (2) of section 52;
- (za) standards of performance of a licensee or a class of licensees under sub-section (1) of section 57;
- (zaa) the period within which information to be furnished by the licensee under sub-section (1) of section 59;
- (zb) the period within which the cross-subsidies shall be reduced and eliminated under clause (g) of section 61;
- (zc) the manner of reduction of cross-subsidies under clause (g) of section 61;

- (zd) details to be furnished by licensee or generating company under sub-section (2) of section 62;
 - (ze) the methodologies and procedures for calculating the expected revenue from tariff and charges under sub-section (1) of section 62;
 - (zf) the manner of making an application before the State Commission and the fee payable therefor under sub-section (1) of section 64;
 - (zg) issue of tariff order with modifications or conditions under subsection (3) of section 64;
 - (zh) the manner by the which development of market in power including trading specified under section 66;
 - (zi) the powers and duties of the Secretary of the State Commission under sub-section (1) of section 91;
 - (zj) the terms and conditions of service of the secretary, officers and other employees of the State Commission under sub-section (2) of section 91;
 - (zk) rules of procedure for transaction of business under sub-section (1) of section 92;
 - (zl) minimum information to be maintained by a licensee or the generating company and the manner of such information to be maintained under sub-section (8) of section 128;
 - (zm) the manner of service and publication of notice under section 130;
 - (zn) the form of and preferring the appeal and manner in which such form shall be verified and the fee for preferring the appeal under sub-section (1) of section 127;
 - (zo) any other matter which is to be, or may be, specified.
- (3) All regulations made by the State Commission under this Act shall be subject to the condition of previous publication.

Rules and regulations to be laid before State Legislature [Section 182]

Every rule made by the State Government and every regulation made by the State Commission shall be laid, as soon as may be after it is made, before each House of the State Legislature where it consists of two Houses, or where such Legislature consists of one House, before that House.

Power to remove difficulties [Section 183]

- (1) If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order published, make such provisions not inconsistent with the provisions of this Act, as may appear to be necessary for removing the difficulty:

Provided that no order shall be made under this section after the expiry of two years from the date of commencement of this Act.

- (2) Every order made under this section shall be laid, as soon as may be after it is made, before each House' of Parliament.

Provisions of Act not to apply in certain cases [Section 184]

The provisions of this Act shall not apply to the Ministry or Department of the Central Government dealing with Defence, Atomic Energy or such other similar Ministries or Departments or undertakings or Boards or institutions under the control of such Ministries or Departments as may be notified by the Central Government.

Repeal and saving [Section 185]

- (1) Save as otherwise provided in this Act, the Indian Electricity Act, 1910, the Electricity (Supply) Act, 1948 and the Electricity Regulatory Commissions Act, 1998 are hereby repealed.

- (2) Notwithstanding such repeal, -
- (a) anything done or any action taken or purported to have been done or taken including any rule, notification, inspection, order or notice made or issued or any appointment, confirmation or declaration made or any licence, permission, authorisation or exemption granted or any document or instrument executed or any direction given under the repealed laws shall, in so far as it is not inconsistent with the provisions of this Act, be deemed to have been done or taken under the corresponding provisions of this Act.
 - (b) the provisions contained in sections 12 to 18 of the Indian Electricity Act, 1910 and rules made thereunder shall have effect until the rules under section 67 to 69 of this Act are made;.
 - (c) Indian Electricity Rules, 1956 made under section 37 of the Indian Electricity Act, 1910 as it stood before such repeal shall continue to be in force till the regulations under section 53 of this Act are made.
 - (d) all rules made under sub-section (1) of section 69 of the Electricity (Supply) Act, 1948 shall continue to have effect until such rules are rescinded or modified, as the case may be;
 - (e) all directives issued, before the commencement of this Act, by a State Government under the enactments specified in the Schedule shall continue to apply for the period for which such directions were issued by the State Government."
- (3) The provisions of the enactments specified in the Schedule, not inconsistent with the provisions of this Act, shall apply to the States in which such enactments are applicable.
- (4) The Central Government may, as and when considered necessary, by notification, amend the Schedule.
- (5) Save as otherwise provided in sub-section (2), the mention of particular matters in that section, shall not be held to prejudice or affect the general application of section 6 of the General Clauses Act, 1897, with regard to the effect of repeals.

Study Note - 8

CORPORATE GOVERNANCE



This Study Note includes

- 8.1 Overview-Issues and Concepts**
- 8.2 Corporate Governance Practices/Codes in - UK, Germany, Japan, India and USA**
- 8.3 Corporate Governance in Family Business**
- 8.4 Corporate Governance in State-owned Business - the MOU System**

8.1 OVERVIEW-ISSUES AND CONCEPTS

'Corporate Governance' has become one of the most commonly used phrases in the current global business vocabulary. This raises the question, 'is corporate governance a vital component of successful business or is it simply another fad that will fade away over time? The notorious collapse of Enron in 2001, one of America's largest companies, has focused international attention on company failures and the role that strong corporate governance needs to play them. The UK has responded by producing the Higgs Report (2003) and the Smith Report (2003), whereas the US produced the Sarbanes – Oxley Act (2002). Nations around the world are instigating far-reaching programmes for Corporate governance reform, as evidenced by the proliferation of Corporate Governance codes and policy documents, voluntary or mandatory, both at the national and supra-national level. We believe that the present focus on corporate governance will be maintained into the future and that, over time, corporate governance issues grow in importance, rather than fade into insignificance. The phenomenal growth of interest in Corporate Governance has been accompanied by a growing body of academic research. As the discipline matures, far greater definition and clarity are being achieved concerning the nature of corporate governance. In this chapter we consider the broad-ranging nature of corporate governance and the many ways of defining the subject. We discuss Corporate Governance from a theoretical perspective.

Concept and Definition

There is no single, accepted definition of Corporate Governance. There are substantial differences in definition according to which country we are considering. Arriving at 'a' definition of Corporate Governance is no easy task. Corporate Governance as a discipline in its own right is relatively new. We consider that the subject may be treated in a narrow or a broad manner, depending on the viewpoint of the policy maker, practitioner, researcher or theorist. It seems that existing definitions of Corporate Governance fall on to a spectrum, with 'narrow' views at one end and more inclusive, 'broad' views placed at the other. Once approach toward Corporate Governance adopts a narrow view, where Corporate Governance is restricted to the relationship between a company and its shareholders. This is the traditional finance paradigm, expressed in 'agency theory'. At the other end of the spectrum, corporate governance may be seen as a web of relationships, not only between a company and its owners (shareholders) but also between a company and a broad range of other 'stakeholders': employees, customers, supplies, bondholders, to name but a few. such a view tends to be expressed in 'stakeholder theory'. This is a more inclusive and broad way of treating the subject of corporate governance and one which is gradually attracting greater attention.

Corporate governance is...

- The process of supervision and control intended to ensure that the company's management acts in accordance with the interests of shareholders (Parkinson, 1994). – Strongly agree
- The governance role is not concerned with the running of the business of the company per se, but with giving overall direction to the enterprise, with overseeing and controlling the executive actions of management and with satisfying legitimate expectations of accountability and regulation by interests beyond the corporate boundaries (Tricker, 1984). – Agree
- The governance of an enterprise is the sum of those activities that make up the internal regulation of the business in compliance with the obligations placed on the firm by legislation, ownership trusteeship of assets, their management and their deployment (Cannon, 1994). – Agree
- The relationship between shareholders and their companies and the way in which shareholders act to encourage best practice (e.g., by voting at AGMs and by regular meetings with companies' senior management). Increasingly, this includes shareholder 'activism' which involves a campaign by a shareholder or a group of shareholders to achieve change in companies (The Corporate Governance Handbook, 1996). – Some agreement
- The structures, process, cultures and systems that engender the successful operation of the Organization (Keasey and Wright, 1993). – Some agreement
- The system by which companies are directed and controlled (The Cadbury Report, 1992) – slight agreement

We consider some published definitions of corporate governance each of which adopt a different view of the subject and provide a consensus on the relative importance of these definitions. These definitions were not intended to discriminate completely between different views, but rather each was chosen to emphasize slightly different interpretations of the Corporate Governance function. The selection represents a range of definitions, starting from the narrowest which described the basic role of Corporate Governance (The Cadbury Report, 1992; see also, Cadbury, 2002) to a solely financial perspective involving only shareholders and company management (Parkinson, 1994) and extending to a broader definition that encompassed corporate accountability to a wide range of stakeholders and society at large (Tricker, 1984). We also included a definition that emphasized the importance of shareholder activism, as this allowed us to gauge institutional investors' views on their own role in Corporate Governance (The Corporate Governance Handbook, 1996). The selection also included definitions that were regulation-centered (Cannon, 1994) or focused on corporate success (Keasey and Wright, 1993). The definitions are ranked according to the institutional investors' views of their relative importance.

In general the definitions of Corporate Governance found in the literature tend to share certain characteristics, one of which is the notion of accountability. Narrow definitions are oriented around corporate accountability to shareholders. Some narrower, shareholder-oriented definitions of Corporate Governance focus specifically on the ability of a country's legal system to protect minority shareholder rights (e.g., La Porta et al., 1998). However, such definitions are mainly applicable to cross-country comparisons of Corporate Governance. We return to the legal influence on different systems of corporate governance around the world.

Broader definitions of Corporate Governance stress a broader level of accountability to shareholders and other stakeholders. We can see that Tricker's (1984) definition, encompassing accountability to a broader group of people than just the shareholders. This demonstrates an interest within the financial community in a broader, stakeholder-oriented approach to Corporate Governance. The broadest definitions consider that companies are accountable to the whole of society, future generations and the natural world. Relatively broad, definitions consider that companies are accountable to the whole of society, future generations and the natural world. We suggest that corporate governance is the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity.

Theoretical frameworks that suggest companies should be accountable only to their shareholders are not necessarily inconsistent with theoretical frameworks that champion stakeholder accountability. The reason underlying this argument is that shareholders' interest can only be satisfied by taking account of stakeholder interests, as companies that are accountable to all of their stakeholders are over the long term more successful and more prosperous. Definition of Corporate Governance therefore rests on the perception that companies can maximize value creation over the long term, by discharging their accountability to all of their stakeholders and by optimizing their system of Corporate Governance.

Overall, this perception is growing among the professional community and academic research is beginning to provide empirical in support of this view of corporate governance, accountability and corporate profitability. However, this is the 'business case' for corporate governance and, more generally, for corporate social responsibility. Should companies improve corporate governance and discharge accountability to all of their stakeholders purely because it is ethical? We discuss these ethical issues in the subsection on stakeholder theory. In the real world, it is unlikely that businessmen and investors will be interested in acting ethically unless there are positive financial returns to be made from so doing, as there appears to be a strong business case underlying corporate governance reform and stakeholder accountability, then the corporate and financial communities are more likely to embrace these approaches.

8.2 CORPORATE GOVERNANCE PRACTICES/CODES IN - UK, GERMANY, JAPAN, INDIA AND USA

CORPORATE GOVERNANCE IN THE UK

The UK has a well-developed market with a diverse shareholder base including institutional investors, financial institutions, and individuals. The UK illustrates well the problems that may be associated with the separation of the ownership and control of corporations and hence has many of the associated agency problems. These agency problems, including misuse of corporate assets by directors and a lack of effective control over, and accountability of, directors' actions, contributed to a number of financial scandals in the UK.

As in other countries, the development of corporate governance in the UK was initially the findings of a trilogy of codes: the Cadbury Report (1992), the Greenbury Report (1995), and the Hampel Report (1998).

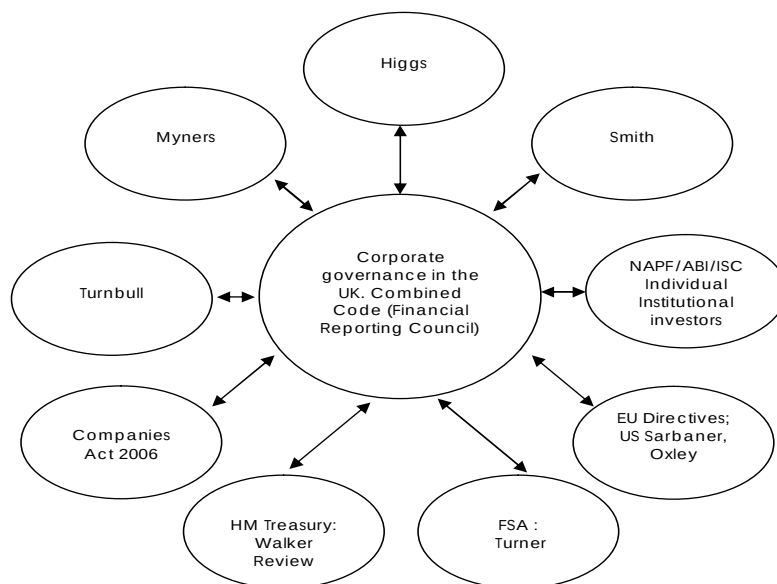


Figure: Development of corporate governance in the UK

Figure illustrates the development of corporate governance in the UK. The centre oval represents the Combined Code published in 2008 by the Financial Reporting Council. Around the centre oval, we can see the various influences since 1998 (the original Combined Code, published in 1998, encompassed the Cadbury, Greenbury, and Hampel report recommendations). These influences can be split into four broad areas. First, there are reports that have looked at specific areas of Corporate Governance: the Turnbull Report on Internal Controls the Myners review of Institutional Investment, the Higgs Review of the role and effectiveness of non-executive directors, and the Smith Review of Audit Committees. Secondly, there has been the influence of institutional investors and their representative groups. Thirdly, influences affecting the regulatory framework within which corporate governance in the UK operates have included the UK company law review, the Walker Review for HM Treasury and the Financial Services Authority Review. Fourthly, there have been what might be termed 'external influences' such as the EU review of company law and the US Sarbanes-Oxley Act. Each of these is now discussed in turn.

Various Reports on Governance:

Cadbury Report (1992)

Following various financial scandals and collapses (Coloroll and Polly Peck, to name but two) and a perceived general lack of confidence in the financial reporting of many UK companies, the Financial Reporting Council, the London Stock Exchange, and the accountancy profession established the Committee on the Financial Aspects of Corporate Governance in May 1991. After the Committee was set up, the scandals at BCCI and Maxwell happened, and as a result, the committee interpreted its remit more widely and looked beyond the financial aspects to Corporate Governance as a whole. The Committee was chaired by Sir Adrian Cadbury and, when the Committee reported in December 1992, the report became widely known as 'the Cadbury Report'.

The recommendations covered: the operation of the main board; the establishment, composition, and operation of key board committees; the importance of, and contribution that can be made by, non-executive directors; the reporting and control mechanisms of a business. The Cadbury Report recommended a code of Best Practice with which the boards of all listed companies registered in the UK should comply, and utilized a 'comply or explain' mechanism. This mechanism means that a company should comply with the code but, if it cannot comply with any particular aspect of it, then it should explain why it is unable to do so. This disclosure gives investors detailed information about any instances of non-compliance and enables them to decide whether the company's non-compliance is justified.

Greenbury Report (1995)

The Greenbury committee was set up in response to concern at both the size of directors' remuneration packages and their inconsistent and incomplete disclosure in companies' annual reports. It made, in 1995, comprehensive recommendations regarding disclosure of directors' remuneration packages. There has been much discussion about how much disclosure there should be of directors' remuneration and how useful detailed disclosures might be. Whilst the work of the Greenbury Committee focused on the directors of public limited companies, it hoped that both smaller listed companies and unlisted companies would find its recommendations useful.

Central to the Greenbury report recommendations were strengthening accountability and enhancing the performance of directors. These two aims were to be achieved by (i) the presence of a remuneration committee comprised of independent non-executive directors who would report fully to the shareholders each year about the company's executive remuneration policy, including full disclosure of the elements in the remuneration of individual directors; and (ii) the adoption of performance measures linking rewards to the performance of both the company and individual directors, so that the interests of directors and shareholders were more closely aligned.

Since that time (1995), disclosure of directors' remuneration has become quite prolific in UK company accounts.



Hampel Report (1998)

The Hampel Committee was set up in 1995 to review the implementation of the Cadbury and Greenbury Committee recommendations. The Hampel Committee reported in 1998. The Hampel Report said: 'We endorse the overwhelming majority of the findings of the two earlier committees'. There has been much discussion about the extent to which a company should consider the interests of various stakeholders, such as employees, customers, suppliers, providers of credit, the local community, etc., as well as the interests of its shareholders. The Hampel report stated that the directors as a board are responsible *for relations with* stakeholders; but they are accountable *to* the shareholders'. However, the report does also state that directors can meet their legal duties to shareholders, and can pursue the objective of long-term shareholder value successfully, only by developing and sustaining these stakeholder relationships'.

The Hampel Report, like its precursors, also emphasized the important role that institutional investors have to play in the companies in which they invest (investee companies). It is highly desirable that companies and institutional investors engage in dialogue and that institutional investors make considered use of their shares in other words, institutional investors should consider carefully the resolutions on which they have a right to vote and reach a decision based on careful thought, rather than engage in 'box ticking'.

Combined Code (1998)

The Combined Code drew together the recommendations of the Cadbury, Greenbury, and Hampel reports. It has two sections, one aimed at Companies and another aimed at Institutional Investors. The combined code operates on the 'comply or explain' basis mentioned above. In relation to the internal controls of the business, the combined code states that 'the board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets' and that 'the directors should, at least annually, conduct a review of the effectiveness of the group's system of internal control and should report to shareholders that they have done so. The review should cover all controls, including financial, operational, and compliance controls and risk management'. The Turnbull Report issued in 1999 gave directors guidance on carrying out this review.

Turnbull (1999)

The Turnbull Committee, chaired by Nigel Turnbull, was established by the Institute of Chartered Accountants in England and Wales (ICAEW) to provide guidance on the implementation of the internal control requirements of the Combined Code. The Turnbull Report confirms that it is the responsibility of the board of directors to ensure that the company has a sound system of internal control, and that the controls are working as they should. The board should assess the effectiveness of internal controls and report on them in the annual report. Of course, a company is subject to new risks both from the outside environment and as a result of decisions that the board makes about corporate strategy and objectives. In the managing of risk, boards will need to take into account the existing internal control system in the company and also whether any changes are required to ensure that new risks are adequately and effectively managed.

Myners (2001, 2008)

The Myners report on Institutional investment, issued in 2001 by HM Treasury, concentrated more on the trusteeship aspects of institutional investors and the legal requirements for trustees, with the aim of raising the standards and promoting greater shareholder activism. For example, the Myners report expects that institutional investors should be more proactive, especially in the stance they take with underperforming companies. Some institutional investors have already shown more of a willingness to engage actively with companies to try to ensure that shareholder value is not lost by underperforming companies.

In 2007, the NAPF published the results of its review of the extent to which Pension Fund trustees were complying with the principles. The report stated 'the recommendations set out in this report provide a

framework for developing further the Principles so that they remain relevant for the world in which pension fund trustees operate today'. Subsequently HM Treasury published *Updating the Myners Principles: A Response to Consultation* in 2008. There are six principles identified: effective decision-making; clear objectives; risk and liabilities; performance assessment; responsible ownership; transparency; and reporting. The report emphasized greater industry ownership of the principles and places the onus on trustees to report on their own practices.

Higgs (2003)

The Higgs Review, chaired by Derek Higgs, reported in January 2003 on the role and effectiveness of non-executive directors. Higgs offered support for the Combined Code whilst making some additional recommendations. These recommendations included : stating the number of meetings of the board and its main committees in the annual report, together with the attendance records of individual directors; that a chief executive director should not also become chairman of the same company; non-executive directors should meet as a group at least once a year without executive directors being present, and the annual report should indicate whether such meetings have occurred; chairmen and chief executives should consider implementing executive development programmes to train and develop suitable individuals in their companies for future director roles; the board should inform shareholders as to why they believe a certain individual should be appointed to a non-executive directorship and how they may meet the requirements of the role; there should be a comprehensive induction programme for new non-executive directors, and resources should be available for ongoing development of directors; the performance of the board, its committees and its individual members, should be evaluated at least once a year, the annual report should state whether these reviews are being held and how they are conducted; a full time executive director should not hold more than one non-executive directorship or become chairman of a major company; no one non-executive director should sit on all three principal board committees (audit, remuneration, nomination). There was substantial opposition to some of the recommendations but they nonetheless helped to inform the Combined Code. Good practice suggestions from the Higgs Report were published in 2006.

Following a recommendation in chapter 10 of the Higgs Review, a group led by Professor Laura Tyson, looked at how companies might utilize broader pools of talent with varied skills and experience, and different perspectives to enhance board effectiveness. The Tyson report was published in 2003.

Smith (2003)

the Smith Review of Audit Committees, a group appointed by the Financial reporting council, reported in January 2003. The review made clear the important role of the audit committee: 'While all directors have a duty to act in the interests of the company, the audit committee has a particular role, acting independently from the executive, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control'. The review defined the audit committee's role in terms of a high-level overview-it needs to satisfy itself that there is an appropriate system of controls in place but it does not undertake the monitoring itself.

Combined Code (2003)

The revised Combined Code, published in July 2003, incorporated the substance of the Higgs and Smith reviews. However, rather than stating that no one non-executive director should sit on all three board committees, the Combined Code stated that 'undue reliance' should not be placed on particular individuals. The Combined Code also clarified the roles of the Chairman and the Senior Independent director (sid), emphasizing the Chairman's role in providing leadership to the non-executive directors and in communicating shareholders' views to the board; it also provided for a 'formal and rigorous annual evaluation' of the board's, the committees', and the individual directors' performance. At least half the board in larger listed companies was to be independent non-executive directors.

Revised Turnbull Guidance (2005)

In 2005, revised guidance on the Turnbull Report (1999) was published. There were few substantive



changes but boards were encouraged to review their application of the guidance on a continuing basis and to look on the internal control statement as an opportunity to communicate to their shareholders how they manage risk and internal control. They should notify shareholders, in the annual report, of how any 'significant failings or weaknesses' in the effectiveness of the internal control system have been dealt with.

Combined Code (2006)

An updated version of the Combined Code was issued in June 2006. There were three main changes made:

- (i) to allow the company chairman to serve on (but not to chair) the remuneration committee where he is considered independent on appointment as chairman;
- (ii) to provide a 'vote withheld' option on proxy appointment forms to enable a shareholder to indicate that they wish to withhold their vote;
- (iii) to recommend that companies publish on their website the details of proxies lodged at general meetings where votes were taken on a show of hands.

Combined Code (2008)

The findings of the Financial Reporting Council (FRC) *Review of the Impact of the Combined Code* were published in December 2007. The overall findings indicated that the Combined Code (2006) had general support and that the FRC would concentrate on improving the practical application of the Combined Code.

In June 2008, the FRC published a new edition of the Combined Code which introduced two changes. These changes were (i) to remove the restriction on an individual chairing more than one FTSE 100 company; and (ii) for listed companies outside the FTSE 350, to allow the company chairman to sit on the audit committee where he or she was considered independent on appointment.

The FRC stated on their website that The revised Code took effect at the same time as new FSA Rules implementing EU requirements relating to corporate governance statements and audit committees. The revised code and new rules will apply to accounting periods beginning on or after 29 June 2008. In practice this means most companies will begin to apply them in 2009, and will report against them for the first time in 2010.

Revised Smith Guidance (2008)

A new edition of the guidance was issued in October 2008. The main changes to the guidance as detailed on the FRC website are:

Audit committees are encouraged to consider the need to include the risk of the withdrawal of their auditor from the market in their risk evaluation and planning; companies are encouraged to include in the audit committee's report information on the appointment, reappointment or removal of the auditor, including supporting information on tendering frequency, the tenure of the incumbent auditor and any contractual obligations that acted to restrict the committee's choice of auditor; a small number of detailed changes have been made to the section dealing with the independence of the auditor, to bring the guidance in line with the Auditing Practices Board's Ethical Standards [2004, revised 2008] for auditors, which have been issued since the guidance was first published in 2003; and an appendix has been added containing guidance on the factors to be considered if a group is contemplating employing firms from more than one network to undertake the audit.

Institutional Investors and their Representative Groups

Large institutional investors, mainly insurance companies and pension funds, usually belong to one of two representative bodies that act as a professional group 'voice' for their views: the Association of British Insurers (ABI) and the national association of Pension Funds (NAPF). Both the ABI and the NAPF have best practice Corporate Governance guidelines that encompass the recommendations

of the Combined Code. They monitor the corporate governance activities of companies and provide advice to members.

Some large institutional investors are very active in their own right in terms of their corporate governance activities. Hermes is a case in point, and it has published the hermes Principles, which detail how it perceives its relationship with the companies in which it invests (investee companies), what its expectations are of investee companies, and what investee companies can expect from hermes.

Companies Act 2006

In the UK, the corporate law has been in need of a thorough review for some years and the Modern Company Law Review culminated in July 2002 in the publication of out line proposals for extensive modernization of company law, including various aspects of corporate governance. These proposals included: statutory codification of directors' common law duties; enhanced company reporting and audit requirements, including a requirement that economically significant companies produce an annual operating and financial review; disclosure on corporate websites of information relating to the annual report and accounts, and disclosure relating to voting.

The government published the Company Law Reform Bill in November 2005, and the Companies Act 2006 was enacted in late 2006. The Act updates previous Companies' Acts legislation, but does not completely replace them, and it contains some significant new provisions which impacts on various constituents including directors, shareholders, auditors and company secretaries. The act draws on the findings of the Company Law Review proposals'.

The main features are as follows:

- directors' duties are codified;
- companies can make greater use of electronic communications for communicating with shareholders;
- directors can file service addresses on public record rather than their private home addresses;
- shareholders will be able to agree limitations on directors' liability;
- there will be simpler model Articles of Association for private companies, to reflect the way in which small companies operate;
- private companies will not be required to have a company secretary;
- private companies will not need to hold an annual general meeting unless they agree to do so;
- the requirement for an operating and Financial review (OFR) has not been reinstated, rather companies are encouraged to produce a high quality Business Review;
- nominee shareholders can elect to receive information in hard copy form or electronically if they wish to do so;
- shareholders will receive more timely information;
- enhanced proxy rights will make it easier for shareholders to appoint theirs to attend and vote at general meetings;
- shareholders of quoted companies may have a shareholder proposal (resolution);
- circulated at the company's expense if received by the financial year end;
- whilst there has been significant encouragement over a number of years to encourage institutional investors to disclose how they use their votes, the act provides a power which could be used to require institutional investors to disclose how they have voted.

Overall there seems to be an increasing burden for quoted companies whilst on the other hand the burden seems to have been reduced for private companies. In terms of the rights of shareholders



these are enhanced in a number of ways including greater use of electronic communications, more information, enhanced proxy rights, and provision regarding the circulation of shareholder proposals at the company's expense. Equally there is a corresponding emphasis on shareholders' responsibilities with encouragement for institutional shareholders to be more active and to disclose how they have voted.

Financial Services Authority

In September 2002, the Financial Services Authority (FSA) launched a review of the listing regime with the main aim being to assess the existing rules and identify which should be retained, and which changed. The areas covered by the review were: Corporate Governance; continuing obligations (encompassing corporate communication, and shareholders' rights and obligations); financial information; the sponsor regime.

The FSA Review took place against the background of potentially significant changes in both the EU and UK regulatory environments, and although some changes were made, there was much continuity in the proposals introduced in 2005.

Following the global banking crisis, Lord Adair Turner, Chairman of the FSA, was asked by the Chancellor of the Exchequer to carry out a review and make recommendations for reforming UK and international approaches to the way banks are regulated. The Turner Review was published in the Spring 2008. Issues highlighted include remuneration policies designed to avoid incentives for undue risk taking; whether changes in governance structure are needed to increase the independence of risk management functions; and consideration of the skill and time commitment required for non-executive directors of large complex banks to effectively perform their role.

Financial Reporting Council

The Financial Reporting Council (FRC) has six operating bodies: the Accounting Standards Board (ASB), the Auditing Practices Board (APB), the Board for Actuarial Standards (BAS), the Professional oversight Board, the Financial Reporting Review Panel (FRRP), and the Accountancy and Actuarial Discipline Board (AADB).

The importance placed on corporate governance is evidenced by the fact that, in March 2004, the FRC set up a new committee to lead its work on corporate governance.

Overall, the FRC is responsible for promoting high standards of corporate governance. It aims to do so by:

- maintaining an effective Combined Code on Corporate Governance and promoting its widespread application;
- ensuring that related guidance, such as that on internal control, is current and relevant;
- influencing EU and Global Corporate Governance developments;
- helping to promote boardroom professionalism and diversity;
- encouraging constructive interaction between company boards and institutional shareholders.

The FRC has carried out several consultative reviews of the Combined Code which led to the amended Combined Code in 2006, and subsequently in 2008 (discussed earlier). The latest review took place in 2008. The frequency of the reviews are both an indicator of the FRC's responsibility for corporate governance of UK companies which involves leading public debate in the area and its response to the global financial crisis which has, in turn, affected confidence in aspects of corporate governance.

The FRC website mentions the independent review of the governance of banks and other financial institutions carried out by Sir David Walker. The Walker Review published its draft recommendations in July 2009, some of the recommendations could be taken forward through amendments to the Combined Code. The FRC is considering the extent to which the Walker Review recommendations may be applicable for some or all listed companies in other sectors.

'External' Influences

The report of the EU High Level Group of Company Law Experts had implications for company law across Europe including the UK, and is further discussed below in the context of an international development. The impact of recent legislation in the USA, the Sarbanes Oxley Act, has also made its influence felt in the UK, and is also discussed in detail below.

CORPORATE GOVERNANCE IN GERMANY

Charkham (1994) stated that 'if there were a spectrum with "confrontation" at one end and "co-operation" at the other, we would confidently place German attitudes and behaviour far closer to the "co-operation" end than, say, those of the British or Americans'. This is an important statement in the context of understanding the philosophy of the German approach to business and to companies, whereby the shareholders are but one of a wider set of stakeholder interest with the employees and customers being given more emphasis. Charkham (1994) finds this approach evidenced in the industrial relations of German companies: 'Good industrial relations . . . would not be prominent in works on corporate governance systems in most countries, or at best would be regarded as peripheral. In Germany, however, good industrial relations are much nearer centre stage.' This is evidenced in the Works Constitution Act 1972, which sets out the rights of the works council and, broadly speaking, deals with all matters pertaining to the employees' conditions of employment. Works councils are part of the co-operative process between workers and employers, the idea being that **co-determination** (the right to be kept informed about the company's activities and to participate in decisions that may affect the workers) means that there is a basis for more trust and co-operation between workforce and employers. The Co-determination Act 1976 defines the proportion of employee and shareholder representatives on the supervisory board (*Aufsichtsrat*) and also stipulates that the management board has special responsibility for labour-related matters.

The business structure in Germany is detailed in Wymeersch (1998) where he identifies the most used business types in various continental European states. In Germany, as far as the larger business entities are concerned, the business types tend to be either public (*Aktiengesellschaft AG*) or private companies limited by shares (*Gesellschaft mit beschränkter Haftung, GmbH*). However, he identifies a hybrid that is also used in Germany- specifically, a hybrid of the *GmbH & Co. KG*, combining the advantages of the unincorporated *Kommanditgesellschaft* and the limited liability of *GmbH*.

In Germany, as in many continental European countries and the UK, there is a trend away from individual share ownership. The most influential shareholders are financial and non-financial companies, and there are significant cross-holdings, which mean that when analysing share ownership and control in Germany, one needs to look also at the links between companies. Banks, and especially a few large banks, play a central role in German corporate governance with representation on the supervisory boards of companies and links with other companies. Charkham (1994) identifies a number of reasons as to why banks are influential in Germany. First, there is direct ownership of company shares by banks; second, German shareholders generally lodge their shares with banks authorized to carry out their voting instructions (deposited share voting rights, or DSVR); third, banks tend to lend for the long term and hence develop a longer term relationship with the company (relationship lending); fourth, banks offer a wide range of services that the company may find it useful to draw upon. Given these factors, banks tend to build up a longer term, deeper relationship with companies, and their expertise is welcomed on the supervisory boards. hence the German corporate governance system could be termed an 'insider' system.

The German Corporate Governance system is based around a dual board system, and essentially, the dual board system comprises a management board (*Vorstand*) and a supervisory board (*Aufsichtsrat*). The management board is responsible for managing the enterprise. Its members are jointly accountable for the management of the enterprise and the chairman of the management board co-ordinates the work of the management board. On the other hand, the supervisory board appoints, supervises, and advises the members of the management board and is directly involved in decisions of fundamental importance to the enterprise. The chairman of the supervisory board co-ordinates the work of the



supervisory board. The members of the supervisory board are elected by the shareholders in general meetings. The co-determination principle provides for compulsory employees representation. So, for firms or companies which have more than five hundred or two thousand employees in Germany, employees are also represented in the supervisory board which then comprises one-third employee representative or one-half employee representative respectively. The representatives elected by the shareholders and representatives of the employees are equally obliged to act in the enterprise's best interests.

The idea of employee representation on boards is not always seen as a good thing because the employee representatives on the supervisory board may hold back decisions being made that are in the best interests of the company as a whole but not necessarily in the best interests of the employees as a group. An example, would be where a company wishes to rationalize its operations and close a factory but the practicalities of trying to get such a decision approved by employee representatives on the supervisory board, and the repercussions of such a decision on labour relations, prove too great for the strategy to be made a reality.

Table Key characteristics influencing German corporate governance

Feature	Key characteristic
Main business form	Public or private companies limited by shares
Predominant ownership structure	Financial and non-financial companies
Legal system	civil law
Board structure	dual
Important aspect	compulsory employee representation on supervisory board.

The committee on corporate governance in Germany was chaired by dr Gerhard cromme and is usually referred to as the Cromme Report or Cromme Code. The code harmonizes a wide variety of laws and regulations and contains recommendations and also suggestions for complying with international best practice on Corporate Governance.

The Cromme Code was published in 2002 and is split into a number of sections, starting with a section on shareholders and the general meeting. The Cromme Code also reflects some of the latest developments in technology. The Cromme Code was amended in 2005. Whilst it remains substantially the same, there are some significant changes, which are shown in bold in the relevant sections (i)-(vi) below.

(i) Shareholders and the general meeting

At the general meeting, the management board submits the annual, and consolidated, financial statement, and the general meeting decides on the appropriation of net income and approves the decisions of the management board and the supervisory board. An important aspect of the general meeting is that it elects the shareholders representatives to the supervisory board and also, generally, the auditors.

Interestingly, the Cromme Code makes explicit provision that the management board shall not only provide the report and accounts and other documents required by law for the general meeting but should also publish them on the company's website together with the agenda. Similarly, the use of technology is encouraged as the general meeting should be capable of being followed on the internet or similar media.

The shareholders' right to vote is facilitated in a number of ways, including by the personal exercise of shareholders voting rights, and by the use of proxies.

(ii) Co-operation between the management board and the supervisory board

It is essential that the management board and the supervisory board co-operate closely for the benefit of the enterprise. The Cromme Code defines the management board's role as to

co-ordinate the enterprise's strategic approach with the supervisory board and to discuss the implementation of strategy with the supervisory board at regular intervals. There are certain situations, such as those relating to the enterprise's planning, business development, risk situation, and risk management, when the management board should inform the supervisory board immediately of any issues.

The supervisory board is able to specify the management board's information and reporting duties in more detail. It is essential that there is open discussion between the management board and supervisory board as well as amongst the members within each of those two boards. The management board and the supervisory board report each year on the enterprise's corporate governance in the annual report and they should explain any deviations from the Cromme Code. The company shall keep previous declarations of conformity with the Code available for viewing on its website for five years.

{iii) Management board

The composition of the management board is determined by the supervisory board, and should be reported in the notes to the accounts. Any conflict of interest should be disclosed to the supervisory board. The Cromme Code states that 'the management board is responsible for independently managing the enterprise' with a view to acting in the enterprise's best interest, and endeavouring to increase the sustainable value of the enterprise. As mentioned earlier, the management board develops the enterprise's strategy and co-ordinates with the supervisory board on this issue.

The Cromme Report provides for the compensation to be comprised of a fixed salary and variable component. As in many other countries, the variable compensation element should be linked to the business performance as well as long-term incentives. Stock options are mentioned as one possible element of variable compensation components and these should be linked to certain performance criteria such as the achievement of predetermined share prices.

(iv) Supervisory board

It is important that the composition of the supervisory board reflects a suitable level of knowledge, ability, and experience to be able properly to carry out the tasks relevant to the business. There should be an adequate number of independent members.

'Independence' will mean no business or personal relations with the company or its management board which cause a conflict of interest. To help maintain its independence, not more than two former members of the management board should be members of the supervisory board. the former management board chairman or a management board member should not generally become supervisory board chairman or chairman of a supervisory board committee. Supervisory board members should not have directorships or similar positions or indeed have advisory roles with important competitors of the enterprise.

The supervisory board carries out a number of important functions as follows:

- (i) it provides independent advice and supervision regularly to the management board on the management of the business;
- (ii) the management board and the supervisory board should ensure that there is a long-term succession plan in place;
- (iii) the supervisory board may delegate some duties to other committees, which include compensation and audit committees;
- (iv) the chairman of the supervisory board, who should not be the chairman of the audit committee, co-ordinates work within the supervisory board and chairs its meetings and attends to the affairs of the supervisory board externally.

It is worth elaborating on the committees that may be formed with a remit for various delegated



areas. These may include the audit committee (the chairman of the audit committee should not be a former member of the management board of the company); the chairman of the audit committee should have specialist knowledge and experience in the application of accounting principles and internal control processes, and a compensation committee to look at the compensation of the management board. This committee may also look at the appointment of members of the management board.

The Cromme Code also states that members of the management board of a listed company should not be on more than five supervisory boards in non-group listed companies. The compensation of members of the supervisory board is specified either by a resolution of the general meeting or in the articles of association. Members of the supervisory board may receive performance-related compensation as well as fixed compensation. The compensation of the supervisory board members should be disclosed in the Corporate Governance Report.

An interesting disclosure required by the Cromme Code is that if a supervisory board member takes part in less than half of the meetings of the supervisory board in a financial year, then this will be noted in the report of the supervisory board. Any conflicts of interest should be reported to the supervisory board and the supervisory board would then inform the general meeting of any conflicts of interest together with how these conflicts have been treated.

(v) Transparency

The code provides that the management board should disclose immediately any facts that might affect the enterprise's activities and which are not publicly known. The report emphasizes that all shareholders should be treated equally in respect of information disclosure and that the company may use appropriate media, such as the internet, to inform the shareholders and investors in an efficient and timely manner. There is disclosure required in terms of the shareholdings, including options and derivatives, that are held by individual management board and supervisory board members. These must be reported if they directly or indirectly exceed 1 per cent of the shares issued by the company. The code also states: 'If the entire holdings of all members of the management board and supervisory board exceed 1 per cent of the shares issued by the company, these shall be reported separately according to the management board and supervisory board.' These disclosures should all be included in the corporate Governance report.

(vi) Reporting and audit of the annual financial statements

The code states that the supervisory board or the audit committee should obtain a statement from the proposed auditor clarifying whether there are any 'professional, financial or other relationships' that might call the auditor's independence into question.

Interestingly, this statement should include the extent to which other services have been performed for the company in the past year, especially in the field of consultancy, or which are contracted for the following year. It is the supervisory board that concludes agreement on the auditors fee.

From the discussion above, it can be seen that the defining feature of Germany's corporate governance system is the significant role played by the supervisory board. In addition, the supervisory board has compulsory representation of workers via the co-determination rules. This can have an important impact on key strategic decisions, for example, if a German company decides that it needs to close one of its subsidiaries, then it may prefer to close down a subsidiary overseas, in a country such as the UK, which has a unitary board structure and hence no supervisory board with employee representation. Employees in the UK would therefore be in a weaker position than their German counterparts, and have less influence over any closure decision.

It is interesting to note that Charkham (2005), in reviewing corporate governance developments in Germany, is of the opinion that 'internal and external developments have put pressure on it, but its main provisions remain intact. The factors for change have been the diminishing role of the banks, the international governance codes and principles, and the international capital markets'.

In November 2005, Germany abolished the requirement for shares to be blocked in advance of a shareholder meeting. Blocking had meant that shares could not be traded for a period of time before a company's general meeting, if the holder of the shares wished to be able to vote on the resolutions tabled for the general meeting. therefore, it had effectively been a deterrent to voting because institutional investors often could not afford to be in a position whereby they were unable to trade their shares.

Recent legal changes now require companies to disclose pay details for executive directors, effective for annual reports for 2006 onwards. However, company management may propose that disclosure is limited and if the proposal is approved by 75 per cent of its shareholders, then the additional disclosure does not have to be given. An amended version of the German corporate Governance code was published in 2006 and recommended that various executive remuneration disclosures should be made in the corporate Governance report. Companies would be obliged to disclose if they were to deviate from these recommendations.

There were minor amendments to the German Corporate Governance Code in 2007 and 2008. In the forward to each of these codes, it is mentioned that the European company or Society Europaeen (SE) gives German enterprises the opportunity to opt for the unitary board system in which case the form that co-determination would take would be a matter for agreement between the company management and the employees. Also there is now a recommendation in the section on the 'supervisory Board' that the supervisory board should form a nomination committee composed exclusively of shareholder representatives which should propose suitable candidates to the supervisory board for recommendation to the company's general meeting.

Goergen *et al.* (2008) review the governance role of large shareholders, creditors, the product market and the supervisory board, and also discuss the importance of mergers and acquisitions, the market in block trades, and the lack of a hostile takeover market. They find that, the German system is characterised by a market for partial corporate control, large shareholders and bank/ creditor monitoring, a two-tier (management and supervisory) board with co-determination between shareholders and employees on the supervisory board, a disciplinary product-market, and Corporate Governance regulation largely based on EU directives but with deep roots in the German codes and legal doctrine. Another important feature of the German system is its Corporate Governance efficiency criterion which is focused on the maximisation of stakeholder value rather than shareholder value. However, the German corporate governance system has experienced many important changes over the last decade. First, the relationship between ownership or control concentration and profitability has changed over time. Second, the pay- for-performance relation is unfluenced by large shareholder control: in firms with controlling blockholders and when a universal bank is simultaneously an equity- and debtholder, the pay-for-performance relation is lower than in widely-held firms or blockholder-controlled firms. Third, since 1995 several major regulatory initiatives (including voluntary codes) have increased transparency and accountability.

Odenius (2008) reviews Germany's corporate governance system and the effectiveness of recent reforms. He states that since the early 1990s far-reaching reforms have complemented the traditional stakeholder system with important elements of the shareholder system. he raises the important question of whether these reforms have created sufficient flexibility for the market to optimize its corporate governance structure within well established social and legal norms. he concludes that there is scope for enhancing flexibility in three core areas, relating to: firstly internal control mechanisms, especially the flexibility of board structures; secondly self-dealing; and thirdly external control, particularly take-over activity.

CORPORATE GOVERNANCE IN JAPAN

Japan's economy developed very rapidly during the second half of the twentieth century. Particularly during the period 1985-89, there was a 'bubble economy', characterized by a sharp increase in share prices and the value of land; the early 1990s saw the bubble burst as share prices fell and land was devalued, as well as shareholders and landowners finding themselves losing vast fortunes, banks found



that they had severe problems too. During the bubble period, the banks had lent large amounts of money against the value of land and, as the repayments and the banks were left with large non-performing loans. The effect of the fall in share prices and land values spread through the Japanese economy, which became quite stagnant, and the effects spread to other countries' economies, precipitating a regional recession.

The Japanese government wished to restore confidence in the Japanese economy and in the stock market, and to attract foreign direct investment to help regenerate growth in companies. Improved corporate governance was seen as a very necessary step in this process.

Japan's Corporate Governance System is often likened to that of Germany because banks can play an influential role in companies in both countries. However, there are fundamental differences between the systems, driven partly by culture and partly by the Japanese shareholding structure with the influence of the *keiretsu* (broadly, associations of companies). Charkham (1994) sums up three main concepts that affect Japanese attitudes towards Corporate Governance: obligation, family, and consensus. The first of these, obligation, is evidenced by the Japanese feeling of obligation to family, a company, or country; the second, family, is the strong feeling of being part of a 'family' whether this is a family person, or a company; finally, the third concept, consensus, means that there is an emphasis on agreement rather than antagonism. These three concepts deeply influence the Japanese approach to Corporate Governance.

The *keiretsu* sprang out of the *zaibatsu*. Okumura (2002) states: 'Before World War II, when *zaibatsu* (giant pre-war conglomerates) dominated the Japanese economy, individuals or families governed companies as major stockholders. By contrast, after the war, by virtue of corporate capitalism, companies in the form of corporations became large stockowners, and companies became major stockholders of each other's stock.' The companies forming the *keiretsu* may be in different industries, forming a cluster often with a bank at the centre. Charkham (1994) states that 'banks are said to have encouraged the formation and development of groups of this kind, as a source of mutual strength and reciprocal help'. Indeed, banks themselves have a special relationship with the companies they lend to, particularly if they are the lead or main bank for a given company. Banks often buy shares in their customer companies to firm up the relationship between company and bank. However, they are limited to as per cent holding in a given company but, in practice, the combination of the traditional bank relationship with its client and the shareholding mean that they can be influential, and often very helpful, if the company is in financial difficulties, viewing it as part of their obligation to the company to try to help it find a way out of its difficulties.

When compared to the German system, it should be noted that there is no automatic provision for employees to sit on the supervisory board. However, employees have traditionally come to expect that they will have lifelong employment with the same company - unfortunately, in times of economic downturn, this can no longer be guaranteed.

The Japan Corporate Governance Committee published its revised Corporate Governance Code in 2001. The code had six chapters, which contained a total of 14 principles. The code had an interesting introduction, part of which stated 'a good company maximizes the profits of its shareholders by efficiently creating value, and in the process contributes to the creation of a more prosperous society by enriching the lives of its employees and improving the welfare of its other stakeholders'.

Summary of key characteristics influencing Japanese Corporate Governance

Feature Key characteristic

Main business form Public limited company

Predominant ownership structure *Keiretsu*; but institutional investor ownership is increasing

Legal system civil law

Board structure dual

Important aspect Influence of *keiretsu*

Hence the Code tried to take a balanced view of what a company is all about, and clearly the consideration of stakeholders is seen to be an important aspect. The foreword to the Code discussed and explained some of the basic tenets of Corporate Governance to help familiarize readers of the code with areas including the role and function of the board of directors, the supervisory body, independent directors, incentive-based compensation, disclosure, and investor relations.

(i) Mission and role of the board of directors

This first chapter contained five principles relating to: the position and purpose of the board of directors; the function and powers of the board of directors; the organization of the board of directors; outside directors and their independence; the role of the leader of the board of directors.

The board should be comprised of outside directors (someone who has never been a full-time director, executive, or employee of the company)- preferably a majority- and inside directors (executives or employees of the company). Independent directors are outside directors who can make their decisions independently. The board of directors' role is seen as one of management supervision including approving important strategic decisions, nominating candidates for director positions, appointment and removal of the CEO, and general oversight of accounting and auditing. the board of directors may also be required to approve certain decisions made by the CEO.

(ii) Mission and role of the committees established within the board of directors

The board is recommended to establish various committees including an audit committee, compensation committee, and nominating committee., Each committee established should comprise at least three directors, and an outside director appointed as chair of each committee. The majority of directors on the audit committee should be independent directors, whilst the majority of directors on the audit committee should be independent directors, whilst the majority of directors on the other two committees should be outside directors, of whom at least one should be an independent director.

The roles of the various committees are broadly defined and cover the usual areas that one would expect for each of these committees.

(iii) Leadership responsibility of the CEO

The CEO'S role is to formulate management strategies with the aim of maximizing corporate value in the long term. The CEO is supervised by the board of directors. the CEO may set up an executive management committee to assist him in conducting all aspects of the business. The CEO may not be a member of the committees listed above in (ii).

(iv) Addressing Shareholder Derivative Litigation

A litigation committee, comprised a majority of independent directors, may be established to determine whether litigation action should be made against directors or executives against whom the company/ shareholders may have a claim.

(v) Securing fairness and transparency for executive management

Two important areas were covered in this section of the Code: internal control and disclosure. The CEO should ensure that there is an effective Corporate Governance System with adequate internal control. the audit committee should evaluate the CEO's policies on internal audit and control. The CEO should prepare an annual report about the internal audit and control, which should preferably be audited by a certified public accountant.

Disclosure should be made by the CEO of any information that may influence share prices; also information should be disclosed to the various stakeholder groups as appropriate.



(vi) Reporting To The Shareholders And Communicating With Investors

The shareholders' general meeting is seen as an opportunity for shareholders to listen to the reports of the directors and executives, and to obtain further information about the company through asking questions. Should the questions go unanswered in the general meeting, then the answer should be put on the company's website subsequent to the general meeting.

The company's executives are encouraged to meet analysts and others who can convey information to investors and shareholders about the company. Information should also be posted on the internet to try to ensure equality of access to information amongst the various investors.

The Commercial Code in Japan provides for the appointment of statutory auditors to monitor the various aspects of the company's activities. However, in 2002, there was an extensive revision of the commercial code essentially providing companies with the option of adopting a 'Us-style' corporate governance structure. The US-style structure would have a main board of directors to carry out the oversight function, and involve the establishment of audit, remuneration, and nomination committees, each with at least three members, a majority of whom should be non-executive. A board of corporate executive officers would also be appointed who would be in charge of the day to-day business operations. Under the Us-style structure, the board of statutory auditors would be abolished. It can be seen that the Japanese Corporate Governance Committee's Code's recommendations dovetailed with the revised Commercial Code.

In 2004, the Tokyo Stock Exchange issued the *Principles of Corporate Governance for Listed Companies*. In the preface, the purpose of the Principles is described as being 'to provide a necessary common base for recognition, thereby enhancing corporate governance through the integration of voluntary activities by listed companies and demands by shareholders and investors'. The five principles are based around the OECD Principles of corporate Governance.

The first principle relates to exercising various rights of shareholders, including the right to participate and vote in general meetings, voting on such issues as the election and dismissal of directors and auditors, and fundamental corporate changes, the basic right to share various profits such as dividends, and the special right to make derivative lawsuits and injunction of activities in contravention of laws, regulations, and other rules. The voting environment should be developed and improved so that shareholders can exercise their votes appropriately and participate in general meetings of shareholders.

The second principle relates to the equitable treatment of shareholders, including minority and foreign shareholders. To this end, there should be an adequate system to prohibit transactions through the abuse of officers, employees, and controlling share holders, which are against the primary interests of the company or shareholders. There should be enhanced disclosure where it seems that such actions might occur, and there should be prohibition of special benefits to specified shareholders.

The third principle is the relationship with stakeholders in corporate governance. Whilst Corporate Governance should help to create corporate value and jobs, the fact that companies sustain and improve their strengths and enhance value over time is 'the result of the provision of company resources by all stakeholders', so the establishment of good relationships with stakeholders is important. To this end, companies should cultivate a corporate culture and internal systems, which respect the various stakeholder groups and ensure timely and accurate disclosure of information relating to them.

The fourth principle relates to disclosure and transparency. Companies should ensure timely and accurate disclosure on all material matters, including the financial state and performance of the company and ownership distribution, through both quantitative and qualitative disclosures. The company should seek to ensure that investors can access information easily and that there is equal access to information. Internal systems should seem to ensure the accuracy and timeliness of disclosure.

The final principle relates to the responsibilities of the board of directors, auditors, board of corporate auditors, and other relevant groups. corporate governance should enhance the supervision of management by the aforementioned groups and ensure their account ability to shareholders. Systems should be developed, or enhanced, to ensure that these requirements can be met.

Finally, it is important to note that the legal framework in Japan, via the Commercial Code Revision on Boards (2003), provides for two corporate governance structures: a corporate auditors' system, consisting of general meetings with shareholders, the board of directors, representative directors, executive directors, corporate auditors, and the board of corporate auditors, and a committees system, where there are general meetings of the shareholders, the board of directors, and committees composed of members of the board of directors (nomination committee, audit committee, and compensation committee), representative executive officers, and executive officers. It is up to the company which system it chooses. In each case, the general meeting of shareholders is the decision-making body on matters of fundamental importance to the company. A key difference between the two structures is that companies with a committee system need to re-elect their directors annually through the general meeting of shareholders, because the board of directors has the authority regarding the definitive plan for the distribution of profit, whereas in the corporate auditors' system, this power lies with the general meetings of shareholders.

Charkham (2005) discusses the various changes that have taken place in the context of Corporate Governance in Japan and states:

The important part the banks played has greatly diminished. In its place there are now better structured boards, more effective company auditors, and occasionally more active shareholders. an increase of interest, and, where appropriate, action on their part, might restore the balance that the banks' withdrawal from the scene has impaired.

Ahmadjian and Okumura (2006) also discuss the changes that have taken place in Japan in recent years:

Over the last decade, the debate on corporate governance has contrasted two extremes - whether to become "like the US" or retain the post-war Japanese system of governance. Yet, as we noted earlier, retaining the "traditional" post-war governance system is no longer an option, since it has been severely weakened by the demise of the role of the main bank, unwinding of cross-shareholdings, changes in accounting standards and increased investment by foreigners.

It is interesting to note that Japan is now using poison pills much more to ward off hostile takeover bids (an undesirable development), whereas it does not have the huge problems associated with perceived excessive director remuneration as its directors are not paid the vast multiples of the salary of the ordinary employees as this would be considered culturally unacceptable.

In 2008, the Asian Corporate Governance Association (ACGA) published its 'White Paper on Corporate Governance in Japan'. It states, While a number of leading companies in Japan have made strides in corporate governance in recent years, we submit that the system of governance in most listed companies is not meeting the needs of stakeholders or the nation at large in three ways:

- By not providing for adequate supervision of corporate strategy;
- By protecting management from the discipline of the market, thus rendering the development of a healthy and efficient market in corporate control all but impossible;
- By failing to provide the returns that are vitally necessary to protect Japan's social safety net- its pension system.

It then advocates six areas for improvement: shareholders acting as owners; utilizing capital efficiently; independent supervision of management; pre-emption rights; poison pills and takeover defences; shareholder meetings and voting.



CORPORATE GOVERNANCE IN INDIA

Following on from a period of economic downturn and social unrest in 1990-1, the Indian Government introduced a programme of reforms to open up the economy and encourage greater reliance on market mechanisms and less reliance on government. Further reforms were aimed at making the public sector more efficient and divestment of government holdings was initiated. There were also reforms to the banking sector to bring it into line with international norms, and to the securities market, with the Securities and Exchange Board of India (SEBI) becoming the regulator of the securities market.

The securities market was transformed as disclosure requirements were brought in to help protect shareholders' interest. Kar (2001) mentions how 'foreign portfolio investment was permitted in India since 1992 and foreign institutional investors also began to play an important role in the institutionalization of the market'. All the reforms above led to a much improved environment in which Corporate Governance was able to develop.

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India has a range of business forms, including public limited companies, which are listed on the stock exchange, domestic private companies and foreign companies. Ownership data is difficult to find because the number of studies carried out in this area is few, however it is clear that, as the economy has opened up, so the institutional investors are increasing their share of the market.

The confederation of Indian industries published a *Desirable Corporate Governance in India - A Code* in 1998 and a number of forward-looking companies took its recommendations on board. However, many companies still had poor governance practices, which led to concerns about their financial reporting practices, their accountability, and ultimately to losses being suffered by investors, and the resultant loss of confidence that this caused.

SEBI formally established the Committee on Corporate Governance in May 1999, chaired by Shri Kumar Mangalam Birla. The *Report of the Kumar Mangalam Birla Committee on Corporate Governance* (hereinafter the report) was published in 2000.

The Report emphasizes the importance of corporate governance to future growth of the capital market and the economy. Three key aspects underlying corporate governance are defined as accountability, transparency, and equality of treatment for all stakeholders.

Table 13.2 Summary of key characteristics influencing Indian Corporate Governance

Feature	Key characteristic
Main business form	Public limited company
Predominant ownership structure	Corporate bodies; families; but institutional investors' ownership increasing

Legal system	common law
Board structure	Unitary
important aspect	some aspects of the code are mandatory recommendations

The impact of corporate governance on both shareholders and stakeholders is mentioned, although the corporate objective is seen as one of maximizing shareholder value, and indeed the Committee views the fundamental objective of Corporate Governance as 'enhancement of shareholder value, keeping in view the interests of other stakeholders'. The Committee feels that companies should see the Code as 'a way of life'. The recommendations apply to all listed private and public sector companies, and are split into mandatory requirements (ones that the committee sees as essential for effective corporate governance) enforceable via the listing rules, and non-mandatory (but nonetheless recommended as best practice).

(i) Board of directors

This section of the code covers the composition of the board, and independent directors. The board provides leadership and strategic guidance for the company and is at all times accountable to the shareholders. The code recommends that not less than 50 per cent of the board is comprised of non-executive directors; where there is a non-executive chairman, then at least one-third of the board should comprise independent directors, but where there is an executive chairman, then at least half of the board should be independent. The latter recommendation is mandatory.

(ii) Nominee directors

The Indian system allows for nominee directors to be put forward by financial or investment institutions to safeguard their investment in the company. The Code decided to allow this practice to continue, but stated that such nominees should have the same responsibility as other directors and be accountable to the shareholders generally.

(iii) Chairman of the Board

Whilst recognizing that the roles of chairman and chief executive are different, the code recognizes that the roles may be combined and performed by one individual in some instances,

(iv) Audit Committee

There are a number of mandatory recommendations in the code in relation to audit committees, including the recommendation that a qualified and independent audit committee is established to help to enhance confidence in the company's disclosures. The committee should comprise a minimum of three members, all of whom are non-executive, with a majority being independent; it should be chaired by an independent director. At least one director should have appropriate financial knowledge. The audit committee is empowered to seek external advice as appropriate, and interestingly, to seek information from any employee.

(v) Remuneration Committee

A remuneration committee should be established to make recommendations on executive directors' remuneration. The committee should be comprised of at least three non-executive directors, and chaired by an independent director. A mandatory requirement is that there should be disclosures in the annual report relating to 'all elements of remuneration package of all the directors, i.e. salary, benefits, bonuses, stock options, pension, etc.' together with 'details of fixed component and performance-linked incentives, along with performance criteria'. Finally, another mandatory requirement is that the board of directors should decide the remuneration of the non-executive directors.



(vi) Board Procedures

Mandatory requirements in relation to board meetings are: first, that they should be held at least four times a year with a maximum of four months between any two meetings; second, that a director should not be involved in more than ten committees or act as chairman of more than five committees across all companies with which he is a director.

(vii) Management

The role of the management of the company (chief executive, executive directors, and key management personnel) in ensuring the smooth running of the day-to-day activities of the company is emphasized. A mandatory recommendation is that there should be disclosure in the annual report, either as part of the directors' report, or as a 'management discussion and analysis' report, about the company's position, its outlook, performance, and other relevant areas of interest to shareholders. There should also be disclosure of any material financial/commercial transactions in which management has a personal interest that may have a potential conflict with the interest of the company.

(viii) Shareholders

Shareholders are entitled to be able to participate effectively in the annual general meeting. Therefore, in support of this aim, it is a mandatory recommendation that, on the appointment of new, or reappointment of existing, directors, the shareholders are provided with relevant information about the director(s). Similarly, companies are mandated to disclose information, including their quarterly results and presentations, to company analysts which may be made available via the internet.

The growing influence of institutional investors is recognized, along with the fact that they have a responsibility to exercise their votes.

(ix) Manner of Implementation

There are mandatory recommendations that a company should have a separate section on Corporate Governance in its annual report, including a detailed compliance report. Non-compliance with any mandatory recommendations should be highlighted, as should the level of compliance with non-mandatory recommendations. A company should obtain a certificate from its auditors in relation to compliance with the mandatory recommendations and it should be attached to the directors' report, which is sent each year to all the shareholders, and to the Stock Exchange.

The Indian Code is clearly rather complex having as it does a series of mandatory and non-mandatory recommendations. The feasibility of this approach will lie in a number of areas: first, the extent to which companies are willing to implement the recommendations; second, the growing influence of shareholders and how effectively they can exercise their voice; third, the approach taken by the Stock Exchange in India in terms of enforcing compliance.

Chakrabarti (2005) provides an interesting review of the evolution of Corporate Governance in India and highlights the fact that, whilst India has good Corporate Governance codes/guidelines, there is poor adoption of the recommendations in many companies. Subsequently Chakrabarti *et al.* (2008) state that while on paper the country's legal system provides some of the best investor protection in the world, the reality is different with slow, over-burdened courts and widespread corruption. Consequently, ownership remains highly concentrated and family business groups continue to be the dominant business model. There is significant pyramiding and tunneling among Indian business groups and, notwithstanding copious reporting requirements, widespread earnings management. However, most of India's corporate governance shortcomings are no worse than in other Asian countries and its banking sector has one of the lowest proportions of non-performing assets, signifying that corporate fraud and tunneling are not out of control.

Balasubramanian *et al.* (2008) provide an overview of Indian corporate governance practices, based primarily on responses to a 2006 survey of 370 Indian public companies. They find that Compliance with legal norms is reasonably high in most areas, but not complete. We identify areas where indian corporate governance is relatively strong and weak, and areas where regulation might usefully be either relaxed or strengthened. On the whole, indian corporate governance rules appear appropriate for larger companies, but could use some strengthening in the area of related party transactions, and some relaxation for smaller companies. Executive compensation is low by Us standards and is not currently a problem area. We also examine whether there is a cross sectional relationship between measures of governance and measures of firm performance and find evidence of a positive relationship for an overall governance index and for an index covering shareholder rights.

CORPORATE GOVERNANCE IN USA

“The world moves forward on the character of good men” —Rev. Edmund A. Walsh. S. J.

The period between thursday, august 2, 2012 and saturday, august 4, 2012 was an auspicious time in the practice of internal auditing in Ghana. during that time, The Institute of Internal Auditors (Ghana), hosted Mr. Philip tarling, the 2012-2013 Global chairman of the institute of internal auditors (iia) worldwide, the first by a Global Chairman. During his visit, Mr. Tarling delivered a public lecture at the British Council Hall, Accra, on the topic “Expanding the Frontiers of Internal auditing – A perspective from the Global Chairman”. He also held sessions with key stakeholders of the profession in the country including chief executive officers, their chief internal auditors and IIA representatives from the West African Institutes. A presidential dinner was held in his honour.

The Institute of Internal Auditors is the global body for the internal audit profession. Established in 1941, The Institute of Internal Auditors (IIA) is an international professional association with global headquarters in altamonte springs, Florida, USA. The IIA is the internal audit profession’s global voice, recognized authority, acknowledged leader, chief advocate, and principal educator. Generally, members work in internal auditing, risk management, governance, internal control, information technology audit, education, and security. Historians have traced the roots of internal auditing to ancient times, as merchants verified receipts for grain brought to market. The real growth of the profession occurred in the 19th and 20th centuries with the expansion of corporate business. Demand grew for systems of control in companies conducting operations in many locations and employing thousands of people. Traditionally, internal auditing has been concerned with accounting and financial activities. Historically, internal auditing emerged to satisfy some well defined management needs in the areas of accounting and financial matters. Management needed to satisfy itself whether:

- (a) The assets of the entity were properly protected;
- (b) The policies of the entity were being complied with;
- (c) Financial records were accurate and reliable.

Additionally, prevention and detection of fraud was a major focus of management. In that environment, the internal auditor was a financially oriented person with limited responsibility in the management process. He was seen more as a policeman and a checker and less as a co-worker. Internal auditing was also seen as an extension of external auditing.

The role of the internal auditor has been changing greatly over a period of time, leading to a greater reliance on him by management and the expansion of the internal audit function. This has resulted from the complexity of modern day businesses which are taking the form of multiple multi-national business units as well as the additional demands on management from various stakeholders. Competition dictates that organizations should be managed more effectively and efficiently if they are to survive and achieve growth. There is the need to optimize business performance and obtain operational excellence through greater effectiveness and efficiency. Cost reduction schemes must be



implemented. Introduction of information technology into business operations have also brought its own challenges. There is therefore the need for greater protection against inefficiency, misconduct and fraudulent and illegal practices. Along the line, the realization dawned that the internal auditor could play an enhanced role in offering expanded protection all the new challenges facing management have therefore dictated the changing role of the internal auditing. Modern internal auditing today reflects two broad roles: assurance and consulting. Today, internal auditing has moved from the more routine compliance level when it used to be integrated with regular accounting activities where it was carried out entirely or substantially only in the strictly financial areas to higher levels in all operational areas of management where it has established itself as a valued and respected part of top management practice. Apart from compliance reviews and analysis of financial information, the modern internal auditor performs other functions as the examination and assessment of risk management, emerging technologies, and global issues.

The year 1941 marked a major turning point. Victor Z. Brink authored the first major book on internal auditing. And at the same time, John B. Thurston, internal auditor for the North American Company in New York, had been contemplating establishing an organization for internal auditors. He and Robert B. Milne had served together on an internal auditing subcommittee formed jointly by the Edison Electric Institute and the American Gas Association, and they agreed that further progress in bringing internal auditing to its proper level of recognition would be best made possible by forming an independent organization for internal auditors. When Brink's book came to the attention of Thurston, the three men got together and found they had a mutual interest in furthering the role of internal auditing.

As an organizing committee, Brink, Milne, Thurston, contacted a small group of internal audit practitioners throughout the United States who expressed interest in forming a national – even international – organization for internal auditors. The IIA's certificate of incorporation was filed on November 17, 1941, and just prior to the first annual meeting on December 9, 1941, the Williams Club located at 24 East 39th Street in New York City, 24 charter members were accepted for membership. Thurston was elected as the first president of The IIA. Membership grew quickly. It went from the original 24 members to 104 by the end of the first year, to 1,018 at the end of five years. By 1957, membership had expanded to 3,700 and 20 percent were located outside of the United States. More than 70 years later, the IIA is a dynamic global organization with more than 175,000 members worldwide. Today, many people associate the genesis of modern internal auditing with the establishment of the IIA.

The Institute of Internal Auditors (Ghana) was formally registered in April 2001 in Ghana under the Professional Bodies Registration Decree, 1973 (NRCD 143) as a professional association dedicated to the promotion and development of the practice of internal auditing in Ghana. The Institute was formally inaugurated on Friday, May 13, 2005 by the then Hon. Minister of Finance & Economic Planning on behalf of His Excellency the President of the Republic of Ghana. The IIA (Ghana) is a full-fledged member institute of the Global Internal Audit family. It also actively pursues collaboration and partnership with sister national institutes, particularly the African institutes. IIA Ghana is a founding member of AFIIA – the African Federation of Institutes of Internal Audit, and currently represents West Africa on its governing council.

IIA Ghana is governed by a nine-member council supported by the immediate Past-President of the Institute who is an ex-officio member. The present Council (2011-2012) comprising the following members, was elected in February 2011 and will serve until the 2012 annual General Meeting, which will be held in February 2013:

- (a) Eric N. Yankah (**President**);
- (b) Richard Ntim (**Vice President**);
- (c) Juliet Aboagye-Wiafe (Mrs.);
- (d) Thomas M. Atuam;
- (e) Elsie Bunyan (Mrs.);

- (f) Leonard B.L. Donkoh;
- (g) Rebecca a. Lomo (Ms.)
- (h) Kofi Okofo-Dartey;
- (i) Daniel Kwame Opare;
- (j) John Djanie (***Immediate Past President***)

BY Kwame Gyasi

On November 16, 2012, Institutional Shareholder Services Inc. ("ISS") released the 2013 Updates to its U.S. **Corporate Governance** Policy (the "2013 Updates"). The 2013 Updates will be effective for shareholder meetings on or after February 1, 2013, unless otherwise noted below.

Issues affecting advisory votes on executive compensation

Investors continue to rank executive compensation as the top **corporate governance** topic. the 2013 Updates to the pay-for-performance evaluation undertaken in advance of an advisory "say-on-pay" vote on executive compensation refine how the subject companies' peer groups are selected, adjusting the criteria in an effort to include within the relevant peer group companies that have more in common with the subject company. The 2013 Updates also add the concept of "realizable pay" to the qualitative analysis for large cap companies.

Peer Groups

The 2013 Updates generally retain the methodology used by iss in 2012 to evaluate a say-on-pay proposal, utilizing both a quantitative and qualitative analysis to assess the alignment between pay and performance and determine the recommendation of iss on the proposal. As part of the quantitative analysis, the previous methodology focused the selection of a peer group on the subject company's Global Industry Classification Standard ("GICS") industry group. The GICS classification, however, does not always capture the multiple business lines in which a company operates, which may lead to the omission of direct competitors from a company's peer group or the inclusion of companies without much relation to the business of the subject company.

The 2013 Updates expand the scope of companies selected for a peer group. Instead of relying on only the company's GICS classification, the 2013 Updates provide for use of the peers from the subject company's GICS group as well as from GICS industry groups represented in the peer group the company has self-selected in benchmarking its executive compensation, while maintaining approximate proportions of these industries in the final peer group. The new methodology additionally focuses initially at an 8-digit GICS level rather than more specific levels, to be better aligned in terms of industry. ISS will prioritize for inclusion peers that (a) maintain the subject company near the median of the peer group in revenue/asset size, (b) are in the subject company's peer group and (c) have chosen the subject company as a peer. iss' selection criteria will continue to focus on companies that are reasonably similar in industry profile, size and capitalization.

Other changes to the peer group methodology include using slightly relaxed size requirements, especially at very small and very large companies, and using revenue instead of assets for certain financial companies.

Realizable Pay

The 2013 Updates expand the list of qualitative factors used to analyze pay-for-performance alignment at large cap companies to include "realizable pay", which may ultimately mitigate or exacerbate pay-for-performance concerns. While the grant date pay disclosed in a company's summary compensation Table reflects the intent of the Compensation Committee's pay decisions, it does not necessarily reflect the final payouts of performance awards or changes in value due to gains or losses in the subject company's stock price.



Realizable pay will consist of the sum of relevant cash and equity-based grants and awards made during the specific performance period being measured, based on equity award values for actual earned awards, or target values for ongoing awards, calculated using the stock price at the end of the performance measurement period. Stock options and SARs will be re-valued using the remaining term and updated assumptions, as of the performance period, using the Black-Scholes option pricing model.

Golden Parachute Proposals

The Dodd-Frank Act requires companies to hold separate shareholder votes on potential “golden parachute” payments when they seek approval for mergers, sales and certain other transactions. In determining the recommendation with respect to a golden parachute proposal, the 2013 Updates include the consideration of any existing change-in-control arrangements maintained with named executive officers, rather than focusing only on the new or extended arrangements. The list of features considered problematic has been refined. Recent amendments that incorporate problematic features will tend to carry more weight in the overall analysis. However, close scrutiny will also be given if multiple legacy problematic features are present.

Issues affecting votes on Director Nominees in Uncontested elections

Hedging and Pledging

current iss policy provides for the recommendation of a negative vote for directors, whether individually or as part of a committee or the entire board, due to material failures of risk oversight at the company. The 2013 Updates expand the examples of a failure of “risk oversight” to include, among other things, the hedging of company stock and the significant pledging of company stock as collateral for a loan.

These practices are seen as severing the alignment of interests between the officers and directors and the shareholders. Hedging of company stock at any level and in any form poses enough of a problem to warrant a negative vote recommendation. For companies in which officers or directors have pledged company stock as collateral, ISS considers the following factors in determining vote recommendations for the election of directors:

- Presence in the company’s proxy statement of an anti-pledging policy that prohibits future pledging activity;
- Magnitude of aggregate pledged shares in terms of total common shares outstanding or market value or trading volume;
- Disclosure of progress or lack thereof in reducing the magnitude of aggregate pledged shares over time;
- Disclosure in the proxy statement that shares subject to stock ownership and holding requirements do not include pledged company stock; and
- Any other relevant factors.

Majority Supported Shareholder Proposals

As the expectations of institutional investors, and the responsiveness of issuers, regarding majority supported shareholder proposals continue to advance, ISS has adjusted its policies accordingly. Beginning with board elections in 2014, ISS will recommend a negative vote on individual directors, committee members or the entire board, as appropriate, when the board has failed to take sufficient action on a shareholder proposal that received the support of a majority of the shares cast on such proposal in the previous year.

The 2013 Updates allow for greater flexibility in recommending a vote against only certain board members, rather than the full board. The 2013 Updates also provide more guidance for evaluating the sufficiency of a company’s response to a majority supported shareholder proposal. Responses that involve less than full implementation of the proposal will be evaluated on a case-by-case basis,

considering the following the factors:

- The subject matter of the proposal;
- The level of support and opposition provided to the resolution in past meetings;
- Disclosed outreach efforts by the board to shareholders in the wake of the vote;
- Actions taken by the board in response to its engagement with shareholders;
- The continuation of the underlying issue as a voting item on the ballot (as either shareholder or management proposals); and
- Other factors as appropriate.

The revised FAQs to be issued by ISS in December may provide more guidance with respect to the implementation evaluation.

Overboarded Directors

Current ISS policy recommends a negative vote on directors who are CEOs of other public companies and sit on board of more than two public companies besides their own – with the withhold recommendation only covering their outside boards. The 2013 Updates eliminate the previous exception that counted the boards of a public company parent and its public company subsidiary as a single board so long

As the parent owned at least 20% of the subsidiary. The 2013 Updates now count these parent and subsidiary boards as two separate boards.

Shareholder Proposals Addressing Social and Environmental Issues

Environmental, Social, and Governance Compensation-Related Proposals

The 2013 Updates modify ISS policy from generally recommending a vote against to making a vote recommendation on a case-by-case basis with respect to proposals that link executive compensation to sustainability criteria, including various environmental and social criteria. As these non-financial performance metrics become more common among certain industries, specifically the extractive industry sectors, and are increasingly addressed in international investor initiatives, the 2013 Updates recognize the increasing interest of institutional investors in sustainability issues as part of the evaluation process.

Lobbying

The 2013 Updates provide for vote recommendations on a case-by-case basis when evaluating proposals requesting information on a company's lobbying activities. The 2013 Updates clarify the scope and focus of lobbying activities covered, adding indirect lobbying activities as well as lobbying procedures and principles to the list that previously included only direct lobbying and grassroots lobbying within the specific policy.

New corporate legislation comes into effect in the Netherlands on 1 October 2012 and 1 January 2013.

It is important to be aware of this as it concerns, amongst other things, **Corporate Governance** issues.

The new management and supervision act (including the one tier board)

As of 1 January 2013 there will be a new **Corporate Governance** and supervision act. It affects public companies ("NVs") and private companies with limited liability ("BVs"); some clauses are also applicable to foundations.

The most important changes are:

- One tier board versus two tier board: in addition to the two tier board, the one tier board is now established. Until today, only a two tier board, with the management board and the supervisory board as a separate body, was laid down in Dutch law. This new law brings the possibility, with certain limitations, to create a board with executive management board members and non

executive (supervisory) management board members, both with their own duties. We are coming closer to the US and the UK. The one tier board differs from the two tier board in that the non-executive members in a one-tier board system are part of the management board and are therefore subject to director's liability.

- Conflict of Interest: the members of the management board and the supervisory board who have an (in) direct conflict of interest can no longer be part of the decision-making process regarding the underlying specific subject.
- Composition: for so called large entities there are new rules relating to the composition of the management and supervisory board. The number of permitted positions is limited. Furthermore, in large nvs and Bvs (and structure regimes) at least 30% of the positions on the management board and supervisory board must be held by women and at least 30% by men. This is done to stimulate the appointment of women on the company boards. It is, initially, a temporary rule (up to 1 January 2016).
- Responsibility: on the basis of the new legislation reference can be made to allocation of tasks in the articles of association. Although under Dutch law a division of tasks does not prejudice the joint responsibility of all members of the management board, it might under circumstances help by the so called individual exculpation possibility.
- Employment: management board members of listed companies will no longer be protected against dismissals or in case of illness, as the relationship between a board member and a listed company can no longer be based upon an employment agreement (but only on a management (service) agreement).

There are transitional provisions, but some clauses will apply immediately.

A Dutch BV is much more flexible as per 1 October 2012

On 1 October 2012 the Flex BV act entered into force. This Flex BV act brings major changes for BVs.

Some corporate provisions have changed while other have been deleted.

Amongst other things, amendments relate to the introduction of non-voting shares, capital requirements, the appointment of directors and supervisory board members, distributions, capital reduction, repurchase, vacancy of managing directors, financial assistance and convening general meetings.

The new legislation applies to all Bv's as of 1 october 2012.

Conclusion

Please review the current articles and decision making arrangements of your Dutch BV/NV in light of the possible consequences, and consider bringing the articles of association in line with new (coming) dutch law.

8.3 CORPORATE GOVERNANCE IN FAMILY BUSINESS

Introduction

The dominant form of business around the world is the family-owned business. In many instances, the family-owned business takes the form of a small family business whilst in other cases, it is a large business interest employing hundreds, or even thousands, of staff. The family-owned business can encompass sole traders, partnerships, private companies, and public companies. In fact, family ownership is prevalent not only amongst privately held firms but also in publicly traded firms in many countries across the globe. However, whatever the size of the business, it can benefit from having a good governance structure. Firms with effective governance structures will tend to have a more focused view of the business, be willing to take into account, and benefit from, the views of 'outsiders' (that is, non-family members), and be in a better position to evolve and grow into the future.

Ownership structures around the world

La Porta *et al.* (1999) analysed the ownership structure in a number of countries and found that the family-owned firm is quite common. Analysing a sample of large firms in 27 countries, La Porta *et al.* used as one of their criteria, a 10 per cent chain definition of control. This means that they analysed the shareholdings to see if there were 'chains' of ownership: for example, if company B held shares in company C, who then held company B's shares. On this 10 per cent chain definition of control, only 24 per cent of the large companies are widely held, compared to 35 per cent that are family-controlled, and 20 per cent state-controlled. Overall, they show that:

(1) Controlling shareholders often have control rights in excess of their cash flow rights. (2) This is true of families, who are so often the controlling shareholders. (3) Controlling families participate in the management of the firms they own. (4) Banks do not exercise much control over firms as shareholders... (5) Other large shareholders are usually not there to monitor the controlling shareholders. Family control of firms appears to be common, significant, and typically unchallenged by other equity holders.

La Porta *et al.*'s paper made an important contribution to our understanding of the prevalence of family-owned/controlled firms in many countries across the world.

A key influence on the type of ownership and control structure is the legal system. Traditionally, common law legal systems, such as in the UK and USA, have better protection of minority shareholders' rights than do civil law systems, such as those of France, Germany, and Russia. Often, if the legal environment does not have good protection of shareholders' rights, then this discourages a diverse shareholder base whilst being more conducive to family-owned firms where a relatively small group of individuals can retain ownership, power, and control. For example, in the UK and USA, where the rights of minority shareholders are well protected by the legal system, there are many more companies with diversified shareholder bases and family-controlled businesses are much less common.

However, research by Franks *et al.* (2004 and 2005) highlighted that, in the UK in the first half of the twentieth century, there was an absence of minority investor protection as we know it today, and yet there still occurred a move from family ownership to a more dispersed share ownership. This was attributable to the issuance of shares through acquisitions and mergers, although families tried to retain control of the board by holding a majority of the seats. Franks *et al.* (2004) state, the rise of hostile takeovers and institutional shareholders made it increasingly difficult for families to maintain control without challenge. Potential targets attempted to protect themselves through dual class shares and strategic share blocks but these were dismantled in response to opposition by institutional shareholders and the London Stock Exchange. The result was a regulated market in corporate control and a capital market that looked very different from its European counterparts. Thus, while acquisitions facilitated the growth of family controlled firms in the first half of the century, they also diluted their ownership and ultimately their control in the second half.

On the other hand, in many countries, including European countries such as France, many Asian



countries, and South American countries, the legal protection of minority shareholders is today still either non-existent or ineffective, and so families often retain control in companies because non-family investors will not find the businesses an attractive investment when their rights are not protected.

However, many countries are recognizing that, as the business grows and needs external finance to pursue its expansion, then non-family investors will only be attracted to the business if there is protection of their rights, both in the context of the country's legal framework and also in the corporate governance of the individual companies in which they invest. This is leading to increasing pressure both for legal reforms to protect shareholders' rights and for corporate governance reforms within the individual companies. On the other hand, balanced against the pressures for reform are the, often very powerful, voices of family shareholders with controlling interests who may not wish to see reform to give better protection to minority interests because this would effectively dilute their control.

Family-owned firms and governance

Whilst a family-owned business is relatively small, the family members themselves will be able to manage and direct it. One advantage of a family-owned firm is that there should be less chance of the type of agency problems discussed in Chapter 2. This is because ownership and control rather than being split are still one and the same, and so the problems of information asymmetry and opportunistic behaviour should (in theory, at least) be lessened. As a result of this overlap of ownership and control, one would hope for higher levels of trust and hence less monitoring of management activity should be necessary. However, problems may still occur and especially in terms of potential for minority shareholder oppression, which may be more acute in family-owned firms. Morck and Yeung (2003) point out some of the potential agency costs in family-owned firms:

In family business group firms, the concern is that managers may act for the controlling family, but not for shareholders in general. These agency issues are: the use of pyramidal groups to separate ownership from control, the entrenchment of controlling families, and non-arm's-length transactions (aka 'tunneling') between related companies that are detrimental to public investors.

In some countries, remedies such as formal shareholder agreements, in which the nature of each shareholder's participation in the company is recorded, may be utilized as a mechanism to help resolve the potential oppression of minorities. Furthermore, the EU Commission's proposed Shareholder Rights Directive, issued in January 2006, is designed to help strengthen the role of shareholders by ensuring that they have relevant information in a timely manner and are able to vote in an informed way. Although the proposed directive is aimed at listed companies, and so likely primarily to affect institutional investors, Member States are free to extend to non-listed companies some or all of the provisions of the proposed Directive.

Another advantage of family-owned firms may be their ability to be less driven by the short-term demands of the market. Of course, they still ultimately need to be able to make a profit but they may have more flexibility as to when and how they do so.

However, even when a family business is still relatively small, there may be tensions and divisions within the family as different members may wish to take different courses of action that will affect the day-to-day way the business operates and its longer term development. In the same way as different generations of a family will have diverse views on various aspects of life, so they will in the business context as well. Similarly, as siblings may argue about various things, so they will most probably differ in their views of who should hold power within the business and how the business should develop. Even in the early stages of a family firm, it is wise to have some sort of forum where the views of family members regarding the business and its development can be expressed. One such mechanism is the family meeting or assembly, where family members can meet, often on a formal pre-arranged basis, to express their views. As time goes by and the family expands with family by marriage and new generations, then the establishment of a family council may be advisable. Neubauer and Lank (1998) suggest that a family council may be advisable once there are more than 30-40 family members.

When a business is at the stage where family relationships are impeding its efficient operation and development, or even if family members just realize that they are no longer managing the business as effectively as they might, then it is definitely time to develop a more formal governance structure. There may be an intermediate stage where the family are advised by an advisory board, although this would not provide the same benefits to the family firm as a defined board structure with independent non-executive directors. Figure 5.1 illustrates the possible stages in a family firm's governance development.

Cadbury (2000) states that establishing a board of directors in a family firm is a means of progressing from an organisation based on family relationships to one that is based primarily on business relationships. The structure of a family firm in its formative years is likely to be informal and to owe more to past history than to present needs. Once the firm has moved beyond the stage where authority is vested in the founders, it becomes necessary to clarify responsibilities and the process for taking decisions.

The advantages of a formal governance structure are several. First of all, there is a defined structure with defined channels for decision-making and clear lines of responsibility. Secondly, the board can tackle areas that may be sensitive from a family viewpoint but which nonetheless need to be dealt with - succession planning is a case in point (deciding who would be best to fill key roles in the business should the existing incumbents move on, retire, or die). Succession planning is important too in the context of raising external equity because, once a family business starts to seek external equity investment, then shareholders will usually want to know that succession planning is in place. The third advantage of a formal governance structure is also one in which external shareholders would take a keen interest: the appointment of non-executive directors. It may be that the family firm, depending on its size, appoints just one, or maybe two, non-executive directors. The key point about the non-executive director appointments is that the persons appointed should be independent; it is this trait that will make their contribution to the family firm a significant one. Of course, the independent non-executive directors should be appointed on the basis of the knowledge and experience that they can bring to the family firm: their business experience,



Possible stages in a family firm's governance

or a particular knowledge or functional specialism of relevance to the firm, which will enable them to 'add value' and contribute to the strategic development of the family firm.

Cadbury (2000) sums up the three requisites for family firms to manage successfully the impacts of growth: 'They need to be able to recruit and retain the very best people for the business, they need to be able to develop a culture of trust and transparency, and they need to define logical and efficient organisational structures'. A good governance system will help family firms to achieve these requisites.

Bammens and Voordeckers (2009), in a study of family firms in Belgium, find that 'contrary to traditional agency wisdom, family firm boards devote substantial attention to controlling the management team... those family firms that employ trust and control in a complementary manner will be most effective'.

In the context of succession planning, Bennedsen *et al* (2006), in a study of family firms in Denmark, report that their empirical results demonstrate that professional, non-family CEOs provide extremely valuable services to the organizations they head. On the other hand, they report that family CEO underperformance is particularly large in fast-growing industries, industries with a highly skilled labor force and relatively large firms.

Smaller quoted companies

In the UK, many firms with family control will be smaller quoted companies, either on the main market or on the UK's Alternative Investment Market (AIM), which can be seen as a way for smaller firms to



obtain market recognition and access to external sources of finance, often before moving on to the main market.

The Combined Code 2008 forms part of the UK Listing Authority's Rules and is applicable to all UK listed companies. This means that there should be no distinction between the governance standards expected of larger and smaller companies. The Combined Code states that it encourages smaller companies to adopt the Code's approach. However, in relation to smaller companies (those outside the FTSE 350), it states that they should have at least two independent non-executive directors (rather than half the board being independent non-executive directors, which is the requirement for larger companies); and also for listed companies outside the FTSE 350, it allows the company chairman to sit on the audit committee where he or she was considered independent on appointment.

The Quoted Companies Alliance (QCA), formerly the City Group for Smaller Companies (CISCO), is an association representing the interests of smaller companies and their advisers. The QCA fully embraces the principles of corporate governance contained in the Combined Code and advocates that these principles should be adopted by all public quoted companies in so far as it is practicable for their size. *QCA Guidance for Smaller Companies* (2001), updated in 2004, urges smaller companies to comply with the Combined Code as far as they are able, but where they are unable to comply fully, then they should explain why they are unable to comply. The QCA Corporate Governance Committee (2005, updated in 2007) published a corporate governance guide for AIM companies to help smaller companies seeking to develop their governance, or to meet the expectations of institutional investors.

There has been a distinct lack of research into aspects of corporate governance in small companies, with a few exceptions being Collier (1997) on audit committees in smaller listed companies, and Mallin and Ow-Yong (1998a, 1998b) on corporate governance in AIM companies and corporate governance in small companies on the main market. Mallin and Ow-Yong (2008) carried out a further study of corporate governance in AIM companies and highlighted a concern that 'with the rapid expansion of AIM and the increasing number of overseas companies, from countries whose culture of good governance may be weaker than that of the UK, a damaging financial scandal or collapse is only a matter of time'. They recommended that the role of the NOMAD [nominated advisor] be re-examined; the admission of overseas companies to AIM should be more closely scrutinized; small boards which may not be able to institute all the features of 'good' corporate governance should consider increasing the number of directors on their board, subject to resource constraints; and the regulatory authorities should monitor more closely the governance of AIM companies which have yet to start trading.

Another strand of the literature concentrates on firm-level characteristics that may serve to differentiate large and small firms. Larger firms tend to be more complex, whereas smaller firms adopt simpler systems and structures; smaller firms tend to have more concentrated leadership, whilst in a larger firm control may be more diffuse, or more subject to question by a larger board (Fama and Jensen 1983; Begley and Boyd 1987). In terms of the impact on corporate governance structures, it can be expected that in general, small and medium-sized firms will have simpler corporate governance structures than large firms - this may include: combining various of the key committees (audit, remuneration, nomination); a smaller number of non-executive directors (NEDs); a combined chair/CEO; longer contractual terms for directors due to the more difficult labour market for director appointments into small and medium-sized companies.

The role and importance of NEDs was emphasized in the Cadbury Report (1992) and in the Code of Best Practice it is stated that NEDs 'should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct'. Similarly, the Hampel Report (1998) stated: 'Some smaller companies have claimed that they cannot find a sufficient number of independent non-executive directors of suitable calibre. This is a real difficulty, but the need for a robust independent voice on the board is as strong in smaller companies as in large ones'. The importance of the NED selection process is also emphasized: they 'should be selected

through a formal process and both this process and their appointment should be a matter for the board as a whole'.

From the above diagram, it can be seen that the areas where potential difficulties are most likely to arise tend to be those relating to the appointment of directors, particularly non-executive directors, which has implications for board structure. These differences arise partly because of the difficulties of attracting and retaining suitable non-executive directors in small companies.

Mallin and Ow-Yong (1998b) found that the most important attribute for small businesses when recruiting non-executive directors was their business skills and experience. Overall, the inference could be made that the ability to 'add value' to the business is the most important factor influencing NED appointments, which is in line with a study by Collier (1997). Similarly, the Hampel Committee (1998) stated 'particularly in smaller companies, non-executive directors may contribute valuable expertise not otherwise available to management'.

Areas of the Combined Code that may prove difficult for smaller companies

Combined Code recommendations	Potential difficulty
Minimum two independent NEDs	Recruiting and remunerating independent NEDs
Split roles of chair/CEO	May not be enough directors to split the roles
Audit committee comprised of two NEDs	Audit committee may include executive directors
NEDs should be appointed for specific terms	NEDs often appointed for term

However, many small companies do not have a nomination committee, and therefore non-executive director appointments are often made by the whole board. Interestingly, Mallin and Ow-Yong (2008) found that the factor that was considered to be most influential when making non-executive director appointments was considered to be 'objectivity and integrity' followed by 'relevant business skills and experience'. This perhaps highlights the impact of various corporate scandals and collapses in bringing to the fore the importance of these characteristics of objectivity and integrity.

In terms of the adoption of board committees, such as audit, remuneration, and nomination committees, small companies tend to have adopted audit and remuneration committees fairly widely but not nomination committees. In some smaller companies, the committees may carry out combined roles where, for example, the remuneration and nomination committees are combined into one committee; often the board as a whole will carry out the function of the nomination committee rather than trying to establish a separate committee from a small pool of non-executive directors.

A word of caution should be sounded though in relation to quoted companies where there is still a large block of family ownership (or indeed any other form of controlling shareholder). Charkham and Simpson (1999) point out:

the controlling shareholders' role as guardians is potentially compromised by their interest as managers. Caution is needed. The boards may be superb and they may therefore be fortunate enough to participate in a wonderful success, but such businesses can decline at an alarming rate so that the option of escape through what is frequently an illiquid market anyway may be unattractive.

The points made are twofold: first, that despite a good governance structure on paper, in practice, controlling shareholders may effectively be able to disenfranchise the minority shareholders; secondly, that in a family-owned business, or other business with a controlling shareholder, the option to sell one's shares may not be either attractive or viable at a given point in time.

Conclusions

In many countries, family-owned firms are prevalent. Corporate governance is of relevance to family-owned firms, which can encompass a number of business forms including private and publicly quoted companies, for a number of reasons. Corporate governance structures can help the company to develop successfully - they can provide the means for defined lines of decision-making and



accountability, enable the family firm to benefit from the contribution of independent non-executive directors, and help to ensure a more transparent and fair approach to the way the business is organized and managed. Family-owned firms may face difficulties in initially finding appropriate independent non-executive directors but the benefits that such directors can bring is worth the time and financial investment that the family-owned firm will need to make.

SUMMARY

- Family ownership of firms is the prevalent form of ownership in many countries around the globe.
- The legal system of a country tends to influence the type of ownership that develops, so that in common law countries with good protection for minority shareholders' rights, the shareholder base is more diverse, whereas in civil law countries with poor protection for minority shareholders' rights, there tends to be more family ownership and control.
- The governance structure of a family firm may develop in various stages such as starting with a family assembly, then a family council, advisory board, and finally, a defined board structure with independent non-executive directors.
- The advantages to the family firm of a sound governance structure are that it can provide a mechanism for defined lines of decision-making and accountability, enable the family firm to benefit from the contribution of independent non-executive directors, and help to ensure a more transparent and fair approach to the way the business is organized and managed.

Example: Cadbury plc; UK

This is an example of a family firm that grew over time, developed an appropriate governance and became an international business.

Today, Cadbury is a household name in homes across the world. It was founded in the first part of the nineteenth century when John Cadbury decided to establish a business based on the manufacture and marketing of cocoa. His two sons joined the firm in 1861 and, over the years, more family members joined, and subsequently the firm became a private limited liability company, Cadbury Brothers Ltd. A board of directors was formed comprising of members of the family.

Non-family directors were first appointed to the firm in 1943, and in 1962, the firm became a publicly quoted company with the family members still being the majority on the board and holding a controlling interest (50 per cent plus) in the shares. Cadbury merged with Schweppes in the late 1960s, and over the next 40 years, Cadbury Schweppes developed a diverse shareholder base and a board of directors appointed from the wider business community. The direct family involvement, via either large shareholdings or board membership, therefore declined over the years. In the Spring of 2007, Cadbury Schweppes revealed plans to split its business into two separate entities: one focusing on its main chocolate and confectionery market; the other on its US drinks business. The demerger took effect in May 2008 so that Cadbury Schweppes plc became Cadbury plc (focusing on the former market) and Dr Pepper Snapple Group Inc: (focusing on the QS drinks business).

In 2009, Kraft launched a hostile takeover bid for Cadbury. Cadbury decided to fight to retain its independence.

Example: Hutchison Whampoa, Hong Kong

This is an example of an international company where there is controlling ownership by a family via a pyramid shareholding.

Hutchison Whampoa is a multinational conglomerate with five core businesses including ports and related services, property and hotels, telecommunications, retail and manufacturing, energy and infrastructure. It ranks as one of the Most valuable companies in Hong Kong and a large proportion of it is controlled by Cheung Kong Holdings in which the Li Ka Shing family have a significant interest which

means that the Li Ka Shing family has significant influence over both companies, one through direct ownership, the other via an indirect, or pyramid, shareholding.

Hutchison Whampoa has, for many years, been the recipient of various awards and accolades. In 2005, it was voted the best-managed company in Hong Kong in a poll of institutional investors and equity analysts carried out for the Finance Asia annual awards. In the same poll, it was voted Asia's Best Conglomerate and its CFO received the Best CFO Award in Hong Kong. The Hong Kong Institute of Certified Public Accountants awarded its significant improvement Award in the Hang Seng Index Category to Hutchison Whampoa in 2005 for its 'very clear and positive approach to upgrading its corporate governance practice'. Whilst having a controlling family interest, Hutchison Whampoa is committed to good corporate governance and to its wider shareholder base. More recently, in 2008, it was recognized by Corporate Governance Asia as one of 'The Best of Asia', that is one of Asia's Best Companies for Corporate Governance.

Mini case study: Fiat, Italy

This is a good example of a firm where the founding family still have significant influence through a complex shareholding structure.

Fabbrica Italiana Automobile Torino, better known as Fiat, was founded in 1899 by a group of investors including Giovanni Agnelli. Fiat automobiles were immediately popular not just in Italy but internationally too. Fiat expanded rapidly in the 1950s and, in 1966, the founder's grandson, also Giovanni Agnelli, became the company's chairman. As well as cars, Fiat's business empire included commercial vehicles, agricultural, and construction equipment, insurance, aviation, the press, electric power and natural gas distribution. In past years, it has achieved enormous financial success.

More than 90 per cent of Italian registered companies are family owned, with many companies being run by Italian families who wield great power. Traditionally, control has been achieved, often with the minimum of capital outlay, through a complex structure involving a series of holding companies. In the case of Fiat, control by the Agnelli family is via pyramids (indirect holdings) and voting trusts particularly Ifi (a financial holding company) in which the Agnelli family have control of all the votes.

By 2002, Fiat had significant financial problems with losses of US\$1.2 billion in 2002. General Motors, which had acquired a 20 per cent shareholding in Fiat at a cost of US\$2.4 billion, was asked to invest further in Fiat but was reluctant to do so. In 2003, the group restructured its core business area by again focusing manufacturing and service activities on the traditional motor vehicle sector.

In 2003, Umberto Agnelli died, and in 2004, Luca Cordero di Montezemolo was nominated as Chairman. Also in 2004, Sergio Marchionne was appointed as Chief Executive of Fiat and this marked a turning point in the company's fortunes. An astute and experienced businessman, Mr Marchionne oversaw changes to various areas of the Fiat business. At the beginning of 2005, Fiat announced the creation of Fiat Powertrain Technologies, a new industrial unit designed to integrate the groups' innovation capabilities and expertise in engines and transmissions. In February 2005, the boards of directors of Fiat and General Motors met to approve the contract to terminate the master agreement and related joint ventures between the two companies. The Chairman of Fiat, Luca Cordero di Montezemolo, said:

We are delighted to have been able to conclude this agreement with General Motors. While highly beneficial to both Fiat and GM since 2000, the arrangements had become too confining for the development of Fiat Auto in today's market environment. We now have all the necessary freedom to develop strategic growth alternatives for Fiat Auto, while retaining a base on which to build a much more construction relationship with GM in the future.

There were also important changes to Fiat's corporate governance structure in June 2005, with Fiat extending its board of directors to 15 members, so that the board comprised a majority of independent non-executive directors. At the same time, Fiat strengthened its independence requirements for directors. In its press release, it stated:



After a thorough review of current international practice on this issue, the Company has adopted a set of criteria which are designed to ensure that the independence qualification is held to the highest possible standard. As an example, directors who have served on the Board for more than nine years, even though not consecutively, are deemed not to be independent. Furthermore, board members who are executive directors of other companies on whose board[s] sit executive board members of Fiat are also deemed not to be independent.

In January 2006, Fiat announced another significant strategic change with the signing of an agreement to co-operate on dealer networks with Tata Motors Ltd., which meant that Fiat cars could be distributed via the Tata network in India. Late in January 2006, Fiat announced that it had seen its first positive quarterly trading profit after 17 successive quarters of losses.

With the revision of Italian corporate governance provisions, the Fiat Group adopted and abides by the Corporate Governance Code of Italian Listed Companies issued in March 2006. Fiat provides information regarding how it meets the individual principles and criteria of the Corporate Governance code by providing a reprise of the individual principles and criteria, and then summarizing how each of these is implemented at Fiat.

2006 saw the strengthening of Fiat's presence in Europe and the gain of access into markets including China, India, and Russia. In 2007, Sergio Marchionne announced the 2007-2010 plan geared towards growth. In 2009 he unveiled his plan to put Fiat at the heart of the car-making industry globally by forging an alliance with the giant troubled US car manufacturers Chrysler and General Motors (Opel, the European arm) in June 2009, Fiat and Chrysler announced that they had finalised a global strategic partnership to begin immediately. The ultimate success of the alliance will depend on many factors and will likely have implications for the workforces in the various countries affected including Germany and the UK.

8.4 Corporate Governance in state-owned business- the MOU system Introduction

Most of the industrialization in developing countries was initiated by governments due to the inherent problems associated with the mobilization of capital for the purpose of industrialization. Also, the pursuit of economic systems and ideologies such as socialism or communism required such countries either to wholly depend on or at least sustain with the initiatives of the public sector. While many countries initiated steps to gradually do away with the whole concept of the public sector except in strategically important areas such as defence or space research like the US or UK, the Government of India has been following a policy where the public sector co-exists with the private sector even though a great deal of effort has been taken at privatization of government-owned enterprises or part divestment of government stakes in the public sector companies. Corporate governance has become applicable to many of the public sector enterprises (PSEs) as they have chosen to raise funds from the capital markets, either through public offers of equity capital or through a process of divestment of equity in favour of private corporate bodies or institutional investors.

Difficulties Encountered in Governance

While routine governance regulations become applicable for public sector companies formed under the Companies Act, 1956 and come under the purview of SEBI regulations the moment they mobilize funds from the public, the typical organizational structure of PSUs makes it difficult for the implementation of corporate governance practices as applicable to other publicly-listed private enterprises. The typical difficulties faced are:

- The board of directors will comprise essentially of bureaucrats drawn from various ministries which are interested in the PSU. In addition, there may be nominee directors from banks or financial institutions who have loan or equity exposures to the unit. The effect will be to have a board much beyond the required size, rendering decision-making a difficult process.
- The chief executive or managing director (or chairman and managing director) and other

functional directors are likely to be bureaucrats and not necessarily professionals with the required expertise. This can affect the efficient running of the enterprise.

- Difficult to attract expert professionals as independent directors. The laws and regulations may necessitate a percentage of independent component on the board; but many professionals may not be enthused as there are serious limitations on the impact they can make.
- Due to their very nature, there are difficulties in implementing better governance practices. Many public sector corporations are managed and governed according to the whims and fancies of politicians and bureaucrats. Many of them view PSUs as a means to their ends. A lot of them have turned sick due to overdoses of political interference, even when their areas of operations offered enormous opportunities for advancement and growth. And when the economy was opened up, many of them lacked the competitiveness to fight it out with their counterparts from the private sector.

OECD Guidelines for Corporate Governance of State-owned Enterprises

Many of the developing countries still continue to have a dominant presence of state-owned enterprises. Hence, OECD thought it appropriate to evolve a set of governance guidelines for the state-owned enterprises as it did for the private enterprises in member countries. According to OECD, A major challenge is to find a balance between the state's responsibility for actively exercising its ownership functions, such as, the nomination and election of the board, while at the same time refraining from imposing undue political interference in the management of the company. Another important challenge is to ensure that there is a level playing field in markets where private sector companies can compete with the state-owned enterprises, and that governments do not distort competition in the way they use their regulatory or supervisory powers.'

According to OECD, the guidelines 'suggest that the state should exercise its ownership functions through a centralized ownership entity, or effectively co-ordinated entities, which should act independently and in accordance with a publicly disclosed ownership policy. The guidelines also suggest the strict separation of the state's ownership and regulatory functions. If properly implemented, these and other recommended reforms would go a long way to ensure that state ownership is exercised in a professional and accountable manner, and that the state plays a positive role in improving corporate governance across all sectors of our economies. The result would be healthier, more competitive, and transparent enterprises'.

The major recommendations in OECD guidelines are as discussed below.

Ensuring an effective legal and regulatory framework for state-owned enterprises

- There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.
- SOEs should not be exempt from the application of general laws and regulations. Stakeholders including competitors, should have access to efficient redress and an even-handed ruling when they believe that their rights have been violated.
- SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions, and other state-owned companies, should be based on purely commercial grounds.

State acting as an owner

The state should act as an informed and active owner, and establish a clear and consistent ownership policy, ensuring that governance of state-owned enterprises is carried out in a transparent and accountable manner with the necessary degree of professionalism and effectiveness.

- The government should develop and issue an ownership policy that defines the overall objectives



of state ownership, the state's role in corporate governance of SOEs, and how it will implement its ownership policy.

- The government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives.
- The state should let SOE boards exercise their responsibilities and respect their independence.
- The state should exercise its ownership rights according to the legal structure of each company. Keeping this in mind, it should ensure that remuneration schemes for SOE board members foster the long-term interest of the company, and can attract and motivate qualified professionals.

Equitable treatment of shareholders

The SOEs should recognize the rights of all shareholders and in accordance with the OECD principles of corporate governance, ensure their equitable treatment and equal access to corporate information.

- SOEs should observe a high degree of transparency towards all shareholders.
- The co-ordinating or ownership entity and SOEs should ensure that all shareholders are treated equally.
- The participation of minority shareholders in shareholder meetings should be facilitated in order to allow them to take part in fundamental corporate decisions, such as board election.

Relations with stakeholders

The state ownership policy should fully recognize the state-owned enterprises' responsibilities towards stakeholders and report their relations with them.

- Listed on large SOEs, as well as SOEs pursuing important public policy objectives, should report on stakeholder relations.

Transparency and disclosure

State-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.

- SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent company organ.
- SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures does not substitute for an independent external audit.

Responsibilities of the boards of state-owned enterprises

The boards of state-owned enterprises should have the necessary authority, competencies, and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

- The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company's performance. The board should be fully accountable to the owners, act in the best interest of the company, and treat all shareholders equally.
- SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the government and the ownership entity. They should have the power to appoint and remove the CEO.
- The boards of SOEs should be so composed that they can exercise objective and independent judgement. Good practice calls for the chair to be separate from the CEO.

- SOE boards should carry out an annual evaluation to appraise their performance.

Conflicts of Interest

Conflicts of interest are a major challenge to the establishment and maintenance of good governance practices, and can occur and exist irrespective of the ownership structures. While some of the conflicts may be similar in nature, others may be typical to the type of ownership structure.

Most of the conflicts of interest in PSUs occur because of the roles played by bureaucrats and politicians in the running and management of the enterprise. For example, politicians or bureaucrats may try to have their candidate as the chairman and/or managing director in order to push through their private agendas rather than getting the best professional to run the PSU. There have also been many instances where the chairman and/or managing director, or other senior executives of the PSU has placed orders or awarded contracts at rates higher than the best prices, and earned hefty commissions on these. Orders or contracts may also be given to those who do not have the necessary capabilities to execute them. What is best for the PSU usually gets neglected. There may also be issues such as ministers or politicians yielding to recommendations of their cadre and sometimes even creating positions or designations that are not at all needed, leading the PSU to have a bloated workforce and driving it into the sick category. Politicians or bureaucrats may even harp on the flimsy reason that PSUs have employment generation as one of their aims. Most of the conflicts of interest with regret to PSUs dwell on the area of decision-making, which is very often not founded on merit.

Public Sector Enterprises and the Memorandum Of Understanding:

After Independence, Public Sector Enterprises (CPSEs) were set up in India with an objective to promote rapid economic development through the creation and expansion of infrastructure by the government. With different phases of development, the role of CPSEs has changed and their operations have extended to a wide range of activities in manufacturing, engineering, steel, heavy machinery, machine tools, fertilizers, drugs, textiles, pharmaceuticals, petro-chemicals, extraction and refining of crude oil and services such as telecommunication, trading, tourism, warehousing, etc. as well as a range of consultancy services. While there have been many CPSEs that have performed very well in competition with private sector enterprises, there are also many CPSEs that have performed very poorly. In an economic environment that has changed considerably in the last two decades, the role of CPSEs has changed and they have been increasingly guided to reduce their dependence on the Government. They have been listed on the stock exchange and few of them have been privatized. The Government has provided CPSEs the necessary flexibility and autonomy to operate effectively in a competitive environment. However, there are a few issues with the operation and management of CPSEs which still persist and need to be attended to. There is a need to develop a mechanism on how government can get an efficient Indian presence in the sectors where the private sector investments are not forthcoming especially in strategic areas where developing capabilities is essential if India has to play its rightful role among the among the nations of the world.

Governance in India: The Path Ahead

The Indian economy on the eve of the Twelfth Plan is characterized by strong macro-fundamentals and good performance over the Eleventh Plan period, though clouded by some slowdown in growth in the current year with continuing concern about inflation and a sudden increase in uncertainty about the global economy. The objective of the Eleventh Plan was faster and inclusive growth and the initiatives taken in the Eleventh Plan period have resulted in substantial progress towards both objectives. Inevitably, there are some weaknesses that need to be addressed and new challenges that need to be faced. Some of the challenges themselves emanate from the economy's transition to a higher and more inclusive growth path, the structural changes that come with it and the expectations it generates. There are external challenges also arising from the fact that the global economic environment is much less favourable than it was at the start of the Eleventh Plan. These challenges call for renewed efforts on multiple fronts, learning from the experience gained, and keeping in mind global developments. We focus on the backdrop of target setting and areas of focus of the Eleventh Plan. India entered



the Eleventh Plan period (2007-2012) with an impressive record of economic growth. The vision for the Eleventh Plan prominently included an improvement in governance. Over the years, the governments at the Centre and the States have launched a large number of initiatives at substantial public expense to achieve the objectives of growth with poverty alleviation and inclusiveness. Experience suggests that many of these initiatives have floundered because of poor design, insufficient accountability and also corruption at various levels. Increasingly, there is demand for effective implementation without which expanded government intervention will be infructuous. The strategy for the Eleventh Plan was therefore aimed at bringing about major improvements in governance which would make government-funded programmes in critical areas more effective and efficient. The best possible way of achieving this objective may be by involving communities in both the design and implementation of such programmes, although such involvement may vary from sector to sector. For achieving the vision of the Eleventh Plan, it is extremely important to experiment with programme design to give more flexibility to decision making at the local level. It is especially important to improve evaluation of the effectiveness of how government programmes work and to inject a commitment to change their designs in the light of the experience gained. Evaluation must be based on proper benchmarks and be scientifically designed to generate evidence-based assessment of different aspects of programme design. Along with greater transparency and feedback from community participation, this is particularly important in the case of programmes delivering services directly to the poor. Accountability and transparency are critical elements of good governance. The Right to Information Act (RTI) enacted in 2005 empowers people to get information and constitutes a big step towards transparency and accountability.

MoU in India

Notwithstanding the spectacular performance of CPSEs in several areas, there has been a sense of disillusionment with some aspects of CPSE performance such as low profitability and lack of competitiveness. The extensive regulation of CPSEs by government had stifled the initiative and growth of public sector. The Economic Administration Reforms Commission (Chairman: L. K. Jha) had dwelt on issue of autonomy and accountability. The Commission had recommended a careful re-consideration of extant concepts and instrumentalities relating to the accountability of public enterprises with a view to ensuring (a) that they do not erode the autonomy of public enterprises and thus hampers the very objectives and purposes for which these enterprises have been set up and given corporate shape and for which they are to be accountable; and (b) accountability has to be secured in the wider sense of answerability for the performance of tasks and achievements of results (EARC-II/Report No. 4, p. 22). The adoption of MoU system in India could be seen as an attempt to operationalize this very vital recommendation.

Memorandum of Understanding: In Retrospect

The concept of Memorandum of Understanding (MoU) has been designed to provide flexibility and autonomy to Central Public Sector Enterprises (CPSEs) such that it facilitates them in pursuing the objectives and purposes, for which the enterprises have been set up. Accountability has to be understood in a wider sense by associating it with answerability for the performance of the tasks and the achievement of targets negotiated mutually between the Government and the CPSE. The rationale for MoU could be derived from principal/agent theory. The principal (administrative ministry on behalf of real owners- the people) can only observe outcomes and cannot measure accurately the efforts expended by the agent (CPSE managers). Also the Principal can only, to a limited extent, distinguish the effects of influences from other factors, which affect the performance (Laffont and Tirole 1993). Therefore extensive intervention by administrators, who might not be too knowledgeable about the nature of problems confronting the enterprises, not only impacts productivity and profitability but also makes it impossible to fix accountability for non-achievement of targets.

A negotiated incentive contract (MoU), hence, is viewed as a device to reveal information and motivate managers to exert effort. Proponents argue that the contract can translate multiple objectives into targets which can be measured by specified criteria and could be given weights to reflect priorities. Moreover, targets can be set to take into account circumstances where CPSE managers have less

control over their firms than their counterparts in the private sector. For example, performance might be judged against the firm's past trends, rather than against an industry standard, to take account of situations where the firm's performance is sub-standard because of government imposed constraints (such as prohibitions on layoffs, price controls, etc.).

By specifying targets and evaluating results ex post, the MoU is seen by its advocates as a way to encourage governments to reduce ex ante controls, giving managers more freedom and motivation to improve operating efficiency.

Hence, it is strongly felt that Performance Contracts will improve performance only if they elicit both the Government's and the Firms' commitment. Since Government is both a signatory and the enforcer of the contract, it is especially important that its commitment remains credible. Political determinants may preclude the design of incentive contracts and impede CPSEs in producing the sort of productivity gains being achieved by the private firms. These findings suggest that effort in designing a framework of MoU on consistent basis can produce good results.

The Memorandum of Understanding (MoU) System in India was introduced in the year 1986, after the recommendations of the Arjun Sengupta Committee Report (1984). Twenty six years after its inception, the MoU system has evolved and is being strengthened, through regular reviews, to become a management tool that helps in performance evaluation as well as performance enhancement of CPSEs in the country.

In the backdrop of the dynamic external environment, "world-wide competition" and globalization, it is critical that the MoU system is strengthened such that it facilitates the CPSEs in becoming economically viable through efficient management and control. Hence, the MoU system aims at offering autonomy to CPSEs and is designed such that it can aid in the assessment of the extent to which mutually agreed objectives (Mandal, 2012) are achieved. This section of the report traces the evolution of the MoU system through various committee reports and highlights the major observations, along with the actions taken thereafter. This would act as an indicator of the developments that have happened in the MoU system in India and, through the study of extant literature, would also highlight the areas of concern raised after each study.

The various committees formed over the years are:

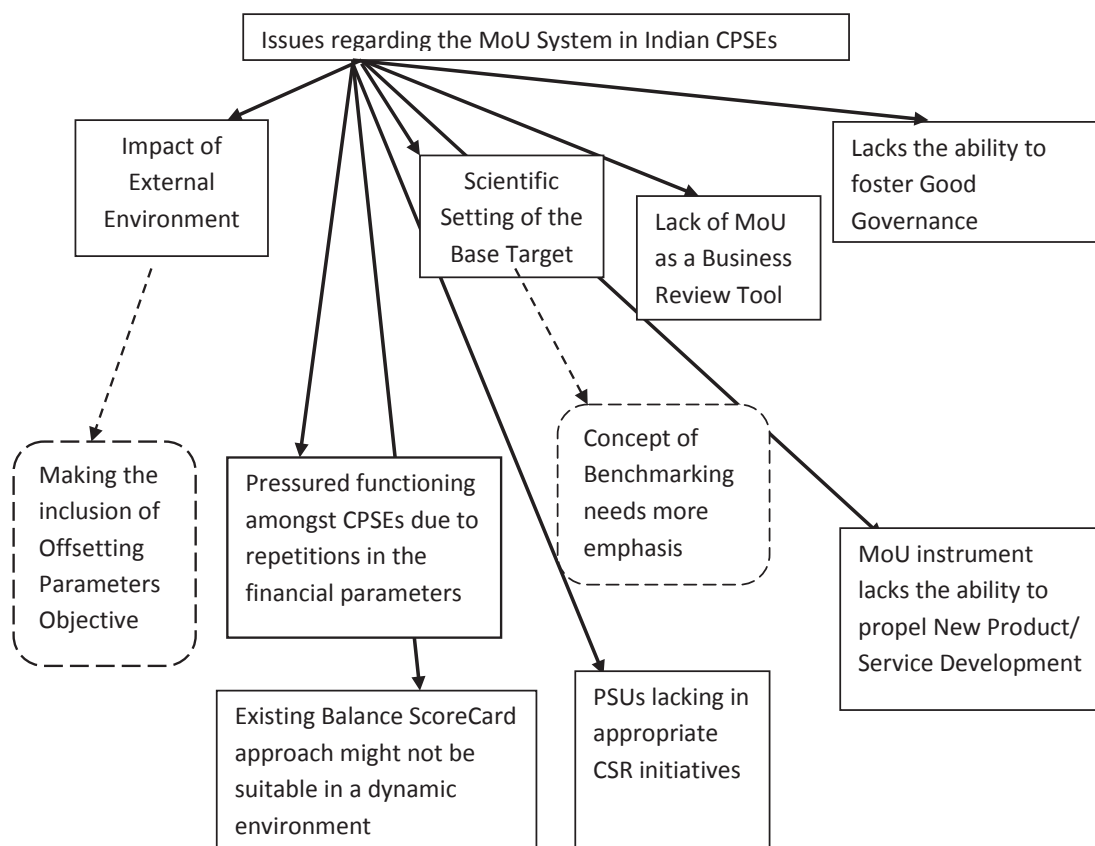
1. Arjun Sengupta Committee Report (1984)
2. National Council of Applied Economic Research (2004)
3. Report of the Working Group (2008)
4. S.K. Roongta Committee Report (2011)
5. Mankad Committee and Task Force (2012)

Concerns Regarding Memorandum of Understanding (MoU)

Thematic analysis has been applied, in this study, as a qualitative research method and the emergent issues/ challenges with the current MoU system have been clearly identified. Each issue is highlighted in the concrete box while sub-issues have been highlighted in dotted boxes. The Initial Thematic Web is presented in Figure below

Figure clearly brings out the several challenges which the MoU system in India, currently faces. These issues and challenges have also been highlighted by various committee reports and extant literature.

- Dark Lines Connect Broad Themes (Issues)
- Dotted lines connect Sub-Themes (Issues)



Conclusion:

It has been established through the discussion that from the year of its inception - 1986 till today (2013), the Memorandum of Understanding system in India has been consistently moving towards improvement to eventually become a management tool. The tool not only measures the performance of CPSEs on financial parameters but also on strategic, non- financial parameters. However, the existing literature, nationally as well as internationally, highlights the areas of improvement in the MoU framework and the present study group, attempts to fill the identified gaps through scientific research.

As corporate governance practices need to be understood as a significant part of the broader CPSE reform and renewal programme rather than as a separate stand-alone exercise, the study group recommends that the MoU System for CPSEs needs to inject the following good governance practices to enhance the autonomy as well as efficiency of the CPSEs:

- Professionalizing the CPSE Boards by including managers from the private sector in the CPSE Boards as independent directors;
- Rolling out leadership development programmes which would be compulsory for the Board members; and
- Increasing transparency of the CPSEs by making internal controls and audit strong, as well as carrying out supplementary audits on a timely basis.

Study Note - 9

SOCIAL, ENVIRONMENTAL AND ECONOMIC RESPONSIBILITIES OF BUSINESS



This Study Note includes

- 9.1 Corporate Social Responsibility: Towards a Sustainable Future
- 9.2 CSR: A Commonly Misunderstood Concept
- 9.3 Corporate Social Responsibility– Perspectives and Best Practices
- 9.4 Corporate Social Responsibility Voluntary Guidelines 2009 from Ministry of Corporate Affairs, Government of India
- 9.5 Whole Life Costing - Assessment of Socio-economic impact of Strategic and Operational Decisions of Business

9.1 CORPORATE SOCIAL RESPONSIBILITY: TOWARDS A SUSTAINABLE FUTURE

Background

The role of corporates by and large has been understood in terms of a commercial business paradigm of thinking that focuses purely on economic parameters of success.

As corporates have been regarded as institutions that cater to the market demand by providing products and services, and have the onus for creating wealth and jobs, their market position has traditionally been a function of financial performance and profitability.

However, over the past few years, as a consequence of rising globalisation and pressing ecological issues, the perception of the role of corporates in the broader societal context within which it operates, has been altered.

Stakeholders (employees, community, suppliers and share-holders) today are redefining the role of corporates taking into account the corporates' broader responsibility towards society and environment, beyond economic performance, and are evaluating whether they are conducting their role in an ethical and socially responsible manner.

As a result of this shift (from purely economic to 'economic with an added social dimension'), many forums, institutions and corporates are endorsing the term Corporate Social Responsibility (CSR).

They use the term to define organisation's commitment to the society and the environment within which it operates.

The World Business Council on Sustainable Development's (WBCSD) report was titled Corporate Social Responsibility: Making Good Business Sense and the OECD Guidelines for Multi-National Enterprises which includes a discussion on how CSR is emerging as a global business standard.

Further, there is a global effort towards reinforcing CSR programmes and initiatives through local and international schemes that try to identify best-in-class performers.

CSR: A Historical Perspective

The concept of CSR in India is not new, the term may be. The process though acclaimed recently, has been followed since ancient times albeit informally.

Philosophers like Kautilya from India and pre-Christian era philosophers in the West preached and promoted ethical principles while doing business. The concept of helping the poor and disadvantaged was cited in much of the ancient literature.

The idea was also supported by several religions where it has been intertwined with religious laws. “Zakaat”, followed by Muslims, is donation from one's earnings which is specifically given to the poor and disadvantaged. Similarly Hindus follow the principle of “Dhramada” and Sikhs the “Daashaant”.

In the global context, the recent history goes back to the seventeenth century when in 1790s, England witnessed the first large scale consumer boycott over the issue of slave harvested sugar which finally forced importer to have free-labor sourcing.

In India, in the pre independence era, the businesses which pioneered industrialisation along with fighting for independence also followed the idea.

They put the idea into action by setting up charitable foundations, educational and healthcare institutions, and trusts for community development.

The donations either monetary or otherwise were sporadic activities of charity or philanthropy that were taken out of personal savings which neither belonged to the shareholders nor did it constitute an integral part of business.

The term CSR itself came in to common use in the early 1970s although it was seldom abbreviated. By late 1990s, the concept was fully recognised; people and institutions across all sections of society started supporting it.

This can be corroborated by the fact that while in 1977 less than half of the Fortune 500 firms even mentioned CSR in their annual reports, by the end of 1990, approximately 90 percent Fortune 500 firms embraced CSR as an essential element in their organisational goals, and actively promoted their CSR activities in annual reports (Boli and Hartsuiker, 2001).

According to “Altered Images: the 2001 State of Corporate Responsibility in India Poll”, a survey conducted by Tata Energy Research Institute (TERI), the evolution of CSR in India has followed a chronological evolution of 4 thinking approaches:

Ethical Model(1930 –1950): One significant aspect of this model is the promotion of “trusteeship” that was revived and reinterpreted by Gandhiji. Under this notion the businesses were motivated to manage their business entity as a trust held in the interest of the community. The idea prompted many family run businesses to contribute towards socioeconomic development. The efforts of Tata group directed towards the well being of the society are also worth mentioning in this model.

Statist Model (1950 –1970s): Under the aegis of Jawahar Lal Nehru, this model came into being in the post independence era. The era was driven by a mixed and socialist kind of economy. The important feature of this model was that the state ownership and legal requirements decided the corporate responsibilities.

Liberal Model (1970s –1990s): The model was encapsulated by Milton Friedman. As per this model, corporate responsibility is confined to its economic bottom line. This implies that it is sufficient for business to obey the law and generate wealth, which through taxation and private charitable choices can be directed to social ends.

Stakeholder Model (1990s – Present): The model came into existence during 1990s as a consequence of realisation that with growing economic profits, businesses also have certain societal roles to fulfill. The model expects companies to perform according to “triple bottom line” approach. The businesses are also focusing on accountability and transparency through several mechanisms.

CSR: Definition

The totality of CSR can be best understood by three words: ‘corporate,’ ‘social,’ and ‘responsibility.’ In broad terms, CSR relates to responsibilities corporations have towards society within which they are based and operate, not denying the fact that the purview of CSR goes much beyond this. CSR is comprehended differently by different people.



Some perceive it to be a commitment of a company to manage its various roles in society, as producer, employer, customer and citizen in a responsible manner while for others it is synonymous to Corporate Responsibility (CR) or Corporate Citizenship or Social Action Programme (SAP). Of late, the term has also been started to link up with Triple Bottom Line Reporting (TBL) which essentially measures an enterprise's performance against economic, social and environmental indicators.

Discourses on CSR suggest that many definitions of CSR exist within the business community, and CSR continues to be an evolving concept, with no single definition that is universally accepted. Given below are three key definitions that have garnered wide acceptance and favour amongst business circles:

Definition # 1: Philip Kotler and Nancy Lee (2005) define CSR as "a commitment to improve community well being through discretionary business practices and contributions of corporate resources" whereas Mallen Baker refers to CSR as "a way companies manage the business processes to produce an overall positive impact on society."

Definition # 2: According to World Business Council for Sustainable Development "Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large".



Definition # 3: Archie Carroll in 1991 describes CSR as a multilayered concept that can be differentiated into four interrelated aspects – economic, legal, ethical and philanthropic responsibilities.

Carroll presents these different responsibilities as consecutive layers within a pyramid, such that "true" social responsibility requires the meeting of all four levels consecutively. The model probably is the most accepted and established.

While the definitions of CSR may differ, there is an emerging consensus on some common principles that underline CSR:

CSR is a business imperative: Whether pursued as a voluntary corporate initiative or for legal compliance reasons, CSR will achieve its intended objectives only if businesses truly believe that CSR is beneficial to them.

CSR is a link to sustainable development: businesses feel that there is a need to integrate social, economic and environmental impact in their operation; and

CSR is a way to manage business: CSR is not an optional add on to business, but it is about the way in which businesses are managed.

9.2 CSR: A COMMONLY MISUNDERSTOOD CONCEPT

In the absence of a universally accepted definition for CSR, there are some myths that surround the concept:

Myth # 1: Businesses invest the money, therefore they decide the modus operandi of the CSR initiative

There is a notion that since businesses invest money in society, they are the one who will be deciding upon the modus operandi of the CSR initiative. However this is not true. CSR driven by the mandate of an enterprise alone may not generate desired results. Stakeholders must be involved from the onset in defining an initiative to make it successful. Corporates must not assume that they understand the needs of a community by taking them at face value; stakeholder's needs must be considered within the local context and culture.

Myth # 2: Financial resources alone can meet CSR needs of an enterprise.

In fact, financial resources are only part of the equation. Besides financial resources, it is equally or even more important for the CSR programmes to be well defined and well accompanied by adequate human resources if they are to meet the intended objectives.

Myth # 3: CSR is interchangeable with corporate sponsorship, donation or other philanthropic activities.

The focus of responsible business practices in the profit sector is hitherto largely confined to community charity-based projects.

While this may have been relevant for the historical context in the mid-90s when Carroll's definition was coined, the current thinking of CSR has moved beyond philanthropy to in fact encompass all internal and external segments of business operations: employees, market environment and community.

CSR: Rationale

The rationale for CSR has been articulated in a number of ways. In essence, it is about building sustainable businesses, which need healthy economies, markets and communities. The major reasons for CSR can be outlined as -

Globalisation

As a consequence of cross-border trade, multinational enterprises and global supply chains, there is an increased awareness on CSR concerns related to human resource management practices, environmental protection, and health and safety, among other things. Reporting on the CSR activities by corporates is therefore increasingly becoming mandatory.

In an increasingly fast-paced global economy, CSR initiatives enable corporates to engage in more meaningful and regular stakeholder dialogue and thus be in a better position to anticipate and respond to regulatory, economic, social and environmental changes that may occur.

There is a drive to create a sustainable global economy where markets, labour and communities are able to function well together and companies have better access to capital and new markets.

Financial investors are increasingly incorporating social and environmental criteria when making decisions about where to place their money, and are looking to maximise the social impact of the investment at local or regional levels.

International Legal Instruments and Guidelines

In the recent past, certain indicators and guidelines such as the SA 8000, a social performance standard based on International Labour Organization Conventions have been developed. International agencies such as United Nations and the Organization for Economic Co-operation and Development



have developed compacts, declarations, guidelines, principles and other instruments that set the tone for social norms for organisations, though these are advisory for organisations and not mandatory.

One of the United Nations Millennium Development Goals calls for increased contribution of assistance from country states to help alleviate poverty and hunger, and states in turn are advising corporates to be more aware of their impact on society. In order to catalyze actions in support of the MDGs, initiatives such as Global Compact are being put in place to instrumentalise CSR across all countries.

As the world's largest, global corporate citizenship initiative by the UN, the Global Compact, a voluntary initiative is concerned with building the social legitimacy of business.

The Global Compact is a framework for businesses that are committed to aligning their business operations and strategies with ten universally accepted principles that postulate that companies should embrace, support and enact, a set of core values in the areas of human rights, labour standards, the environment, and anti-corruption.

Changing Public Expectations of Business

Globally companies are expected to do more than merely provide jobs and contribute to the economy through taxes and employment. Consumers and society in general expect more from the companies whose products they buy. This is coherent with believing the idea that whatever profit is generated is because of society, and hence mandates contributing a part of business to the less privileged.

Further, separately in the light of recent corporate scandals, which reduced public trust of corporations, and reduced public confidence in the ability of regulatory bodies and organisations to control corporate excess. This has led to an increasing expectation that companies will be more open, more accountable and be prepared to report publicly on their performance in social and environmental arenas.

Corporate Brand

In an economy where corporates strive for a unique selling proposition to differentiate themselves from their competitors, CSR initiatives enable corporates to build a stronger brand that resonates with key external stake-holders – customers, general public and the government.

Businesses are recognising that adopting an effective approach to CSR can open up new opportunities, and increasingly contribute to the corporates' ability to attract passionate and committed workforces.

Corporates in India are also realising that their reputation is intrinsically connected with how well they consider the effects of their activities on those with whom they interact. Wherever the corporates fail to involve parties, affected by their activities, it may put at risk their ability to create wealth for themselves and society.

Therefore, in terms of business, CSR is essentially a strategic approach for firms to anticipate and address issues associated with their interactions with others and, through those interactions, to succeed in their business endeavors. The idea that CSR is important to profitability and can prevent the loss of customers, shareholders, and even employees is gaining increasing acceptance.

Further, CSR can help to boost the employee morale in the organisation and create a positive brand-centric corporate culture in the organisation. By developing and implementing CSR initiatives, corporates feel contented and proud, and this pride trickles down to their employees.

The sense of fulfilling the social responsibility leaves them with a feeling of elation. Moreover it serves as a soothing diversion from the mundane workplace routine and gives one a feeling of satisfaction and a meaning to their lives.

Trends in CSR: From Charity to Responsibility

An insight into the history of CSR reveals that till 1990s it was solely dominated by the idea of philanthropy.

Considering CSR as an act of philanthropy, businesses often restricted themselves to one time financial grant and did not commit their re-sources for such projects. Moreover, businesses never kept the stakeholder in mind while planning for such initiatives, thereby reducing the efficacy and efficiency of CSR initiatives. However, over the last few years, the concept of CSR has been changing.

There has been an apparent transition from giving as an obligation or charity to giving as a strategy or responsibility. Review of the case studies and work done on CSR by companies in India suggests that the CSR is slowly moving away from charity and dependence and starting to build on empowerment and partnership.

Conceptualisation

Nowadays corporates are treating CSR as a separate entity and devote attention to it. Most of the corporates have a vision and mission statements often at the corporate level or some-times at the CSR level that drive their CSR initiative. Deliberations are made to choose specific issues and initiatives. It has been observed that the areas they choose somewhere relate to their core values.

Companies today are increasingly sensitive about their social role. The companies not only concentrate on how they will position their product or how they will sell it but also they have a social strategy because they have started feeling that brands are built not only around good quality of the product; but also around emotions and values that people ascribe to those products.

Today, CSR has been understood in terms of accountability where corporates are feeling that they are responsible for the impact their actions have on several stakeholders. They feel that the basic motive of CSR today is to increase the company's overall impact on the society and stakeholders.

Implementation

Moving away from the traditional approach, corporates rather than following top to bottom mechanism are increasingly bearing stakeholders' perspectives in mind, thereby considering CSR as a comprehensive set of policies, practices and programmes that are integrated throughout the business operations.

It can thus be deduced that radical transformation is happening with CSR practices across India. The changes happened at conceptual level where charity oriented approach is now being seen as a stakeholder oriented approach and at implementation level where other important resources except finance are being dedicated. Several innovative programmes in thematic areas of public health, education, environment, microfinance and related areas are being developed. These programmes are developed bearing in mind the local cultural context and the needs of people. Apart from devoting funds, expertise in terms of knowledge and human resource is also allocated for successful implementation of these programmes.

In a growing number of companies these processes are encouraged and rewarded by top management. The implementation of programmes through a trained resource makes a real difference in the community that has been chosen for implementation.

The following are key focus areas being incorporated into business practices:

Partnership with NGOs and Government

There has been an increase in the number of corporates partnering with NGOs and the Government to ensure successful execution of initiatives.

Community development

Most large companies either have their own foundations or contribute to other initiatives that directly support the community upliftment, notably in health, education, and agriculture.



Environmental management

Environmental policies and programmes are now standard, and many companies have implemented the ISO 14 001 system throughout their businesses.

Workplace

Growing out of a long-standing commitment to training and safety is a more recent emphasis on knowledge and employee well-being.

Evaluation

Along with innovation at conceptualisation and implementation, corporates are now undertaking greater evaluation and stricter accountability and transparency norms. Evaluating the programme essentially answers the question “what good did we do?” Evaluating programmes, based on internationally accepted formats provide feedback for correction and based on that public disclosure is done.

Reporting

A very important aspect of CSR is the reporting practices that corporates adhere to inform their key internal and external stakeholders of social responsibility practices. In the recent past, several indicators such as the Global Reporting Initiatives guidelines and sustainability reporting have been developed. Sustainability Reporting (SR) frameworks help the companies conform to the global standards of disclosures for maintaining transparency with regard to its operations and value chain and ensuring accountability towards its internal and external stakeholders.

CSR: A Quantitative Analysis

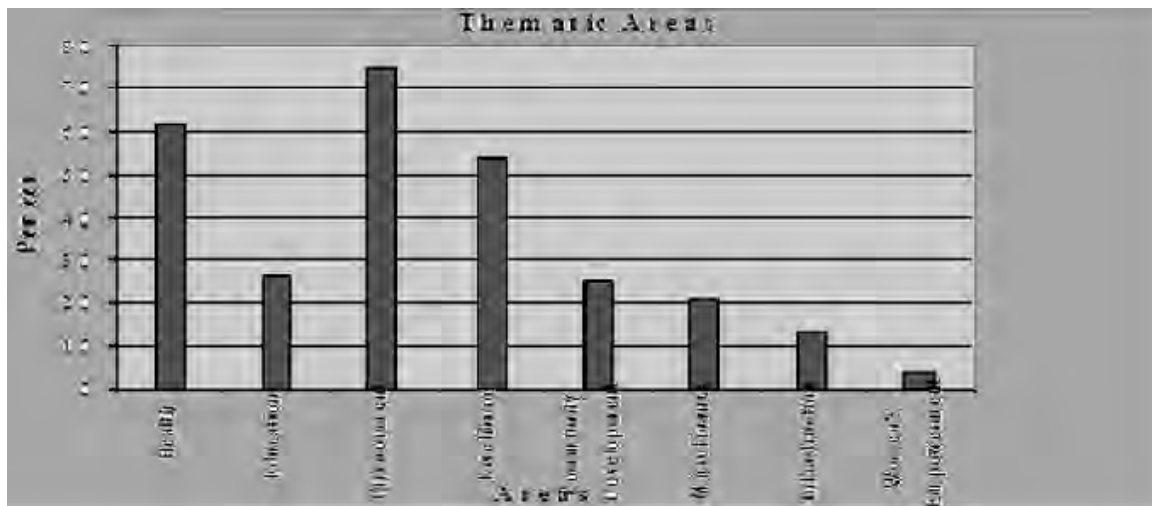
The Case Study quantitative analysis represents an objective overview of the corporate social responsibility trends in India based on the desktop research and case study analysis of the Corporates who have responded to the request by ASSOCHAM to share their CSR efforts and initiatives, for the compendium. 27 case studies were submitted in total and out of these 24 were used as a base to deduce some directional pointers on the status of CSR and some trends in India. The analysis does not intend or aim to pass a qualitative judgement on any corporate initiative or how good or bad it is, but rather focuses on presenting a broad overview of implementing the CSR practices.

It is assumed that there is an inherent bias, as the corporate that have submitted case studies are implementing the CSR in a way or other. Moreover the source of information being they (corporates) is not an unbiased source.

Thematic Areas

Action in CSR in India largely spans a diverse set of thematic areas – health, education, livelihood, poverty alleviation, environment, water, housing, energy and microfinance. However some other areas like women empowerment, child development and infrastructure also appeared in the case studies.

Based on the comparative study of the 24 companies, it was found that while some companies chose to narrow their focus on a few thematic areas, others took a broader view and undertook a larger scope of areas to focus on. Out of 24 case studies that were analysed, it was found that there were as many as 16 corporates focusing on 3-5 thematic areas,



Whereas only 4 Corporates catered to 1-2 thematic areas of work and remaining four stuck to six or more thematic areas.

In terms of the area focus environment garnered the maximum attention from Corporates while women empowerment and poverty alleviation were neglected areas with minimal corporate focusing on the same,

CSR Management



It has been observed that for 37 percent Corporates, the CSR initiative is being implemented through a well structured separated Foundation. Among 58 percent corporate there is separate CSR department that takes care of the activities to be implemented.

Partnership

The importance of building strong public – private partnerships as well as working closely with NGOs as implementation partners being increasingly realised by corporate. It has been

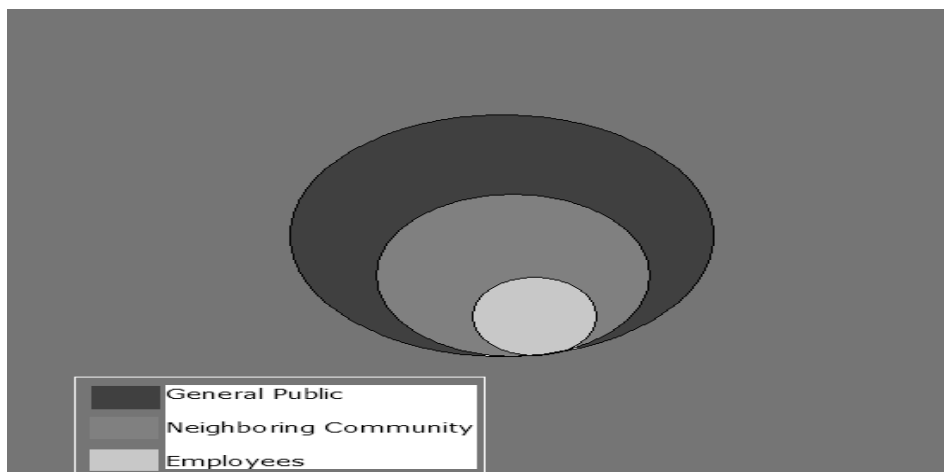


Observed that 58 percent of the corporate within the surveyed sample partnered with the government departments. The number is higher for the engagement with NGOs where approximately 67 percent corporate have formed linkages. 21 percent corporate were working in partnership with multilateral or bilateral organisations.

Stakeholders

Stakeholder engagement has become one of the important aspects of CSR practices. Though there are different sets of stakeholders that can be taken into account while implementing CSR, we decided to obtain information on the following – employees, neighboring community and general public. Neighboring community refers to the people in catchment area of corporate who have a direct effect of business on them.

Out of total 24, five corporates work towards the benefit of employees, neighboring community and general public. There are 2 corporates that have set of employees and general public as their stakeholders.



Five and two corporates have as their stakeholders the set of general public and neighboring community and employees and neighboring community respectively.

Only one corporate has decided to concentrate on the neighboring community as the stakeholder.

Sustainability Reporting (SR) is also gaining prominence and recognition as a value added tool for displaying a corporate's commitment towards transparency and accountability towards its stakeholders.

It helps a company to report on the social, environmental and economic impact of its activities, along with a report on the internal state of its management and employee welfare system in a manner as rigorous and transparent as financial reporting.

A well drafted Sustainability report provides a balanced and reasonable representation of the sustainability performance of a reporting organisation (both positive & negative).

SR helps the organisations define and communicate their overall context and rationale to solve global problems through its specific business model or elicit whether its business model design is influenced by those problems. SR is also increasingly recognised as a tool for brand and image building.

Reporting Initiatives

Public disclosure and reporting was another metric used to Compare the CSR initiatives of corporates. It was observed that within the sample of 24 companies used, 25 percent are reporting as per the GRI guidelines while 21 percent were signatories of the UN Global Compact.

An equal number of corporates (21 percent) come up with a separate CSR report while there are only a few (8 percent) who have a mention of their CSR activities in the annual report.

Comparative numbers of reporting of CSR in the annual report at global level are much higher. For instance in 1977 the number was 50 percent, which rose to 90 percent in 1990.

The Way Forward

The World Business Council for Sustainable Development has noted that a coherent CSR strategy based on integrity, sound values and a long-term approach offers clear business benefits to companies and contributes to the well-being of society. As companies move forward to design a CSR strategy that provides the intended leverage point as intended, key success factors that need to be borne in mind are -

Corporate Social Responsibility is not charity

The originally defined concept of CSR needs to be interpreted and dimensionalised in the broader conceptual framework of how the corporate embed their corporate values as a new strategic asset, to build a basis for trust and cooperation within the wider stakeholder community.

Though there have been evidences that record a paradigm shift from charity to a long-term strategy, yet the concept still is believed to be strongly linked to philanthropy. There is a need to bring about an attitudinal change in people about the concept.

By having more coherent and ethically driven discourses on CSR, it has to be understood that CSR is about how corporates place their business ethics and behaviors to balance business growth and commercial success with a positive change in the stakeholder community.

Several corporates today have specific departments to operationalise CSR. There are either foundations or trusts or a separate department within an organisation that looks into implementation of practices.

Being treated as a separate entity, there is always a flexibility and independence to carry out the tasks.

But often these entities work in isolation without creating a synergy with the other departments of the corporate. There is a need to understand that CSR is not only a pure management directive but it is something that is central to the company and has to be embedded in the core values and principles of the corporate.

Whatever corporates do within the purview of CSR has to be related to core business. It has to utilise things at which corporates are good; it has to be something that takes advantage of the core skills and competencies of the companies. It has to be a mandate of the entire organisation and its scope does not simply begin and end with one department in the organisation.

While conceptualisation and implementation seem firmly underway, evaluation is still taking a back seat. There is a need to incorporate an evaluation plan, which along with presenting a scope of



improvement in terms of fund utilisation and methodology adopted for the project, measures the short and long term impact of the practices.

While there have been success stories of short term interventions, their impact has been limited and have faded over a period of time. It is essential for corporates to adopt a long term approach rather than sticking to short term interventions, involving the companies and employees in the long-term process of positive social transition.

A clearly defined mission and a vision statement combined with a sound implementation strategy and a plan of action firmly rooted in ground realities and developed in close collaboration with implementation partners, is what it takes for a successful execution of CSR.

An area that can be looked upon is the sharing of best practices by corporates. A plausible framework for this could be bench-marking. While benchmarking will help corporates evaluate their initiatives and rank them, it will also provide an impetus to others to develop similar kind of practices. Credibility Alliance, a consortium of voluntary organisations follows a mechanism of accreditation for voluntary sector. Efforts have to be directed towards building a similar kind of mechanism for CSR as well.

Sustainable development, like building a successful business, requires taking the long-term view. The KPMG International Survey of Corporate Responsibility Reporting 2005 showed that voluntary reporting on sustainability is on the increase across all the countries. Sustainability Reporting is emerging as a key vehicle to implement CSR and measure its progress in organisations.

As we move forward, increasing numbers of companies are expected to issue Sustainability Reports, with the scope of issues broadening from purely environmental reporting to a more comprehensive coverage of the environmental, social and economic dimensions.

There is a strong corporate initiative on joining the Global Compact Society in India, as well, with 43 Indian companies having already joined Global Compact as of January 2008.

Corporate Citizenship: A new way to market CSR?

A new terminology that has been gaining grounds in the business community today is Corporate Citizenship. So what is corporate citizenship and is this fundamentally different from corporate social responsibility? Corporate citizenship is defined by the Boston College Centre for Corporate Citizenship, as the business strategy that shapes the values underpinning a company's mission and the choices made each day by its executives, managers and employees as they engage with society.

According to this definition, the four key principles that define the essence of corporate citizenship are: (i) Minimise harm (ii) Maximise benefit (iii) Be accountable and responsive to key stakeholders (iv) Support strong financial results.

Thus, corporate citizenship, similar to its CSR concept, is focusing on the membership of the corporation in the political, social and cultural community, with a focus on enhancing social capital. Notwithstanding the different terminologies and nomenclature used, the focus for companies today should be to focus on delivering to the basic essence and promise of the message that embodies these key concepts – CSR and Corporate Citizenship.

Conclusion

Corporate Social Responsibility is not a fad or a passing trend, it is a business imperative that many Indian companies are either beginning to think about or are engaging with in one way or another.

While some of these initiatives may be labeled as corporate citizenship by some organisations, there basic message and purpose is the same.

A successfully implemented CSR strategy calls for aligning these initiatives with business objectives and corporate values thereby integrating corporate responsibility across the business functions and enhancing business reputation.

The challenge for us is to apply fundamental business principles to make CSR sharper, smarter, and focused on what really matters.

This can be done by:

- Focusing on priorities
- Allocating finance for treating CSR as an investment from which returns are expected
- Optimising available resources by ensuring that efforts are not duplicated and existing services are strengthened and supplemented
- Monitoring activities and liaising closely with implementation partners such as NGOs to ensure that initiatives really deliver the desired outcomes
- Reporting performance in an open and transparent way so that all can celebrate progress and identify areas for further action.

A long term perspective by organisations, which encompasses their commitment to both internal and external stake-holders, will be critical to the success of CSR and the ability of companies to deliver on the goals of their CSR strategy.

9.3 CORPORATE SOCIAL RESPONSIBILITY– PERSPECTIVES AND BEST PRACTICES

Table of Contents

1.	Case Study II ACC Limited
2.	Case Study III Ambuja Cement Limited
3.	Case Study IV Apollo Tyres Limited
4.	Case Study V Bharat Petroleum
5.	Case Study VII Coca-Cola India Inc
6.	Case Study VIII DLF Limited
7.	Case Study X Dr. Reddy's Laboratories
8.	Case Study XIII Infosys Technologies Limited
9.	Case Study XV JSW Steel
10.	Case Study XXI Reliance Industries Limited
11.	Case Study XXIV Tata Steel Limited

Case Study I

Name: ACC Limited

Thematic Areas: Education, Health, Environment, Livelihood and Waste Management

Case Study:

In 2007 several CSR initiatives were taken to meet the requirements of various stakeholder groups.

Community development

We commenced a fresh round of Community Needs Assessment studies by external agencies for those living in the vicinity of all our plants across India.



An important partnership was forged with Development Alternatives, a reputed NGO, to help launch a Sustainable Community Development programme for those living near our Wadi Plant in Karnataka.

The time-bound plan spread over 3 years targets the building of local institutional and human capacities, creation of local enterprise-based livelihoods, healthier habitats with adequate community physical infrastructure, household services and village institution building.

HIV/AIDS Programme

ACC's effort to participate in the national effort against HIV/AIDS included the establishment of a treatment center at Wadi, and partnership with Christian Medical College, Vellore both of which address the challenges in the two states where this virus is most prevalent. The Wadi Anti Retroviral Treatment Center for HIV/AIDS commenced regular operations in March last year.

It has a complement of trained medical and para-medical staff and caters exclusively to the general public. We became the first corporate in the country to have established a standalone center of this kind. It is also the first outside the Government sector to be included in the list of NACO's approved ART Centers in the country.

Knowledge Development

The prestigious Sumant Moolgaokar Technical Institute at Kymore was opened with a new educational curriculum to complement the education provided at ITI's.

Similarly the focus of the Regional Training Center in Jamul, Chattisgarh was redirected to offer professional technical courses of relevance to manufacturing sectors such as cement.

A state-of-the-art Learning Center, ACC Academy, was opened at our Thane complex. We began work on partnering with the government and industry to upgrade the 7 ITI's located near our plants.

Sustainable Construction

We are partnering with Holcim Foundation for Sustainable Construction to promote the concept of sustainable construction in India.

We signed an understanding with Development Alternatives to create a Center of Excellence to pursue solutions for sustainable housing and rural infrastructure, by providing innovation support, capacity building and outreach services to the construction industry and to enable the creation of livelihood opportunities and provide support to small rural entrepreneurs in rural habitat and infrastructure.

Other initiatives Sustainable Development

Other significant achievements included promotion of nation-wide services in Waste Management, and the commissioning of a Wind Farm in Tamil Nadu.

Planning and measuring effectiveness

A CSR Business plan and roadmap has been made listing yearly targets, priority areas and tasks from 2008 till 2011. We adopted 2 good participative practices last year. The first is a model that helps matches areas which are of concern to various stakeholder groups with their impact on the company.

The second is a scorecard that attempts a qualitative assessment of the impact and efficacy of individual community development schemes. We have tested this process successfully and will henceforth use it to measure the effectiveness of all major schemes.

Case Study II

Name: Ambuja Cements Limited

Thematic Areas: Poverty Reduction, Reducing Child Mortality, HIV/AIDS, Education and Environment

Case Study:

Ambuja Cements Ltd. established a foundation, called the Ambuja Cement Foundation in 1993. With its cement plants being situated in the rural areas, the Company realised the need to address the needs of the rural people. These people formed direct or indirect stakeholders of the Company and therefore were important for the Company's sustainability.

Consequently, the ACF's focus has been on integrated rural development programmes. The Foundation works with the mission to "energise, involve and enable communities to realize their potential".

It upholds as its guiding light the parent company's core values and alongside pays due attention to international trends in social development, expressed through guidelines like the Millennium Developmental Goals. Poverty alleviation, achieving universal primary education, reducing child mortality, improving maternal health, combating HIV/AIDS and ensuring environmental sustainability are all integral to the work of the Company and its Foundation.

The Foundation in each location begins by working at the micro level/in a small way with the villages impacted by the Company's operations and gradually over time as partnerships develop expands its area and scope of work. The Foundation at present reaches out to over 1.2 million people in about 670 villages spread across ten states in India.

The large chunk of work of the Foundation is carried out by a team of well-trained and experienced professionals. The range of work of the Foundation is expansive/ diverse and though there are common programmes run across locations, regional variations due to local needs exist.

Provision of preventive and curative health services including reproductive and child health, promotion of education and generation of alternate sources of livelihood coupled with capacity building are some of the key areas of intervention of the Foundation.

Natural Resource Management (NRM) by far forms the largest part of the community initiatives of the Company. NRM includes activities centered on conservation and management of water, land, energy and livestock. Water being the prime mover in rural life and an essential factor for overall rural development, prescribes their work in the area of water re-source management.

In all its endeavors, ACF has since inception made it a mandatory practice to include people's participation in its activities. Those who are stakeholders in the social setting are consciously and regularly included in programmes that are principally meant for them.

They engage with their communities at all levels. Programmes are decided based on the needs expressed by the people during Participatory Rural Appraisals (PRAs). Implementation is carried out with the participation of the people - whether direct or indirect, financial or non-financial. This helps in developing a sense of belonging to the programmes and makes the programmes sustainable.

Natural Resource Management, especially water management, forms a significant part of their work in the rural sector. Water management and conservation is a very broad area of intervention.

The diverse geographical, climatic, topographical and cultural variations across the states have made it necessary for them to make suitable modifications in their water projects to cater to the particular requirements and problems of different regions. Substantial water resource management activities are conducted in 4 states –Gujarat, Rajasthan, Maharashtra and Himachal Pradesh.

Each of these states faced specific water- related problems which they have tried to address through their scientifically grounded, economically viable and socially acceptable techniques. A brief description of the water projects in these states follows.



Salinity Ingress Reduction

In the state of Gujarat the rural communities are situated along the coastal belt in Junagadh and Amreli Districts. Due to over-utilisation and over-exploitation of ground water over years, these areas faced a serious salinity ingress problem. The rivers in this area were seasonal and the ponds that were fed by these rivers also dried up by the time winter arrived making the water problem even worse.

To tackle these problems, ACF adopted innovative techniques like interlinking of water bodies, tidal regulators and rivers through link water channels. This technique proved to be effective in collecting the run-offs of the rivers and consequently increased the quantity of water being saved and stored.

Ground water was recharged and the salinity levels of the underground water declined to improve the quality of water. The mined out pits of the Company have been converted into water reservoirs creating a store of 11.04 MCM of water for the use of the people.

Parts of Rajasthan being desert areas have for centuries had chronic water scarcity. The rainfall in the state is scanty and often uncertain. Rivers are seasonal and traditional ponds have over the years become silted and hold lesser and lesser quantities of water with each passing year.

The ground water is characterised by high fluoride and other salts contents that are known to be hazardous to health. ACF is situated in the Jaitaran block of Pali and Mundwa block of Nagaur District in this State.

The water problems here were addressed in 2 ways – by revival of old water reservoirs and construction of new structures to collect water. Traditional ponds were deepened and de-silted so that they would hold water for upto 10–12 months in the year as opposed to only 3–4 months.

Dykes were constructed in the rivers that directly impacted the ground water level and at the same time the river banks were de-silted. These immediately raised the water level by an average of 14 feet. Agricultural productivity increased. As in Gujarat, Roof Rain Water Harvesting (RRWHS) structures were constructed in Rajasthan too. These structures helped households collect monsoon water and store it for use through the year.

In the hilly state of Himachal Pradesh, the local people depend heavily on the forests for their livelihood. The terrain makes storage of water and conservation of the top soil issues of serious consideration. NRM in the State is aimed at enabling the people to manage their own resources and derive a fair share from them. Water shed development covered 9000 Ha in the last 4 years.

As a result of decreased soil erosion and increased moisture, the agricultural production has gone up. The water and soil conservation programme along with forestation have shown good results. Farmers are able to grow more than one crop a year. Their cropping pattern has diversified and consequently their incomes have increased. Wastelands have been developed as pasture lands, which have benefited villagers owning cattle. The milk yield of the cattle has also seen an improvement as a result of this.

ACF is active in Rajura, Korpana and Jivati blocks of Chandrapur District in Maharashtra. The focus in this State has been improving access and availability of potable water. For this, old ponds were renovated and brought into use once again. Streams and rivers were de-silted. Wherever possible check dams were built, bore wells dug and storage structures constructed. To address soil erosion, large tracts were collected under bunding and gully plugging. A fall out of these activities was that the availability of water for agricultural and household uses improved and a positive impact on agricultural productivity was noted.

Detailing specific project: Salinity Ingress Mitigation

The water resource management work has been going on for the longest duration in Kodinar, Junagadh District, Gujarat. The scope of work being done here is extensive. As a result of numerous factors, salinity ingress is a serious problem in this location. With the increase in the population, demands on

existent water resources have increased and therefore there has been an over-exploitation of these resources.

With the fragmentation of the joint family system, each of the nuclear family unit involved in agriculture is increasing the number of wells and extensively using pumps to meet their increasing water demands.

Water intensive crops have been artificially introduced in the area, sharply increasing the demand on water for agricultural purposes. Mismanagement and misuse of water along with recurrent droughts have further worsened the situation.

The cumulative impact of all these occurrences has been that the villagers have been facing water shortage along with salinity ingress in this area.

Taking into consideration the scale of the problem, multiple interventions were planned and implemented by ACF and the rural people. This multi-pronged approach included the following:

Interlinking of rivers and canals

They initiated an innovative intervention technique of inter-linking local rivers and canals. This was done in a relatively limited geographical area where the distance between the rivers and /or canals wasn't too large.

A large amount of water in Kodnar gets wasted because it gets drained into the sea.

This water was diverted into nearby water bodies through channels. In interlinking, excess water from one source flows into the next, almost completely eliminating water wastage.

Water conservation structures like check dams have been made at appropriate places along the rivers and streams in-creasing recharge of the entire area. Villagers provided crucial information for this project. Having inhabited the area for generations, they were able to help locate the potential sinks and the shortest routes to these, which were essential for identifying watershed dynamics.

There have been direct benefits of this project. The crops in the region have diversified because of increased availability of water; and there is now a sustained water table. Farmers are now also growing crops and vegetables which are less water intensive.

The household income of the farming families has resultantly increased. We have been successful in changing the farming practices of the cultivators. The crop yields have also in-creased.

Pond deepening and interlinking

In 1999–2000 an interlinking project was undertaken that involved five adjacent villages. The village ponds in these villages were identified and deepened to increase their capacity and interlinking canals were constructed between villages.

During monsoons, the stream overflowed and the excess water got collected in these ponds. After the water level passed a stipulated height in one pond, it automatically got diverted to the next interlinked pond, thereby preventing wastage of water.

The total storage capacity of 0.42 million cubic meters benefited 339 wells and 1161 hectares of parched land thereby benefiting 316 farmers of the region. A lot of water that used to flow into the sea in the past has now been diverted into the downstream ponds which were previously starved of water. An analysis of the impact of this project showed a drastic reduction in the salinity in the area and farmers are now able to cultivate three crops in a year, as against one earlier. Due to the reduction in the salinity, now farmers also require 30–60 percent less seeds for sowing as compared to earlier, while yield in Kg/Ha increase by an average of 55 percent for the 5 major crops being grown in this area.



Utilising mined out pits

ACL uses open cast mines to obtain limestone and marl that are essential for cement production. Owing to the mining, large pits measuring between 12 to 15 meters in depth are created. Generally these pits are reclaimed by filling, afforestation, pastureland development.

Tidal regulator

Tidal regulators were constructed by the Government to act as a barrier between the agricultural land and salinity. The regulators reverse the natural flow of water from the sea to the land. To further augment the benefits of the regulators, ACF excavated link canals from the tidal regulators to the villages.

This has given the villagers numerous benefits of the project. In just one village Panch Pipalwa 67 farmers covering an area of 234Ha benefited, with all their wells being recharged. There is now multi-cropping in the area and agriculture yields are higher by at least 30 percent and the salinity in drinking water wells has reduced.

Roof Rain Water Harvesting Structures

The droughts and water salinity in Kodinar area created a serious drinking water crisis for many years. Villagers were forced to either walk unreasonable distances to collect water or had to depend on the uncertain tanker water provided by the local authorities.

In almost all cases without exception, the women and girls in the families had to shoulder the responsibility of collecting water. This meant a large chunk of daytime was spent on this activity and very often young girls had to drop out of school to help out in this chore.

ACF has promoted a simple and cost effective means to deal with the problem. Roof Rain Water Harvesting Structures (RRWHS) have been built in homes. RRWHS are simple structures that collect fresh rain water during the monsoons and store it in underground tanks for use throughout the year.

In addition to the RRWHS, ACF has also renovated wells to provide drinking water to the villagers. The renovation of wells has greatly improved the quality of the water in these wells. In conclusion.

Their work in water management and salinity mitigation in Gujarat has become a model for them. They have applied some of the water management techniques to other locations and found them to be just as effective.

Their projects have been appreciated by their people and governmental and non-governmental organisations. They would be very keen in sharing their experiences and learning with other organisations working in the same field.

Case Study III

Name: Apollo Tyres Limited

Thematic Areas: Health

HIV-AIDS Programme in Apollo Tyres Ltd.

Background

Apollo started its fight against HIV-AIDS in a project called Healthy Highways. The project was in partnership with DFID and started in Sanjay Gandhi Transport Nagar in the year 2000.

Today Apollo has a comprehensive programme on HIV-AIDS focusing on its employees, customers and supply chain.

The programme focus is on building awareness and prevention aspect of the epidemic. The approach is to forge strategic tie-ups with organisations, which bring the technical skills and capacity building aspects in to the partnership.

Apollo Tyres Health Care Centers

Apollo Tyres Health Care Centers are targeted interventions for truckers. The location for clinics is identified on the HIV prevalence, density of trucking and mobile population and the current level of work being done by other organisations in the area. Currently, the company has 7 clinics running in North, West & South of India. All clinics are strategically located in transport nagars. Attached to HIV-AIDS, however the focus of the services provided is on HIV-AIDS.

The main components of the programme are:

(a) Behaviour Change Communication (BCC)

The communication is directed at increasing awareness regarding the basics of HIV/AIDS. The communication addresses the modes of transmission, myths regarding HIV, connection between sexually transmitted diseases and HIV through one-to-one and one-to-group interactions.

(b) Peer Educators

Building an effective peer educator network is the most important link of the entire program. The peer educators become imperative given the geographical spread of the transportnagars and the mobile nature of the population.

(c) Condom Promotion

Condom promotion takes place through free distribution as well as social marketing of condoms. These condoms are available at various outlets and strategic points within the transport nagars.

Also the outreach workers and the peer educators emphasise and educate the target audience on the correct usage and disposal of condoms.

Sexually Transmitted Diseases and Infection Identification and Treatment

The outreach workers and the peer educators are trained in the identification of sexually transmitted diseases and infections. There is a strong referral system in place and patients are by guided by the outreach workers and peer educators to the clinic.

The clinics provide treatment for sexually transmitted diseases and infections only. In case the doctor or the counselors are not satisfied they refer the patient for voluntary testing at the government hospitals. The pre and post test counseling is available at all Apollo Tyres Health Care Centers.

Workplace Programme

In June 2006 a workplace sensitisation programme was rolled out in partnership with International Labour Organisation. The programme targets 7500 employees across all locations of the company.

The programme started with a half day sensitisation of the top management of Apollo. A steering committee was formed post the sensitisation of the top management. About 26 ambassadors were identified and trained as master trainers in a two day workshop and simultaneously a survey to gauge the existing knowledge in the company was undertaken.

So far over 5000 employees have been covered under the programme. The next level of this programme is targeting contract workers.

Integration with Supply Chain

Extension of the HIV programme into the supply chain was a natural progression for ATL. Under this Apollo has taken the prevention and awareness programme across its supply chain.

The model is similar to the employee engagement programme wherein a peer educator network is trained by Apollo's master trainers. The objective is to create a chain which has a multiplier effect in carrying the message on prevention forward.



Monitoring, Reporting & Evaluation

- The reporting system is standardised and a common format is available with all clinics to file a monthly report. The reports capture all details of BCC, STI and counseling at the centers. The reports provide both quantitative and qualitative aspect
- A monthly report is filed by the master trainers for the workplace programme as per ILO's format
- A monthly report is received from supply chain partners and also by Apollo
- A six monthly detailed report is filed to steering committee on the entire committee

A study on an annual basis is undertaken to gauge the impact of the programme across the target segments. The first one has been conducted in December 2007

Case Study IV

Name: Bharat Petroleum

Thematic Areas: Health, Education, Infrastructure, Income Generation, Vocational Guidance, Livelihood & Environment Conservation

Case Study:

Community Development at village 'Ramthenga', Jajpur Dist, Orissa

Community participation

- (i) To help the village become socially conscious
- (ii) To improve the general health of the villagers
- (iii) To improve community participation
- (iv) To help them become self-reliant.

This village is dominated by the tribal population – 'Santhal Tribe'. Their socioeconomic status was highly impoverished. Most of the villagers worked in the neighboring mines. Due to prolonged and non-conductive working environment, they had developed severe respiratory / skin infections.

The children did not attend any school and the nutrition status of the children was very poor. There was also a severe problem of alcohol abuse amongst the men. The women were suppressed and worked in the farm as well as in the mines. Lack of availability of water was also one of the main concerns of the villagers. There were bore wells but they were non-functional.

Major interventions were required in the area of:

- Health
- Education
- Awareness about health/ sanitation/ hazards of working in the mines
- Precautions to prevent respiratory illness
- Making water available

Having understood the need of the community, BPCL constituted a team to implement the work in the community. The main participants in the project were :

- Villagers
- NGO partner – Research Analysis Consultants
- BPCL LPG Team based in Bhuvaneshwar and Khurda headed by TM Khurda
- BPCL HR Team at Kolkata headed by HR Chief and CSR co-ordinator

- BPCL Corporate CSR Team headed by GM (Admin)

Strategy & Execution

A plethora of activities were undertaken in the village. However, depending upon the need at that particular time, the activities were phased out. The activity matrix developed was very strategically planned and executed.

Phase 1

A visit was made to the village by BPCL Kurda Team. There was lot of inhibition among the villagers to discuss and participate. However with repeated visits the villagers began to open up.

Since there was a need to execute the project very professionally, the BPCL Khurda Team identified an NGO with its main office in Bhuvaneshwar. The NGO had extensive experience of having worked in the mentioned areas and implemented community development projects.

The NGO did a need assessment of the village with complete village participation. Assistance for providing health services and primary education emerged as one of the main needs.

Also what emerged from the need assessment was to enable the formation of Self Help Groups. The general participation level among the villagers was very high.

Phase 2

BPCL supported the project through NGO RAC by:

Providing the services of a doctor (from neighboring area)

The Homeopathic Doctor would check the patients for free thrice in a week. Since the medicines were sweet there was less resistance among the villagers and children to eat the same. Moreover for the problems that they were more succumbing to, like respiratory illness, skin infections, homeopathic medicines were much more effective.

Initiating a Balwadi (pre-primary) for children within the village

This put the children into the habit of attending school especially when their parents would go to work in the mine. The teacher for the village was identified from within the village. She was subsequently trained about innovative methods in teaching and needs of pre primary children. She was also the main force in convincing the parents to put the children in main school after their pre primary.

Phase 3

Once the basic trust level amongst the villagers was attained, then:

Awareness was created about precautions for working in the mines

Awareness was created amongst the villagers about the precautions they need to take while working in the mines nearby. The modes of communication were through street plays, skits during village festivals, drawing competitions for children.

The homeopathic doctor played a vital role in creating this awareness. A lot of awareness was also created about alcohol abuse.

Deepening of village pond and encouraged fishery

There was a pond in the village, which had to be cleaned. With support from RAC the villagers engaged in cleaning the pond and also dredging the same. With the help of Central Institute of Fresh Acqua Culture, Bhuvaneshwar, the villagers were trained of fishery management. It was a community pond, and the fishes caught were shared by the villagers this activity was more favored by villagers during monsoon, when there is ample of water in pond.



Need for formation of Self Help Groups (SHG's)

The fishery management activity established the need for the formation of Self Help Groups – A group which would be trained in activities that can generate income. Meetings were held in the village for formation of Self Help Groups.

Repair and maintenance of Bore wells

Availability of water was an area of concern for the villagers. There were bore wells in the village, but they were non-functional. With the help of volunteers from the village, the bore wells were repaired and the villagers were also trained to maintain the same. Now there is ample water to sustain throughout the year.

Phase 4

The first batch of SHG was formed comprising of mainly women.

Formation of 1st SHG in the village

The group comprised mainly of women. They had mutually agreed to learn stitching and appliqué work (a form of embroidery famous in Eastern India). BPCL supported by way of providing teacher from the nearby village and also 4 sewing machines. Initially the women used to learn stitching work etc in the spare time they got after working in the mines.

Subsequently when the first batch finished the course, simultaneously a course was conducted on marketing the stitched products. A group of women were trained to market the stitched products in the local haats (local bazaar). The course included:

- Communication skills
- Perceiving the market requirements
- Quality of stitched products
- Pricing the clothes stitched
- Co-ordination within SHG
- Roles and responsibilities

The group slowly began to generate income through stitching and that made a breakthrough in the village.

The women from the SHG were able to, though in very small way, substitute the family income which came mainly from mining and agriculture. More and more women began to learn stitching and discontinued the mining job.

Promoting Mushroom Cultivation

The NGO assisted the villagers through the SHG to initiate mushroom cultivation. The SHG would purchase mushroom sponge at INR 17 a packet from 'Orissa Institute of Agriculture and Technology' Bhubaneswar.

Each packet of sponge would generate approximately 1.5 kg of mushroom. This mushroom when sold generates INR 80 from the INR 17 per packet.

The villagers who had very poor health, especially the children were encouraged to include mushroom in their diet and the extra ones were sold in the local market. This activity also generated income for the SHG.

Phase 5

There were 2 well-functioning SHG's in the village. The success of the women's group SHG was instrumental in the formation of the 2nd group, which was a mixed group of men and women.

The good work done by SHG's in this village was duly recognised by the Block Development Officer (BDO), who in turn has rewarded them with the "BEST SHG AWARD" in the District. As an incentive they were given a sum of Rs 2 lakhs. With this, the SHG has bought a stone-cutting machine, which is in turn fetching the SHG INR 15,000 to 20,000 per month.

Where working in the mines the villagers use to earn a meager amount of INR 50 per day, and were employed hardly for 10 to 12 days in a month, now the members of the SHG earn INR 2000 per month, through the various activities of the SHG.

Phase 6

A new group of 20 villagers has been formed in the village, wherein they have been enrolled in an income generation programme – 'Agro Based'. They have been given 2000 banana plantations. The plantations are being grown on 2 hectares of a common land.

The offshoots of the plantations would be given to another 20 families free of cost. Once the fruit comes, a market linkage for the same has already been created. Through this activity the results are that each house hold is getting an additional income of INR 7,000 to 8,000 in the first year.

Another group of 20 villagers are being supported in poultry. In the first year itself all the group members will benefit. How-ever from the second year offspring of the nurtured animals will be freely distributed to other needy villagers and the process will continue.

Phase 7

Already necessary approvals have been obtained to support another set of 20 and 20 families by way of papaya cultivation under agro-based initiatives and goatry under non-farm sector.

This way the entire village will have been roped into diverse activities and each family is can earn extra income for the sustenance of the entire family.

The education of pre-primary students, which was initiated and supported by BPCL, has been withdrawn. The pre-primary education has now been taken over under central Government ICDS scheme.

This way the Corporations fund were more channelised to-wards health support, formation of SHG's and developing in-come generation programmes.

Evaluation of Success/Results

The impact of the whole programme has been overwhelming. In another two years, BPCL would be in a position to with-draw all the financial support being extended to this village, and extend its support to some other deserving village.

- Where the entire village was mainly into mining work, now there are hardly a couple of families
- There are two registered SHG's functioning very well with good co-ordination
- BPCL initiated pre-primary school and mid-day meal scheme, which has now been withdrawn and through the NGO made village, children receive the same benefit from central Governments ICDS scheme
- The State health workers are involved in creating awareness about health and hygiene issues in the village
- All the bore wells of the village are functional and there is no scarcity of water even during summers
- The pond, which was a breeding ground for mosquitoes, is now being utilised for fishery



- The SHG group members are earning a steady income of INR 2000 per month
- The members of the banana plantations and poultry are earning an additional income of INR 7,000 to 8,000 per annum
- The work done by SHG's in this village has been recognised by the Block Development Officer (BDO), who in turn has rewarded them with the "BEST SHG AWARD" in the District.

The entire project has created goodwill for the company in the hearts of villagers in and around Ramthenga. More so the success from this project has given us the confidence about project replication in other regions.

Case Study V

Name: Coca-Cola India Inc

Thematic Areas: Health, Environment, Education, Livelihood

Case Study:

According to Atul Singh, President & CEO, Coca-Cola India, "We at Coca-Cola are committed to refresh the lives of communities on an everyday, all-day basis. As part of the same strategy, sustainable water management remains our top priority. We will continue to find innovative solutions in all areas of water management through our integrated 4 R strategy. Starting in 2000, over the last 7 years, we have taken the lead in improving water use efficiency by nearly 30 percent in our operations across India."

They identify partners primarily on the basis of the need of a specific project, understand their experience and expertise in specific fields; their ability to deal/engage with the community; their working relationships with other stakeholders such as the government at state/local or district level; their commitment to make the project sustainable; manage crisis as and when they arise etc.

They form a group comprising of experts from (within the system) departments such as Technical, Public Affairs & Communications, Regional bottling units and the implementing agency; visit the project sites; interact with the community frequently; understand the progress and impact of the project.

So far, the Company's water initiatives have improved the lives of more than 140,000 Indians and made millions more aware of the crucial importance of water conservation.

The Company's aim is to return whatever water it has been drawing from the ground by 2009 through water conservation projects.

To this effect, they have taken the lead in improving water use efficiency by nearly 30 percent in our operations across India and have returned 85 percent of the total water that we have returned approximately 85 percent of the water that they have drawn from the ground"

Their key activities include:

(a) Rain Water Harvesting

Working alongside local NGOs and communities, Coca Cola India has been installing rooftop rainwater harvesting projects at all of its bottling plants in India besides other communities and has also has been installing checkdams, recharge shafts etc in rural areas.

In Delhi alone, the existing RWH structures have the potential to harvest over 100 million liters of rain water.

Other key watersustainability projects that have run alongside the rainwater harvesting programmes are the construction of check dams.

(b) Check dams

In Andhra Pradesh, in partnership with the Hyderabad Urban Development Agency, local village

committees and NGOs, Coca-Cola India has helped 16,000 villagers of Saroor Nayar restore existing “check dam” water catchment areas.

The project involved removing silt, recreating the pond and making the check dam with strengthened stone in order to stop the decline in groundwater levels.

In Bangalore, Karnataka, the Company recently dedicated a Check Dam at Kurubarakarena Halli.

With a capacity to harvest 1080 Kilo liters (1080000 litres) of rain water per annum, this Check Dam with a catchment area of 2 Sq Km will benefit 3000 people in the villages around. The system helps in recharging (improving water levels) of 30 bore wells around the check dam area.

(c) Recharge Shafts

Also in Rajasthan, in its many arid open areas, the Company has undertaken the construction of more than 100 Recharge Shafts where rainwater collects but does not percolate into the ground due to the nature of the soil.

Today, nearly 15,000 villagers are reaping the benefits of a steady or increasing water table without having the need to further deepen their existing bore wells.

The result of the water programmes is an increase in the amount of ground water available to local residents. Studies of the Rajasthan State Ground Water Board, for example, show the 2005 Kaladera ground water level was 21.85 meters below the ground, up from 22.23 meters in 2004.

(d) Restoring Old Water Bodies

In Rajasthan, one of the driest states of India, Coca-Cola has aided the restoration of a series of ancient and historic “Bawari”, or step well, water catchment systems.

The 400-year-old Sarai Bawari and Kala Hanuman ki Bawari, both located on the Delhi-Jaipur Highway in Jaipur, have both been completed and residents in the nearby communities are now able to draw drinking water from them.

The restoration project of Kale Hanuman ki Bawari witnessed active community involvement in the selection of the project site, design, source of supply for labor and material, implementation and creation of awareness for the project.

The actual restoration work included the removal of silt, rubble and algae, repairs to the infrastructure in the traditional “Jaipuri” style, and re-opening of the facility for use.

Today, thousands of gallons of water flow into the step wells from underground pores or streams, and the storage and recharge capacity has reached more than 8m liters of water. More than 3,000 villagers near each of the Bawari now have a sustained source of clean water. In addition, both step wells are now fully restored heritage sites and tourist attractions.

Facilitating Water Access

In its aim to provide access to clean drinking for the under-privileged in and around Chennai and in northern parts of Tamil Nadu covering the districts of Thiruvannamalai, Vellore, Kanchipuram and Chengelpet, the Company has launched Elixir of Life, which is a convergence of the vision of the 2 partners – Rotary International and Coca-Cola India, and is an extension of the Rotary’s ‘Schools into Smiles’ project that envisages betterment of the quality of lives of students.

Elixir of Life is enhancing the quality of life of students in these schools as unsafe water is the root cause for most of the health hazards and fatal diseases affecting young children, and in particular those from the underprivileged sections in the country.

These children are more susceptible to the water-borne diseases and the project is helping to realise one of their distant dreams by making clean drinking water available to them.



The unique aspects of the Elixir of Life project include a pioneering initiative to maintain the system for the next 3 years. In addition to this, a comprehensive maintenance and servicing protocol has been prepared for ensuring the ongoing success of this project.

This includes fortnightly inspection, cleaning of raw and treated water tanks, rinsing and flushing of micron filters, apart from emergency breakdown and repair service.

When Rotary celebrated the 100th year during 2004–05, RI District 3230 planned to execute a landmark project to commemorate the centenary year. The team surveyed 1,200 schools in five northern districts of Tamil Nadu and selected the 100 worst schools.

Thereafter, these schools were adopted through different Rotary Clubs which reconstructed the schools and added new class rooms, compound walls, good toilet/water facilities, besides providing noon meal kitchens, desks and benches.

The Schools into Smiles project is being continued this year by adding more schools but, at the same time, in order to improve the existing schools which have already been renovated, the Elixir of Life project has been launched with the support of Coca-Cola India so that every child gets access to potable water.

As of now the project has been completed in 20 Schools impacting the lives of around 10,000 children.

Creating Awareness

Besides the quantitative results, Coca-Cola's water initiatives in India have ushered in a new wave of water consciousness. Millions of Indians are being made aware of the importance of water management through the Company's marketing activities and other different fora in partnership with key institutions across the country.

Seminars/Workshops; Jal Yatra; Jaldhara Karavan; Jal Bima Abhiyan; Jal Sanchay Abhiyan; Film on Water Conservation, Community Mobilisation Programme, India celebrations on Water Water Day and World Environment Day, key events with Assocham, CII, FICCI, Rotary etc.

Playing the Role of a Mentor

The Company would be happy to play the role of a mentor in setting up water conservation projects on which it has developed core expertise.

Case Study VI

Name: DLF Limited

Thematic Areas: Rural Development, Urban Community Development, Education and Environment

Case Study:

While DLF continues to create world class infrastructure throughout India, it has not lost sight of its responsibilities as a change agent for accelerating the pace of social and economic transformation across various segments.

Even though there has been tremendous improvement in construction technology and quality, it is distressing to note that the people who actually make all the glitzy buildings are a neglected lot and are often required to do so in inhuman conditions. The sight of construction workers and their children living in jhuggies without even the basic facilities at most of the construction sites is not uncommon.

At DLF it has been our constant endeavor to improve the living conditions of our construction workers by providing them all the basic necessities at the site itself by efficient and effective space management.

DLF seized the initiative in this respect and became a pioneer in providing all necessary facilities to its construction workers on site when it tied up with Laing O Rourke for construction projects.

As a pilot project the site selected was an area of approximately 42 acres in village Silokhera district Gurgaon where an IT Park of 10 million sq feet was to come up. The construction on this site is slated to be completed by 2010.

The total workforce currently deployed at the site consists of about 6000 people. Out of this 5500 are essentially construction labor, with 500 supervisors. Further 1500 people are with families and 3500 are single. There are a total of 4200 men, 1800 women and 2000 children.

Before commencement of the construction a suitable location was identified on site for construction of hutments to house the workforce for the entire duration of the project. Instead of constructing makeshift or temporary accommodation, a budget of INR 6 crores was sanctioned to build a mix of cemented hutments and dormitories for the workers.

The entire area was paved to ensure easy access even during the monsoons and the work of sanitation and housekeeping was outsourced to a third party namely M/s Lion Services.

All the residential accommodation is provided with electricity, water, fans, beds and linen, and separate areas have been provided for toilets and washing. In order to take care of the children of the workers mobile crèches have been made available on site through a strategic tie up with an NGO.

A subsidised canteen manned by a third party has also been made available on site to ensure hygienic and good quality food on site. Medical help is available on site along with a 24 hour ambulance to take care of emergencies.

In order to improve the skills of the workers as well as train potential workers on site a non-profit residential "Apprentice Training Centre" for imparting skills in carpentry and masonry has also been constructed.

This model is being replicated in 17 sites all over India catering to a workforce of approximately 20,000 workers. It is pro-posed to extend this model to all future sites being developed by DLF.

If all construction companies were to adopt a similar approach then the construction workers would not be forced to live in inhuman conditions on site for the duration of the time they spend in creating the infrastructure which becomes the pride of the nation.

Case Study VII

Name: Dr Reddy's Laboratories

Thematic Areas: Microfinance, Education, Health, Environment, Livelihood and Social Entrepreneurship

Case Study:

Dr. Reddy's purpose is to help people lead healthier lives. This, combined with a clear commitment to their values and ethical practices, forms the foundation of sustainability or CSR.

Being a pharmaceutical company they are deeply sensitive to the needs of accessibility and affordability of medicines in developing and developed countries. They define their strategy and determine their impact.

In an era when increasing demands are being made on healthcare services, generic medicines provide a major benefit to society by ensuring patient access to quality, safe and effective medicines while reducing the cost of healthcare.

Generic medicines cost a fraction of the original products, which is good news for patients and means greater access for more people.

Their active pharmaceutical ingredients (API) and generics businesses focus on affordability by providing lower cost alternatives. They are addressing access needs by investing in innovation with emphasis on



New Chemical Entity (NCE) Re-search and Differentiated Product Development that address unmet and poorly met medical needs.

Their product development effort with example of innovation in making medicines affordable and accessible. In addition, the triple bottom line approach enables us to deliver sustained value with equal emphasis on people, planet and profits through environmentally friendly and socially responsible operations.

Their CSR efforts encompass sustainable business practices, safety, health and environment (SHE) systems, patient assistance programmes, community development, people practices and citizenship.

Dr Reddy's was one of the earliest in establishing a zero liquid discharge facility to ensure 100 percent effluent recycling. They have significant improvements in process development with growing emphasis on green chemistry. Energy saving initiatives and awareness communication on Climate Change is being accelerated in the company Programmes like Sparsh, betaCare, Sarathi, deliver assistance to doctors, pharmacists and patients by improving access to medicines and patient education. These efforts complement our commitment to product responsibility addressing quality and safety of our products.

Dr. Reddy's Execution Excellence Model (DREEM) has spawned focus action in Lean Manufacturing ("doing more with less") in both finished dosage and active pharmaceuticals. Organisational redesign of teams has increased throughput, provided higher quality, lower cost and integration of Intellectual Property in product development.

The community development efforts are evident in places where we live and work, with specific focus on manufacturing locations, implemented by CSR teams in each facility. With a combination of approaches communities in the neighborhood are being assisted to access healthcare, improved education opportunities and sustainable livelihoods.

They encourage employee giving in association with Naandi foundation, an organisation co-founded by Dr Reddy's. 6000 employees contribute to The Power of Ten, the employee giving programme.

Employees are encouraged to volunteer by forming specific interest groups and also join volunteering programmes with Dr Reddy's Foundation.

The Foundation, setup by the company, demonstrates their Citizenship work in the area of poverty alleviation, with specific emphasis on quality in education and sustainable livelihoods.

Over 100,000 sustainable livelihoods with Livelihood Advancement Business School (LABS) programme and out-reach to over 34,000 children in government run schools through School Community Partnerships in Education (SCOPE).

Sustainability involves almost every aspect of a company. It ranges from purpose and values, marketplace and innovation, workplace safety, people practices, environment management, human rights to community contribution.

Dr Reddy's embraces the principles of sustainability to drive responsibility and to create the capacity to re-invent, sustain and thrive through changing generations of technology, managers, shareholders and society.

Dr. Reddy's is the only Indian pharmaceutical company to publish a Sustainability Report and among the few Indian companies to do so. The report is prepared according to guidelines recommended by Global Reporting Initiatives.

Case Study VIII

Name: Infosys Technologies Limited

Thematic Areas: Education, Health, Environment, Livelihood

Case Study:

Infosys was founded in 1981 with the view that sustainability and the success of the organisation would depend on how much wealth they create for their customers, employees and the society in which they operate.

They have been responsible for creating multiple frameworks involving corporate governance, education, infrastructure, and inclusive growth. They believe that corporations must reach out to the society if they want longevity.

It is this belief that drives their commitment to be fair and transparent to their stakeholders, to help people and communities enhance their living conditions, and to improve the quality of education and healthcare through various community development programmes.

Their CSR activities are carried out at 4 different levels – at the Infosys group level, through the Infosys Foundation, through the Internal Board of Directors and by the Infosys Employees at an individual or team level.

Infosys as an organisation runs global initiatives to develop human capital by creating sustainable frameworks with educational institutes for training students and faculty. At the Infosys Foundation level, Mrs. Sudha Murty, Trustee and Chairperson, manages a team of dedicated members to reach out to the underprivileged and enrich their lives.

At the Board level, the members lead by example, by participating in the advisory councils of NGOs and civil bodies, donating their time, money and effort to various causes. At the employee level, there are location-wise CSR teams to cater to local requirements.

The 5 major CSR themes at Infosys include education, healthcare, art and culture, rural upliftment and inclusive growth. They identify partners and beneficiaries based on their goals, credibility, performance and alignment to Infosys vision and values.

They are the first Indian company to emphasise strong Corporate Governance practices and they have expanded their practices significantly beyond the norms.

They complied with the US GAAP accounting requirements and were first to incorporate a number of innovative disclosures in financial reporting including human resources valuation, brand valuation, value added statement and EVA reports.

They are very committed to supplementing Government efforts in branding India in global forums. As a strategic partner of the World Economic Forum (WEF) they lead discussions on social and economic issues.

They help the forum shape its agenda by actively participating in the "Forum of Young Global Leader" and the "Global Growth Companies" programmes. They are prime sponsors at several flagship events like Gartner Summit, Sapphire, Oracle Open World, and World Wide Webs Consortium's W3C Conference.

They have recently initiated the Infosys Young Indians (INFYi), the first corporate chapter of Confederation of Indian Industry (CII) which will strive to provide a platform for social entrepreneurs by undertaking activities in the areas of economy, education, environment, and healthcare and youth affairs. They also participate actively in pro bono engagements.

Their mission to go beyond business translates into every Infoscion and the Internal Board Of Directors (IBOD) the sense of being responsible corporate citizens.



The IBOD serves as member of advisory council / founder trustee in various Government and non-profit organisations to establish views or codes on corporate governance, global warming, education and training, social welfare, healthcare, infrastructure management and rural upliftment.

They have always been the forerunners in providing assistance when disaster strikes – be it the Tsunami, the Gujarat earthquake or Katrina.

As responsible corporate citizens, they not only rushed funds but their employees personally helped the relief operations undertaken by Infosys Foundation and other NGOs.

They have been recognised in fora where CSR is also one of the parameters to measure a company's success:

- Citizen Award – 2001
- Helen Keller Award – 2006, 2007
- NASSCOM – India Today award for gender inclusivity – 2007
- Ranked the “Business world most respected Company” in a survey
- Named the “Most Admired Company” for the sixth consecutive survey by Asia Wall Street Journal

They touched the lives of 150,000 beneficiaries during 2007 and the will continue to conduct business responsibly and ethically in the years to come.

Case Study IX

Name: JSW Steel

Thematics: Women Empowerment

Case Study:

Data Halli – Building and Running a Rural BPO for Women The JSW Group of Companies has interests in core manufacturing, energy and infrastructure areas. In almost all areas, the manufacturing facility/ operation is in remote locations, far from the cities.

The primary source of income in these areas is farming. As new manufacturing facilities are built in these areas, the skill sets of the population around the facilities do not always meet the requirements of the operations. Providing meaningful employment to the local population is thus seen as a challenge.

In order to provide a sustainable and alternate livelihood to the population around the facilities, JSW Foundation, which manages the CSR activities of the JSW Group, embarked upon a novel approach of building a BPO at these remote locations? This gave an alternative employment avenue to the rural men and women, thus empowering them socially and economically.

The idea was spearheaded by Mrs. Sangita Jindal, Chairperson of JSW Foundation. The first BPO at Toranagallu was inaugurated on 15th August 2006. The BPO focuses on non-voice activities and is located adjacent to the JSW Steel Ltd.'s Toranagallu facilities, near Bellary, Karnataka. Starting with a mere 40 men and women, the BPO now employs about 200 women.

The concept of a rural BPO sounds unique and challenging, primarily because BPOs are typically associated with cities. This unique Innovation turns this concept on its head and has demonstrated that the stigma associated with BPOs can be challenged and proven otherwise. Considering the location and activities carried out at the BPOs, the name Data Halli was selected. Halli, in Kannada, means village.

Focusing on womenfolk in the rural areas, where education levels are also lower than in the cities, the rural BPO provides an avenue for these womenfolk to work outside their conventional livelihood and enrich their lives, with the aim of empowering women socially and economically.

JSoft Solutions Ltd., the IT & ITES Company in the JSW Group, currently runs a non-voice BPO at Toranagallu, next to the JSW Steel Ltd.'s Integrated Steel Plant at the same location. The BPO focuses on data entry activities for multiple clients and employs about 200 women.

Plans are afoot to open more such BPOs across the country.

Most women come with little or no exposure to computers. A computer skill is therefore not mandatory. The eligibility criteria are simple - should be 18 years or above and should have passed the SSLC examination.

Upon joining the BPO, the women are given training for a period of 3 to 6 months, depending on their grasping ability, on basic typing, English reading etc. - skills that enable them to be productive, earn a decent living and deliver value at the BPO. In addition, professional training, specific to the projects on hand, is provided for up to 2 months.

Most women come from the near-by villages, from up to a radius of about 60 km. Buses are provided for pick-up and drop from the village to the work spot. In order to take the skills development to the doorsteps, the requisite software is also installed at the village schools where JSW Foundation runs Computer-aided Learning Centers (CALCs).

These are supervised by the BPO women from the same village. Potential candidates therefore do not need to travel to the BPO to develop the requisite skills.

The rural BPO has had a positive impact on many persons. As the nature of the initiative suggests, this impact has been significant on the employees of the BPO. Some of the impact areas are:

- Transformed simple village girls into matured, positive, confident and economically independent professionals who hold a respectable place in their homes and are looked upon as examples of transformation in the villages
- Encouraged villages girls to continue their education up to 10th or 12th Standard, an impossible task prior to the BPO
- Has given them the courage to postpone their marriages which would have otherwise made them wives and mothers at the young ages of 14 or 15
- Teaching of English and Personality Development has boosted their self-confidence and has made them socially known figures in their society as they are now affiliated with a large entity, namely, the JSW Group
- Sowed the seeds of leadership in these ladies by giving them job responsibilities of Supervisors, Trainers, etc., through which they lead their respective teams which has in turn helped in showing them a career path
- Equal employment opportunity is given to quite a few physically challenged ladies who have carved their own identity
- Providing a springboard to look for better work opportunities in the vicinity

Along the way, there have been many challenges – social barriers, resistance from the men folk at home, training, technology, quality of work, transportation, shift working, etc.

Some of the challenges faced were:

Internal Challenges

Skepticism about viability of the Concept

Overcome by focused efforts to streamline the processes, at-tack the issues on hand and hire managerial talent with BPO experience. All this led to a turn-around in the operations and show-casing of the BPO for everyone to see the success.



Lack of infrastructure (IT, space, people, etc.) to handle the daily stream of potential candidates

Overcome by taking the skills development to the villages via the CALCs, thus building a resource pipeline.

External Challenges

Lower Quality and Throughput

Overcome by providing adequate training, dummy projects and hand-holding. With the implementation of a batch tracking software, Individual performance and throughput is also monitored and tracked

Hesitation by the village folk to send their women folk away from their villages

Overcome by arranging for transport up to the villages and making the BPO an all-women

Case Study X

Name: Reliance Industries Limited

Thematic Areas: Microfinance, Education, Environment, Health, Livelihood, Community Development, Child Welfare and Infrastructure Development

Case Study:

Vision: What is good for India is good for Reliance

Reliance Industries Limited has embraced sustainability as a core business strategy and regards sustainability as a foundation for lasting economic success. After all, sustainability is about meeting the needs of the present generation without di-luting the ability of the future generation to meet their needs.

Their commitment to sustainability is backed by active initiatives on the ground, together with a detailed reporting system with third party external assurance certification. Further, they actively engage with their stakeholders (along with their partners who are associated with their various CSR projects) to take their feedback and monitor the progress of the work.

Their maiden Corporate Sustainability Report (2004-05) re-port was the first Corporate Sustainability Report from the Indian Oil & Gas sector. Further, this report obtained "in-accordance" 2002-guidelines status from the Global Re-orting Initiative (GRI) - the official collaborating centre of the United Nations Environment Program (UNEP).

Pursuing their goal of continual improvement in their reporting, the report for FY 2005-06 has an enhanced scope based upon the feedback received for its maiden CSR. Further, it focuses on "issues" and "stakeholders" and includes numerous case studies from different locations and divisions. This report is the only "GRI Checked A+ level" rating report from India.

Their belief, "What is good for India is good for Reliance", drives their effort in positively impacting the life of more than one billion Indians.

They will use sustainability to drive process innovation, new product development, improving manufacturing efficiencies and reducing material and energy consumptions.

They manufacture products that have made a positive impact on millions of people in the country, i.e. fuels for transportation, plastic bags to fiber optics, synthetic fabrics to name a few. Continuing this strategy is their plan to provide a cleaner fuel to millions of households by way of natural gas.

On the health front, they have the distinction of being the founder member of the India Business Alliance of the World Economic Forum. They have resolved to share the responsibility of combating diseases such as Tuberculosis (TB) and HIV/AIDS.

To achieve this, they have collaborated with a large number of agencies working on these issues to create some rather unique Public-Private Partnerships (PPP).

In addition to setting up hospitals at some of their manufacturing locations, they offer medical services at all their manufacturing facilities and offices.

These includes free outdoor medical services for nearby communities, outreach mobile medical services, family planning camps, blood donation drives, antenatal check-ups, vaccination centers, pulse polio camps, school health check-ups, diagnostic multidisciplinary camps, eye camps and other out-reach programmes.

On December 28, 2006, over 40,000 villagers and other stakeholders located near their Dahej Manufacturing Division, Gujarat State, got a unique 'Gift of Life' from this manufacturing facility. In a unique public-private partnership initiative, Dahej Manufacturing Division in partnership with the State Government of Gujarat adopted the existing Public Health Centre (PHC). This is the only nearest public health centre located in this vicinity. The other nearest one is at least 45 to 50 kms away, located at district Bharuch.

Aligned with the goals and vision of the management, several educational initiatives have been proposed/ established as leaps into the future. These ventures aim at building confidence, capacity, global mindsets and communication skills among young people. Their growth will shape and give direction to the growth of our country.

Reliance Rural Development Trust has undertaken a unique corporate initiative to create infrastructure facilities in rural areas. The projects undertaken in rural areas are construction of roads, anganwadis (kindergarten school), panchayat offices and community halls. These are some basic development priorities of rural areas.

In order to give focused attention to the needs of surrounding rural communities, Baroda Manufacturing Division, Gujarat State, initiated a collective action programme by setting up a voluntary society SVADES with the co-operation of all the neighboring industries in Vadodara.

SVADES is a collective endeavor that binds industry and rural community together towards socioeconomic development in the rural areas surrounding the industry. SVADES works in 40 villages covering a population of nearly 200,000.

At Reliance a clean environment for sustainable development is of prime concern. At all their manufacturing sites lush greenery has been developed utilising treated effluents.

Some of their leading Other Community Initiatives

Road at Dwarka, guest house for devotees, electronic security services and maintenance at Dwarka; Gardening of air-port waste land; Gaushala (Cow shed); Cultural promotion programmes for all races; Road safety and emergency services on state highways; Greening and lighting of road di- viders; Sheets and Pipes for Jaipur Foot and Prosthesis with Bhagawan Mahaveer Viklang Sahayata Samiti, Jaipur; Community meals / providing potable water; Empowering women through formation of Mahila Mandals organising vocational training courses for women.

Further, Dhirubhai Ambani Foundation (DAF) - founded under the Patronage of Shri Dhirubhai Ambani (registered under the Bombay Public Trust Act in August 1995) - has been working in partnership with RIL in most of its social initiatives. Smt. Nita Mukesh Ambani leads the CSR initiative at DAF and RIL.

The overall objective of the Foundation is to make philanthropic interventions for the welfare of Indian Society and pro-mote sustainable development of its people through initiatives in the fields of: Health, Hygiene and Sanitation, Education.

Community Revitalisation, Promotion of Social and Economic welfare of and upliftment of the People; Conservation of Natural Resources, Environmental and Ecological Protection; Rural Development and Assistance to other organisations with similar objectives.



The DAF joined hands with the management of Sir Hurkison Das Nurrotum Das Hospital and Research Centre in December 1997 with the commitment to restore the hospital to its erstwhile glory. Consequently the hospital services were restructured and state-of-the-art healthcare technology, conforming to international standards was set up.

Project Drishti, launched, in 2003, in association with the National Association for the Blind (NAB - a non-profit institution serving the blind in India for over five decades) – is a nation-wide corneal grafting drive to bring light in the lives of visually challenged from the underprivileged segment of the society - has illuminated lives of over 5,000 Indians – all free of cost.

This project is the largest (corneal grafting surgery) project undertaken by any corporate entity in the country. Presently, this project has conducted corneal grafting surgeries in over 16 cities in India and efforts are on to spread to far-flung mofussil areas of the country.

Dhirubhai Ambani International School, Mumbai, provides international educational opportunities in the context of the emerging educational needs of students.

The school prepares students for the Indian Certificate of Secondary Education (ICSE), Cambridge University's International General Certificate of Secondary Education (IGCSE) and the International Baccalaureate Diploma (IB) examinations.

Faculty members with rich experience in national and international curricula, educate, mentor and guide the children through these developmentally critical years of growth.

Case Study XI

Name: Tata Steel Limited

Thematic Areas: Microfinance, Education, Environment, Health, Livelihood and Relief during calamities

Case Study:

Vision: To improve the quality of life of the employees and the communities we serve

Tata Steel Ltd, established in 1907, is India's first and fully-integrated steel plant located in Jamshedpur, having employee strength of over 42,000.

As a conscious Corporate Citizen, Tata Steel Ltd is committed to improving the quality of life of its employees and also of the citizens residing in and around the Steel Works in Jamshedpur and the various out locations scattered in different states in the country as well as abroad.

These dual interventions in workplace and community have a far reaching impact. This responsible corporate citizenship is reinforced by the organisation by being a signatory to Global Compact and accepting and practicing the "Ten Principles" in total as well as being a Member of Global Business Coalition on HIV/AIDS.

HIV/AIDS is a disease that threatens to affect communities all over the world and especially the young and productive industrial workforce.

Tata Steel Ltd's involvement vis-à-vis preventing HIV/AIDS dates back to early 1990s when the organisation realised that the disease had acquired epidemic proportions and accepted that its control or prevention was not the sole responsibility of the government.

It decided to respond to the situation by taking appropriate initiatives to safeguard health of the community and prevent spread of the disease.

Tata Steel Ltd., fully mindful of its role, promptly mobilised its resources and evolved a policy on control of HIV/AIDS. The policy is revisited every couple of years with inputs from HIV+ people, and the need of the stakeholders. It also formulated a strategy of creating mass awareness and educating the society to prevent and combat the menace of HIV/AIDS.

In 1994, the management of Tata Steel Ltd evolved a Corporate Sector Model to prevent STD/HIV/AIDS and constituted a Core Group – AIDS and Nodal Centre – AIDS to focus on this disease and formulate strategies for its control and prevention.

The members of Core Group – AIDS comprise experts from various divisions of the company e.g., Community Development & Social Welfare Department, Centre for Family Initiatives, Personnel, Tata Steel Rural Development Society, Tribal Cultural Society, Public Health & Medical Division as well as invitees from local governmental and private organisations. Convener Core Group – AIDS, a technical person, was assigned full time by the Company to run the HIV/AIDS initiatives.

The members conduct AIDS Awareness Programmes especially for women and youth, using various IEC (Information-Education-Communication) media and forum, not only among the citizens in and around the Steel City, but also for those re-siding in (700) villages around its out-locations.

Feedback from the target group acts as input to further improve the programmes. Each year International Candlelight Memorial and World AIDS Day are observed to express solidarity with those affected by HIV/AIDS.

Testimony to Tata Steel Ltd's commitment to prevent and check HIV/AIDS disease is amply provided by the adoption of practice of non-discrimination between HIV infected employees and other employees. The Company firmly believes that by continuously informing and educating various levels of society, adequate awareness can be built in the community, which in turn would take appropriate preventive measures against the disease.

There is no pre-employment screening for HIV status. Confidentiality of HIV+ employees is maintained with continuation of their employment. They are re-located to assignments that are best suited to their physical ability and continue till they are medically fit to work.

Workplace programmes are conducted regularly with the help of HR Personnel for both the permanent employees as well as the contract labor which also helps sensitise employees and reduces stigma and discrimination. Approximately 250 AIDS Awareness Programmes are conducted every year in the workplace.

Comprehensive counseling, treatment and care including the Preventing Parent To Child Transmission Plus programme is provided through all health centers of Tata Steel such as:

Tata Main Hospital, an 850-bed modern specialty hospital and has an Out-patients Department in all specialties and provides "treatment without discrimination" to all positive people. All HIV+ employees or their dependents are provided with HAART free of cost by the Company

12 Out-patients clinics in Jamshedpur Township attached to Tata Main Hospital

21 Maternal & Child Health clinics of Tata Steel Family Initiatives Foundation and

4 Clinics of Tata Steel's Community Development & Social Welfare

Jamshedpur Blood Bank encourages voluntary blood donation which ensures availability of "safe blood."

A "Single window" health delivery concept, Sneh Kendra, was started to provide care and support to those affected by STI/HIV/AIDS. All cases detected HIV+ and their family members are finally referred here by above-mentioned agencies for on-going support. The family members of these patients regularly come for counseling, group support and life skills training.

They are also benefiting from programmes on vocational training, economic support for education of children, formation of Self Help Group for economic rehabilitation and sustainability.

To increase the reach of the programmes Peer leaders are identified in the community and trained. Internal and external experts are invited to conduct training and workshops for capacity building of



knowledge and skills of all stakeholders in health and community-based care and support services on a regular basis.

Tata Steel Ltd believes in networking with like-minded agencies e.g. National AIDS Control Organisation (NACO), UN-AIDS, Global Business Coalition on HIV/AIDS (Tata Steel received an award for its HIV/AIDS initiatives in the community in 2003), ILO, CII-Indian Business Trust, WHO, JSACS, Transport Corporation of India Foundation (TCIF), PFI, The David & Lucile Packard Foundation to share resources.

To help the district health services Core Group – AIDS introduced computer-based Health Information Management System (HIMS) in Jamshedpur. Each month statistics on new HIV+ cases from local Health Institutions is collated in the Civil Surgeon's office.

Tata Steel Ltd is a recipient of Global Business Coalition on HIV/AIDS Award 2003 for its initiatives on HIV/AIDS in the community.

9.4 CORPORATE SOCIAL RESPONSIBILITY VOLUNTARY GUIDELINES 2009 FROM MINISTRY OF CORPORATE AFFAIRS, GOVERNMENT OF INDIA

(1) FOREWORD

The Indian corporate sector has seen the current decade as a period of high growth and the emergence of a strong India Inc. having a significant global footprint. The decade also saw the financial crisis that shook the global markets. While the corporate sector is recovering from the jolt of the global financial crisis, the future is looking bright. However, the corporate sector is also standing in the midst of a sustainability crisis that poses a threat to the very existence of business. What we have before us is a cross-road where one path leads us to inclusive growth and the other may lead to unsustainable future. However, the first path will require careful nurturing for which all stakeholders need to assume and discharge their respective responsibilities.

We have seen the business sector generating wealth and value for the shareholders in the last sixty years, but simultaneously we also have the problems of poverty, unemployment, illiteracy, malnutrition etc. facing the nation. The corporate growth is sometimes seen as widening the gap between the India and Bharat through its income – skewing capability. This gap needs to be bridged. While the Government undertakes extensive developmental initiatives through a series of sectoral programmes, the business sector also needs to take the responsibility of exhibiting socially responsible business practices that ensures the distribution of wealth and well-being of the communities in which the business operates.

The Indian business has traditionally been socially responsible. From inactive philanthropy to the incorporation of the stakeholders' interest in the business model, the Indian business sector practices various methods of discharging its social responsibility. While a lot of human and economic energy is available for utilization in this area, a suitable mechanism is required to channelize this energy for which the Government, corporate sector and the communities need to partner together. Against this background, the Ministry of Corporate Affairs has decided to bring out a set of voluntary guidelines for responsible business which will add value to the operations and contribute towards the long term sustainability of the business. These guidelines will also enable business to focus as well as contribute towards the interests of the stakeholders and the society.

At a time when the Government is engaged with delivery of a gigantic national development initiative and is taking a leadership position on various global issues, I am sure that India Inc. will be ready to walk step in step with the Government to discharge their responsibilities towards national development. I look forward to more and more businesses in India adopting these voluntary guidelines and partnering in the endeavor of national development.

(2) PREFACE

The Ministry of Corporate Affairs has adopted the role of an enabler, facilitator and regulator for effective functioning and growth of the corporate sector. A number of initiatives are underway on the

legislative, service delivery and capacity building sides so that the corporate sector is provided with a buoyant and enabling regulatory environment for its growth. Simultaneously, the Ministry is also focusing on various issues related to inclusive growth in relation to the development of corporate sector.

The subject of Corporate Social Responsibility has evolved during last few decades from simple philanthropic activities to integrating the interest of the business with that of the communities in which it operates. By exhibiting socially, environmentally and ethically responsible behaviour in governance of its operations, the business can generate value and long term sustainability for itself while making positive contribution in the betterment of the society.

Although we have seen a period of sustained economic growth in the current decade, we still continue to face major challenges on the human side in India. The problems like poverty, illiteracy, malnutrition etc. have resulted in a large section of the population remaining as “un-included” from the mainstream. We need to address these challenges through suitable efforts and interventions in which all the state and non-state actors need to partner together to find and implement innovative solutions.

Indian business has traditionally been socially responsible and some of the business houses have demonstrated their efforts on this front in a laudable manner. However, the culture of social responsibility needs to go deeper in the governance of the businesses. In order to assist the businesses to adopt responsible governance practices, the Ministry of Corporate Affairs has prepared a set of voluntary guidelines which indicate some of the core elements that businesses need to focus on while conducting their affairs. These guidelines have been prepared after taking into account the governance challenges faced in our country as well as the expectations of the society. The valuable suggestions received from trade and industry chambers, experts and other stakeholders along with the internationally prevalent and practiced guidelines, norms and standards in the area of Corporate

Social Responsibility have also been taken into account while drafting these guidelines.

The Ministry would look forward to more and more business communities coming forward and adopting these guidelines. We would also welcome comments and suggestions from various stakeholders to enable us to further refine these guidelines and also work out the details of the operational guidance on the principles and core elements that we propose to include in the coming months. I am sure that India Inc. will accept the challenge in making the Indian corporate sector a global leader in responsible business.

(3) PREAMBLE

The 21st century is characterized by unprecedented challenges and opportunities, arising from globalization, the desire for inclusive development and the imperatives of climate change. Indian business, which is today viewed globally as a responsible component of the ascendancy of India, is poised now to take on a leadership role in the challenges of our times. It is recognized the world over that integrating social, environmental and ethical responsibilities into the governance of businesses ensures their long term success, competitiveness and sustainability. This approach also reaffirms the view that businesses are an integral part of society, and have a critical and active role to play in the sustenance and improvement of healthy ecosystems, in fostering social inclusiveness and equity, and in upholding the essentials of ethical practices and good governance. This also makes business sense as companies with effective CSR, have image of socially responsible companies, achieve sustainable growth in their operations in the long run and their products and services are preferred by the customers.

Indian entrepreneurs and business enterprises have a long tradition of working within the values that have defined our nation's character for millennia. India's ancient wisdom, which is still relevant today, inspires people to work for the larger objective of the well-being of all stakeholders. These sound and all-encompassing values are even more relevant in current times, as organizations grapple with the challenges of modern-day enterprise, the aspirations of stakeholders and of citizens eager to be active participants in economic growth and development.

CSR is not philanthropy and CSR activities are purely voluntary- what companies will like to do beyond



any statutory requirement or obligation. To provide companies with guidance in dealing with the abovementioned expectations, while working closely within the framework of national aspirations and policies, following Voluntary Guidelines for Corporate Social Responsibility have been developed.

While the guidelines have been prepared for the Indian context, enterprises that have a trans-national presence would benefit from using these guidelines for their overseas operations as well. Since the guidelines are voluntary and not prepared in the nature of a prescriptive road-map, they are not intended for regulatory or contractual use.

While it is expected that more and more companies would make sincere efforts to consider compliance with these Guidelines, there may be genuine reasons for some companies in not being able to adopt them completely. In such a case, it is expected that such companies may inform their stakeholders about the guidelines which the companies have not been able to follow either fully or partially. It is hoped that "India

Inc." would respond to these Guidelines with keen interest.

After considering the experience of adoption of these guidelines by Indian Corporate Sector and consideration of relevant feedback and other related issues, the Government may initiate the exercise for review of these Guidelines for further improvement after one year.

(4) GUIDELINES

Fundamental Principle

Core Elements:

Each business entity should formulate a CSR policy to guide its strategic planning and provide a roadmap for its CSR initiatives, which should be an integral part of overall business policy and aligned with its business goals. The policy should be framed with the participation of various level executives and should be approved by the Board.

The CSR Policy should normally cover following core elements:

1. Care for all Stakeholders

The companies should respect the interests of, and be responsive towards all stakeholders, including shareholders, employees, customers, suppliers, project affected people, society at large etc. and create value for all of them. They should develop mechanism to actively engage with all stakeholders, inform them of inherent risks and mitigate them where they occur.

2. Ethical functioning

Their governance systems should be underpinned by Ethics, Transparency and Accountability. They should not engage in business practices that are abusive, unfair, corrupt or anti-competitive.

3. Respect for Workers' Rights and Welfare

Companies should provide a workplace environment that is safe, hygienic and humane and which upholds the dignity of employees. They should provide all employees with access to training and development of necessary skills for career advancement, on an equal and non-discriminatory basis. They should uphold the freedom of association and the effective recognition of the right to collective bargaining of labour, have an effective grievance redressal system, should not employ child or forced labour and provide and maintain equality of opportunities without any discrimination on any grounds in recruitment and during employment.

4. Respect for Human Rights

Companies should respect human rights for all and avoid complicity with human rights abuses by them or by third party.

5. Respect for Environment

Companies should take measures to check and prevent pollution; recycle, manage and reduce waste, should manage natural resources in a sustainable manner and ensure optimal use of resources like land and water, should proactively respond to the challenges of climate change by adopting cleaner production methods, promoting efficient use of energy and environment friendly technologies.

6. Activities for Social and Inclusive Development

Depending upon their core competency and business interest, companies should undertake activities for economic and social development of communities and geographical areas, particularly in the vicinity of their operations. These could include: education, skill building for livelihood of people, health, cultural and social welfare etc., particularly targeting at disadvantaged sections of society.

Implementation Guidance

1. The CSR policy of the business entity should provide for an implementation strategy which should include identification of projects/activities, setting measurable physical targets with timeframe, organizational mechanism and responsibilities, time schedules and monitoring. Companies may partner with local authorities, business associations and civil society/non-government organizations. They may influence the supply chain for CSR initiative and motivate employees for voluntary effort for social development. They may evolve a system of need assessment and impact assessment while undertaking CSR activities in a particular area. Independent evaluation may also be undertaken for selected projects/activities from time to time.
2. Companies should allocate specific amount in their budgets for CSR activities. This amount may be related to profits after tax, cost of planned CSR activities or any other suitable parameter.
3. To share experiences and network with other organizations the company should engage with well established and recognized programmes/ platforms which encourage responsible business practices and CSR activities. This would help companies to improve on their CSR strategies and effectively project the image of being socially responsible.
4. The companies should disseminate information on CSR policy, activities and progress in a structured manner to all their stakeholders and the public at large through their website, annual reports, and other communication media.



9.5 WHOLE LIFE COSTING - ASSESSMENT OF SOCIO-ECONOMIC IMPACT OF STRATEGIC AND OPERATIONAL DECISIONS OF BUSINESS

Introduction

Value for money is a concept that is frequently considered when an individual or an organisation is seeking to make a purchase or investment. When acquiring a new car, for example, we may consider the costs of ownership (fuel economy, insurance, maintenance, availability of replacement parts, etc.) when deciding between options. Implicitly then, we consider the long-term costs of ownership in the decision making process.

Furthermore, it could be argued that the larger the capital cost of a product, the more important it is to consider these long-term costs. Buildings are a prime example of high cost purchases, yet consideration of long-term costs is not given the attention it deserves. The past 30 years have seen many attempts to encourage a holistic approach to what is in effect 'whole life' cost analysis, but with limited success, particularly in the United Kingdom.

One such technique that is currently emerging in the industry is whole life-cycle costing (WLCC).

Whole life-cycle costing is a relatively new concept to the construction industry, albeit based upon the foundations of analytical techniques that have been in existence for some time. It is in essence an evolution of lifecycle costing (LCC) techniques that are now commonly used in many areas of procurement. Like LCC, the primary purpose of WLCC is to aid capital investment decision making by providing forecasts of the long-term costs of construction and ownership of a building or structure. However, unlike LCC it is also a dynamic approach, and can provide up-to-date forecasts on cost and performance throughout the life of the building. Some of the ideas behind the justification for WLCC are synonymous with key issues in today's construction industry:

- **Meeting clients' expectations** Clients (especially in the public sector) now require buildings that are efficient during and after construction. WLCC techniques can demonstrate real cost savings in design solutions
- **Sustainability** Achieving sustainable design solutions relies on the consideration of long-term operational costs and performance of building components
- **Monitoring performance of constructed assets** For example, are PFI/PPP (Private Finance Initiative/ Public-Private Partnerships) projects really cost effective? Only by considering the whole life-cycle costs can this be assessed. Using WLCC also supports benchmarking and key performance indicators.
- **Monitoring cost effectiveness of constructed assets**
- **Lean Construction:** By considering long-term cost and physical performance, waste is minimized both during construction and through the life of the building.

Whole life-cycle costing: a brief history

Prior to the 1970s, most clients, developers and professionals involved in building procurement made capital investment decisions solely on the basis of capital cost. Outside the construction industry, it was appreciated in some quarters that making decisions solely on capital cost could be folly. They believed that by possibly spending more in capital cost, the long term would realise substantial cost savings when compared with a cheaper alternative.

This school of thought was known as 'terotechnology', and it was in effect the beginnings of whole life-cycle cost theory. Within the construction industry, nevertheless, terotechnology was largely ignored. Some of the reasons behind this included an ignorance of the importance of whole life-cycle costs, lack of available data and data collection mechanisms, and the fact that those providing the capital

generally had no interest in the subsequent operational costs of the building. In the early 1970s, the term 'cost-in-use' began to cost effective? Only by considering the whole life-cycle costs can this be assessed. Using WLCC also supports benchmarking and key performance indicators

- *Monitoring cost effectiveness of constructed assets* WLCC provides the means by which to constantly review this and base future capital investment on this information
- *Lean construction* By considering long-term cost and physical performance, waste is minimised both during construction and through the life of the building.

The aim of this chapter therefore is to provide a general overview of the fundamental ideas and principles behind WLCC and to demonstrate how it can be of benefit to the construction industry practitioner. The chapter initially examines the history of LCC and its various definitions, moving on to show how WLCC has evolved from LCC as a new and innovative cost analysis tool. The failings of previous LCC methodologies are examined by definition of the innovative aspects of WLCC. appear in the industry and the literature. Cost-in-use refers to the expenditure related to the operation of an asset. Although not related specifically to the construction industry, it was recognised that the underlying principles of costing use could apply to buildings and critical structures. What cost-in-use failed to consider, though, was the necessity for accurate future cost forecasting. It became clear then that some kind of technique was required to facilitate this.

It was not until the mid to late 1970s that LCC emerged as a solution to this problem. LCC fostered a wide-ranging approach to cost appraisal, encompassing all perceivable costs from construction through to eventual disposal –

'the whole life'. Using a variety of forecasting techniques, the analyst was able to demonstrate how increased capital cost could be offset by long-term cost savings. LCC sounded good in theory, but the practical implementation within the construction industry did not reflect this. In terms of the enlargement of life-cycle costing theory, the major factor which frustrated its development was lack of good quality cost-in-use and performance data. This proved to be the principal dissatisfaction felt by those who showed some willingness to employ life-cycle costing techniques.

In 1971, the Royal Institution of Chartered Surveyors established the Building Maintenance Cost Information Service (BMCIS) as a method of collecting operational and running cost data. Its main aim was to adopt a single classification system, which could then be disseminated among subscribers in a common demeanour. Although the BMCIS went some way to addressing the implementation problems of life-cycle costing, it did not address the need for a coherent framework and structure in which to deal most effectively with this information.

In 1977, the then UK Department of Industry published *Life-cycle costing in the management of assets* which presented one of the earliest definitions of LCC:

'A concept which brings together a number of techniques – engineering, accounting, mathematical and statistical – to take account of all significant net expenditures arising during the ownership of an asset. Life-cycle costing is concerned with quantifying options to ascertain the optimum choice of asset configuration. It enables the total life-cycle cost and the trade-off between cost elements, during the asset life phases to be studied and for their optimum selection use and replacement.' Since 1977, LCC has become widely reported on, with a diversity of models and techniques existing. In 1983, two eminent researchers in LCC, Roger Flanagan and George Norman, developed a framework for collecting data, which could then be used to build up the life-cycle cost of a project. By 1992, LCC was a familiar concept to building economists throughout the world, and as such became a recognised standard in the UK under British Standard BS 3843 (1992):

'The costs associated with acquiring, using, caring for and disposing of physical assets, including feasibility studies, research and development, design, production, maintenance, replacement and disposal; as well as all the support, training and operations costs generated by the acquisition, use, maintenance, and replacement of permanent physical assets.'



In 2000, this definition was revised and incorporated into ISO 15686 Part 1 – Service Life Planning which cites LCC as (ISO 2000):

‘A technique which enables comparative cost assessments to be made over a specified period of time, taking into account all relevant economic factors both in terms of initial capital costs and future operational costs.’

The BS/ISO definition, although authoritative, is a daunting and perhaps vague definition given the plethora of cost items that could be included within each cost category. Principally, the authors believe this to be one of the reasons why LCC is still rarely used to the extent that it was initiated for, although others argue that the lack of quality data is the principal reason.

Additionally, the plethora of cost models and definitions associated with LCC has been significant in creating an ‘air of confusion’ over the subject. Ambiguity and inconsistency were identified in Newton (1991), where consideration of the problem of model classification and the inability to compare models on a like-for-like basis are discussed. Furthermore, the individual perception of the life-cycle model raises many concerns. This is validated in Smith (1999), which highlights how LCC has for some time become an important issue in the overall cost picture, but has not featured in the decision making process to the same extent. This lends weight to the argument in Kirkham *et al.*

(1999) that in some respects LCC has remained an academic rather than a practical tool, and that presently the financial burden of implementing an LCC approach outweighs the advocated benefits.

By way of example, consider the application of LCC in other sectors. It has been widely used in the procurement of United States and Australian defence contracts for some time now (Australian National Audit Office 1998; US Department of Defense 1997, 2001). The sheer cost involved in these kinds of projects emphasises the need for LCC; that is, the possibility that significant capital outlay needs to be justified by the longer-term benefits. In some respects, research has shown that LCC has only been applied to projects that have a very high capital cost. In a significant amount of cases, it has been found that ignoring the likely future costs in the conception stage can lead to a significantly more costly endeavour in the future (Smith 1999).

Towards the late 1990s, the concepts of ‘whole life costing’ (WLC) and ‘whole life-cycle costing’ (WLCC) emerged. The terms whole life costing and whole life-cycle costing are interchangeable. WLCC is a new term that appears to have been adopted by many building economists involved in the preparation of forecasts for the long-term cost assessments of capital projects.

There has been debate amongst academics and practitioners as to whether a difference really does exist between WLCC and LCC. The key emphasis in most of the definitions lies in the implication that LCC is only concerned with the economic life of the building, in other words the period of commercial interest. It could be argued that WLCC forms the attempt by academia and practitioners to overcome some of the problems of LCC. Moreover, it takes into account the costs of running and operating a building over its entire life span – ‘the whole life’ – as opposed to over a specified period of time, which is a feature of LCC models. Notwithstanding, some have argued that WLCC is simply synonymous with LCC. Others have specified that a difference exists (Bourke & Davis 1999). In this book, the contention is that the concepts are indeed different and to justify this assumption an online survey was conducted (Boussabaine & Kirkham 2000). The authors sought to assess the opinions of academics and practitioners involved in LCC/WLCC, and to establish if the majority of individuals thought that there was real difference between the concepts. This survey forms part of the backbone of the definition of whole life-cycle costing taken in this book.

Defining whole life-cycle costing

The online survey revealed a broad spectrum of opinion about the difference (if any) between WLCC and LCC. The following are random examples of the responses:

‘The term. . . is whole life costing (WLC) and if you believe the old life-cycle costing (LCC) also included

all capital and revenue costs for the whole business case/project and not merely elements, e.g. cladding, ceilings etc. then LCC and WLC are . . . the same thing.'

'By rights they should mean the same thing, with the "whole" being superfluous. When one considers a "life-cycle", its wholeness is implied. However, it [may be] possible that when some refer to LCC, they may be referring to the consideration of only costs incurred up to the point when the asset is no longer economically viable and ignoring the issues that relate to asset disposal – which is considered to be part of WLCC.'

'If LCC is anything like life-cycle assessment, its completeness is a continuum. . . . In practice, LCAs suffer dramatically from incompleteness, because environmental impacts have to be traced many transactions upstream. This is not a problem for LCC . . . I can't imagine what the problem would be regarding a small amount of information about the scope of LCC. Australian and New Zealand standards I have seen on LCC do not define WLCC. [Why] would the additional term be required?'

'I believe that WLC is simply the modern [equivalent] of LCC. Cost-in-use remains something different. There may be a shift in emphasis to suggest that WLC is not a one-off calculation, but may also be reviewed during the life of the building.'

'As I understand it, WLCC goes slightly beyond that to include costs beyond working life – in the case of a building project therefore demolition costs for example would be included . . .'

'In practice, we refer to WLC as the total operating costs of the building, including energy/utilities costs and facilities management elements that relate to the building, such as maintenance and cleaning. LCC refers to replacement building components within the building such as windows, fan coil units, etc. Over and above this are facilities management costs, such as security and catering.'

'Theoretically speaking, there is no difference between LCC and WLCC. Each sector adopts a different term. For example, the manufacturing and military [sectors] use LCC, whilst the construction industry may use WLCC and . . . oil, gas and prime contracting [companies] use through life cost (TLC). However, in the concept of the Private Finance Initiative (PFI), LCC means life-cycle replacement cost which is a part of WLC.'

It would be fair to speculate, after consideration of the points above, whether we really know what WLCC represents. In the absence of any internationally recognised standard on WLCC, it remains a subjective opinion based upon experience, field of work/study and economic standpoint. Of greatest importance is that not one of the respondents in the survey defined WLCC in similar terms; some though pointed out that LCC and WLCC were two of the same thing. In the absence of any national/international standard, who is to say that the above views are at worst incorrect or at least misguided? Although several institutions within the UK are currently working on WLCC-related projects, how can a wider understanding amongst practitioners and academics be initiated, when the research community as a whole is still confused about terms? Naturally it follows that an urgent need exists to define WLCC.

It is the authors' belief that a tangible difference exists between WLCC and LCC. We see WLCC as an evolution of LCC and not a re-invention of the wheel in terms of its association to LCC. Many have rightly noted that a fundamental problem with LCC is the aspect of uncertainty, the risk that is inherent in future forecasting. Some have gone so far as to say that LCC is based on 'guesswork' and 'speculation'. True, we will never be able to state with a very high degree of certainty how a building will perform economically in terms of operation, maintenance and such like. However, it is possible to quantify that risk, to enable stakeholders and decision makers to base capital investment proposals on a basis by which they are aware of the uncertainty in the forecasts. We are also concerned about the fact that the elemental deterioration of building components and the characteristics of the building itself are not integrated into the WLCC decision making process.

In consideration of the results of the survey, and based upon the previous research activities of the various institutions in the UK and elsewhere, the authors advocate the following definition as that of WLCC:



'Whole life-cycle costing (WLCC) is a dynamic and ongoing process which enables the stochastic assessment of the performance of constructed facilities from feasibility to disposal. The WLCC assessment process takes into account the characteristics of the constructed facility, reusability, sustainability, maintainability and obsolescence as well as the capital, maintenance, operational, finance, residual and disposal costs. The result of this stochastic assessment forms the basis for a series of economic and noneconomic performance indicators relating to the various stakeholders' interests and objectives throughout the life-cycle of a project.'

The WLCC assessment components included in the above definition will serve as the guiding principles for this book. WLCC and risk assessment are but part of the overall management of the whole life-cycle of project processes that comprise the art and science of decision analysis. This book addresses the risk assessment-related aspects of decision making in the process of WLCC. The aim is to convey to the reader the fundamental principles of WLCC and risk assessment and the enveloping processes.

Risk and uncertainty in WLCC

In the previous section, attention has been drawn to the importance of dealing with risk and uncertainty in WLCC analyses. This importance is reflected in the new definition. However, this leads us to a salient point. Is there a difference between uncertainty and risk?

The authors believe there is a great difference. The terms risk and uncertainty are often used interchangeably, although a distinction can be drawn by noting that the concept of risk deals with measurable probabilities while the concept of uncertainty does not. An event contains an element of risk where a probability distribution can be defined. An event is uncertain when no probabilities can be developed concerning its occurrence. Risk refers to probabilities of errors in decisions and WLCC forecasts throughout the life-cycle of a project, or the probabilities of occurrence of events. Risk assessment deals with the likelihood and expectation of possible WLCC outcomes using probability concepts. If computed in terms of the probability of success or failure to achieve the return on investment, the risk is seen as an objective risk. It is an uncertainty when the probability cannot mathematically be indicated but there is enough knowledge to make a subjective judgement about the WLCC decisions. The more explicitly the risk is defined, the greater the possibility for the decision maker to have confidence in using the results of the WLCC analysis.

Subjectivity in WLCC

The issue of subjectivity and vagueness is also a very important facet of WLCC. Subjectiveness, vagueness and ambiguity (used interchangeably in this book) are different from randomness. Randomness deals with uncertainty (in terms of probability) concerning the occurrence or non-occurrence of an event. Subjectivity, on the other hand, has to do with the imprecision and inexactness of events and judgements, including probability judgements. Many WLCC decision problems involve variables and relationships that are difficult, if not impossible, to measure precisely. For example, probability judgements about issues like inflation, operation costs, etc. are not always precise in WLCC and often cost analysts use subjective expressions to express their probability judgements. This applies to probability judgements as well as the costs and benefits in many WLCC decision problems. The requirement for high levels of precision may cause WLCC models to lose part of their relevance to the real world by ignoring some of the relevant decision attributes because these variables are incapable of precise measurement or because their inclusion may increase the complexity of the models. Hence, the key to successful WLCC and risk assessment is to build models that require little information – no more than the users can provide. This is a challenge, but it is a challenge that is addressed through the chapters of this book.

Summary

In this chapter we have looked at the evolution of WLCC and introduced some of the basic principles behind the technique. A working definition of WLCC is proposed, based upon the results of a survey, and we have also briefly introduced the importance of considering risk, uncertainty and subjectivity. In the following chapters we will look in closer detail at the techniques and procedures that are commonly

used in WLCC modeling and how these techniques can be modified to cope with risk.

Dealing with risk and uncertainty in WLCC should be the cornerstone of the analysts' approach to WLCC decision making. The uncertainty of forecasting has always been a key problem with practitioners, so by providing information and quantifying the risk element, stakeholders should be more confident in the information that WLCC can provide.

Why has the construction industry failed to embrace WLCC?

Currently, the application of WLCC in the construction industry is still hindered significantly by the lack of standard methods and the excuse of lack of sound data upon which to arrive at accurate decisions. As a result, the output from WLCC models is looked on as unreliable. A government report issued by the Building Research Establishment (Cliff & Bourke 1998) on whole life costing identified several factors that presently act as barriers to applying WLCC:

WHOLE LIFE-CYCLE COSTING RISK MANAGEMENT

Introduction

Contemporary developments in the construction industry since the mid 1990s have highlighted the benefits that the whole life-cycle cost approach to investment appraisal can bring to the construction industry. Several reports, including those of Latham (1994) and Egan (1998), have strongly advocated the need to consider the long-term cost of design decisions. Guidance from other agencies has also stressed directly the need for design to encompass a WLCC approach. WLCC has been identified specifically as it gives the analyst the ability to generate tangible evidence of the sustainability of building facilities. It also allows insight into the economic efficiency and performance of the asset.

Recent guidance for projects procured using the Private Finance Initiative (PFI) route advocates the use of WLCC techniques specifically as they provide an assessment of the long-term cost effectiveness of a project. Investments in facilities are long-lived and necessarily involve uncertainty about project life, operating and maintenance costs, and many more factors that affect facilities economics. If there is substantial uncertainty concerning cost and time information, a WLCC analysis may have little value for decision makers. Therefore, it is essential to assess the degree of uncertainty associated with the WLCC results and to take that additional information into account when making decisions. Thus, risk management should form an integral part of the WLCC process. This chapter presents a framework for dealing with WLCC risk management.

Why Construction Industry fails to embrace WLCC

Currently, the application of WLCC in the construction industry is still hindered significantly by the lack of standard method and the excuse of lack of sound data upon which to arrive at accurate decisions. As a result, the output from WLCC models is looked on as unreliable. A Government report issued by the Building Research Establishment on Whole Life Costing identified several factors that presently act as barriers to applying WLCC:

- The lack of universal methods and standard formats for calculating whole life costs
- The difficulty in integration of operating and maintenance strategies at the design phase
- The scale of the data collection exercise, data inconsistency
- The requirement for an independently maintained database on performance and cost of building components.

These barriers might be directly related to the absence of adequate knowledge of WLCC processes and mechanisms. There may also be a lack of willingness from stakeholders to set up appropriate mechanisms to solve these problems. If, for example, all building occupiers were required to submit annual running cost profiles, the risk associated with WLCC techniques could be significantly reduced (Bird 1987). In fact, White (1991) argues the case for 'performance profiles' and in particular, highlights



again the requirements for a universal construction data information system. One could argue that a plethora of WLCC models does exist but the common denominator in practical application and development is lack of appropriate information or know-how to use and develop models with existing information.

It seems to be worth noting how both the academic and practical 'schools of thought' in the industry need to get their own houses in order if significant steps are to be taken in the wider applications of WLCC. Newton (1991) in his work in cost modelling procedures highlights the need for a methodological and organised framework for such research activities. The sheer complexity of many models lends little to practical application and in many cases, if not the majority, the lack of available good quality data prohibits further development. In terms of the practitioners, they need to be willing to encourage clients and building occupiers into adopting a more holistic approach to running cost control so that procedures can be put in place to aid all those requiring WLCC cost profiles.

Why risk assessment in whole life costing?

Combined with WLCC, risk assessment should form a major element in the strategic decision making process during project procurement and also in value analysis, especially in today's highly uncertain business environment. WLCC decisions are complex (the complexity level is usually determined by the scale, funding and financial environment surrounding the scheme, amongst other factors), and usually comprise an array of significant factors affecting the ultimate cost decisions. WLCC decisions generally have multiple objectives and alternatives, long-term impacts, multiple constituencies in the procurement of construction projects, generally involve multiple disciplines and numerous decision makers, and always involve various degrees of risk and uncertainty. Project cost, design and operational decision parameters are often established very early in the life of a given building project. Often, these parameters are chosen based on owner's and project team's personal experiences or on an ad hoc static economic analysis of the anticipated project costs. While these approaches are common, they do not provide a robust framework for dealing with the risks and decisions that are taken in the evaluation process. Nor do they allow for a systematic evaluation of all the parameters that are considered important in the examination of the WLCC aspects of a project. The existing methods also do not adequately quantify the true economic impacts of many quantitative and qualitative parameters.

Capital costs and future costs must be quantified, analysed and presented as part of the strategic decision making process in today's business environment. Cost analysis and value analysis techniques are used to quantify and assess the economic implications of investment in building facilities in general. These techniques have typically concentrated on utilising life-cycle and comparative cost procedures to determine either the lowest initial cost alternative or the highest investment return alternative. While these techniques do provide a basis for making project cost decisions, they most often do not account for many of the parameters which may affect the actual project value or cost\ (Plenty *et al.* 1999). The existing methods also do not use formal decision making processes and risk assessment methods in performing cost benefit analysis.

It is not surprising that the BRE report (Clift & Bourke 1998) found that clients have a lack of interest and trust in the value of whole cost exercises. This might be due to the fact that WLCC analysis that is not supplemented with risk assessment of all aspects of decision making involved in this process has little value to any decision maker. Risk assessment should be an integral part of the WLCC process. A significant effort is being invested in developing a framework for data collection but data collection on its own, without the correct methods and tools to identify important decisions in the WLCC process and associated risks, is of little value to clients or other interested parties. Clients did not know what to do with information when received and practitioners did not understand the process or the benefits of WLCC (Clift & Bourke 1998).

A framework that uses formal decision making processes and risk assessment of each aspect of the decision to be taken in performing WLCC life-cycle analysis can help owners, design teams and cost

planners in making strategic decisions based on analysis results that truly reflect the inherent risks and costs related to the project. Alternative building decisions can be evaluated and compared early in the project development stage. Simply choosing an alternative as being 'better' than the others, based on the traditional approach of life-cycle costing, may not be strictly correct. The confidence of the decision maker's choice depends on the level of uncertainty in the variables and decisions considered. If the WLCC computation results were aided with probabilistic information on the potential costs and risks of the various decisions that are taken throughout the whole life-cycle process of a facility, the confidence in the process of whole life-cycle costing would probably be increased. The subsequent chapters in this book are intended to provide this.

Data requirements in whole life-cycle costing and risk assessment

Flanagan and Norman (1983) highlighted three fundamental requirements in successfully implementing a life-cycle costing methodology:

- A system by which the technologies can be used: a set of rules and procedures
- Data for the proposed project under consideration: estimates of initial and running costs of elemental life-cycles, discount rates, inflation indices, periods of occupancy, energy consumption, cleaning and the like. The data required to carry out WLCC analysis can be derived from a range of possible sources (Bennett & Ferry 1987):
 - Direct estimation from known costs and components
 - Historical data from typical applications
 - Models based on expected performance, average, etc.
 - Best guesses of the future trends in technology, market application
 - Professional skill and judgement.

All these factors have some bearing on the quality of data that is collected and how it is used in modelling and decision making processes. Whilst WLCC is now becoming widely used as a valuable tool in the design process, probably two key factors have undersized its potential impact (Flanagan *et al.* 1987; Bird 1987):

- A suspicion that life-cycle cost estimates are in some sense inaccurate or based merely on guesswork
- The absence of sufficient and appropriate cost and performance data.

Data sources

It has been highlighted how important the data and its composition are to WLCC, but where can this data be obtained? Ferry and Brandon (1991) highlighted six main outputs:

- Technical press
- Builder's price books
- Information services such as the Building Cost Information Service (BCIS)
- Government research literature such as from the National Economic Development Office (NEDO)
- University research
- Technical information services.

Flanagan and Norman (1983) defined these into four subgroups:

- Manufacturers' data
- Suppliers and contractors



- Modelling techniques
- Historical data.

The availability of data has a significant impact upon the types of modeling techniques available to the analyst. For instance, monthly data for energy costs can be used to develop time-series forecasts, annual data can be used to model probabilistic distributions, etc.

Manufacturers' data

A unique aspect of the building process is its individuality and specialist requirement. Many building materials and indeed processes are subcontracted out to individual specialists. These specialists as a rule will have detailed breakdowns of the life-cycle of the product, its material components and its performance characteristics.

This data can also be obtained from other authorities that are responsible for testing the integrity and materials for construction. The British Board of Agrément is a UK government testing body which carries out independent testing of materials used in the industry. Materials that meet a set specification and performance are issued with Agrément certificates, which give details on service lives and other critical information. The Building Research Establishment also carries out testing on materials and can be a useful source of information. Furthermore, the American Society of Civil Engineers regularly publishes papers on building material life spans for use in cost profiling (Ehlen 1997).

Forecasts from models

In the absence of any historical or suppliers' data/feedback, models can be used as a way to analyse the WLCC implications of particular design decisions or choices of materials. The concept behind modelling is to facilitate and introduce a higher degree of accuracy in the estimates made by cost analysts when drawing up life-cycle cost profiles. Some dispute the validity of model forecasts but one school of thought advocates that simulated forecasts are as good if not better than historical data due to the following reasons (Ferry & Brandon 1991).

- Historical data by definition relates to the past, whereas simulated data refers to the future. The argument is that for maintenance and servicing costs, data recorded previously would be a poor guide as in the future more sophisticated facilities management techniques and higher quality products and reliability would provide for a different cost structure.
- It is very fortunate to obtain historical data that has not been trained or recorded for other purposes. Typically, in dealing with life-cycle costs, data may be required about a particular element but data may only be available generally for a whole group of elements. Simulation could provide this data in the required format.
- It is also believed that historical data can be inaccurate if those job-sheets and other forms filled in on a 'Friday afternoon' are maintained in a slipshod manner.

These idiosyncrasies can be dealt with, however, using a variety of statistical techniques to reduce data noise, data outliers and other characteristics which are likely to incorrectly skew the results. For example, outliers might be determined using box plots; missing or erroneous data sets are corrected using local means (averages). However, a thorough knowledge of the data used in the modelling should be acquired to ensure that the techniques used are valid and not likely to introduce biases into the modelling process.

Historical data

Historical data can be obtained from a variety of sources such as the BMCIS, clients and building occupiers and in some cases the design team themselves. The value of historical data is relevant in that the values of initial capital cost and subsequent running cost can be categorised for certain groups of element in the building and this comparison can then be used to identify the elements which will benefit from a life-cycle cost approach. For instance, if a building element has a high initial capital

cost and then subsequently low maintenance and running costs, a life-cycle approach would gain little use. However, elements with significant running costs could, through design change, for instance, benefit from life-cycle cost savings.

Specifying a comprehensive set of objectives and measures for each WLCC component

The authors advocate, for this purpose, the use of operational research (OR) and methods described in risk assessment and decision making in business and industry (Pilcher 1992; Koller 1999). OR methods consist of a number of well-defined scientific steps:

- (1) Formulation of the problem, establishing the objectives and any constraints that may apply
- (2) Building a model that represents the system under analysis
- (3) Using the model in order to obtain a solution to the problem
- (4) Comparing a solution obtained by means of the model with that in current use
- (5) Evaluating the results and monitoring the performance of the system through changing conditions.

The above steps must be applied to every aspect of the WLCC. Therefore, the interactive steps that are involved in this process are:

Service life

The prediction of component service life is a very important aspect in WLCC assessment. One such methodology currently in use is the factor method.

The ISO/CD 15686-1 factor method for the estimation of the service life of components or assembly (facility) under specific conditions treats the service life as a deterministic value. In reality the service life has a big scatter and should be treated as a stochastic quantity. Here the authors advocate that at early stages of the project (design) this approach should be used but in conjunction with uncertainty and risk assessment for each of the involved factors. The objectives that need to be assessed include:

- Assumptions about the service life of the major facility components
- Risk of failure of components
- Quality of fabrication and production
- Assumption about the updating and maintenance management plans
- Cost constraints
- Assumptions about frequency and time intervals of maintenance and replacement.

At operation stage the requirements are different and necessitate a completely different method of assessment. The process here is concerned with the prediction of the remaining service life of the facility components and the forecasting of the rate of their deterioration and the maintenance budget required to bring the state of the facility to an operational standard. For this purpose the authors advocate the use of the Markov theory (explained in detail in Chapter 5). The objectives that need to be identified and assessed at this stage include:

- Survey condition of the existing facility components
- Assumption about the remaining service lives of components
- Updating budget requirement
- Priority of components updating – critical components
- Quality of maintenance and replacement components
- Assumption about time-lag replacement or maintenance delays



- The effect of delayed maintenance on budget and deterioration of facility
- Evaluating the economic viability with a view to disposal.

Obsolescence and end of use

Societal and business environments are characterised by rapid changes in technology and user patterns, which also result in changes in the requirements for infrastructure. Changes in use, trends in fashion (this is more likely to be in housing), and the emergence of new technologies (mainly mechanical services and IT) will have a direct effect on the life expectancy of components and facilities in general. Facilities should be designed and constructed with flexibility in mind to allow future adjustments for anticipated and/or likely changes. The objectives that should be identified and assessed include:

- Intangible costs, such as access disruption to building activities or other costs borne by other than clients, which will also be considered under this section
- Birth, growth and death of firms (business). This can be achieved by projecting the number of years that a business is viable. This will have a direct effect on the functional life expectancy of a facility. This assumption can be used for preparing a life-cycle cost analysis
- Physical obsolescence
- Economic obsolescence
- Technological obsolescence
- Functional obsolescence
- Legal and social obsolescence
- Disposal and decommissioning methods
- Demolition, retain or refurbish options
- Asset reuse or recycle of components
- Waste disposal implications
- Site and land clean-up procedures.

Capital costs

Returns on invested capital costs are essential in making decisions on investment scenarios. This requires a combination of knowledge about the investment in question, skill for analysis and elicitation of decisions from the existing information, experience and judgement. The capital cost for acquiring a facility will not be known with certainty until the facility is developed and handed over for operation. Hence, the information required for carrying out whole life-cycle cost and economic viability analysis relies on the availability of previously documented cases and speculative assumptions. The capital cost objectives that need to be assessed include:

- Land acquisition cost. The location, and land viability may have a direct effect on the whole life cost and life expectancy of a facility
- Predesign costs. The amounts of time and quality of information generated (development of the brief and facility specification) at this stage have great consequences on the quality and operation of a facility. The investors have a good opportunity to optimise the whole life cost of a facility through the selection of component and functional flexibility. Ideally, the issues relating to obsolescence should be investigated, accounted for as costs at this stage
- Design costs. The quality of design in terms of error, detailing and buildability will have a direct effect on the cost of production and operation. A high quality building might also require higher costs in use in order to maintain its high aesthetic quality in use (Ashworth & Hogg 2000)

- Development and production costs. The quality of workmanship is directly related to the level of maintenance. It is important to ensure that quality control is in place to ensure sound construction practices are used
- Fees
- Risk costs
- Financial costs, tax, interest, etc.

Operational costs

Operational costs are less certain as the time span increases due to uncertainties in energy costs, maintenance, fees, staff and regulatory changes. It is important to view operational cost estimates in their holistic state; several qualitative factors will have an important effect on the total operational costs.

The operational cost objectives that need to be assessed include:

- Factors which contribute significantly to the total operational costs
- Optimum balance between capital and operational costs
- Operational risk management systems
- Optimum asset cleaning procedures
- Optimum waste management procedures
- Optimum utilities management procedures
- Optimum staffing level
- Minimum disruption due to denial use of the asset.

Maintenance costs

The costs and priority of required maintenance, rehabilitation and replacement can be obtained from historical data but base cost estimates have to be supplemented with expert opinions in order to perform whole life-cycle analysis and risk assessment. The maintenance cost objectives that need to be assessed include (some are from Kirk & Dell'Isola 1995):

- Performance indicators for the assessment of maintenance costs
- Remaining service life of facility components
- Frequency and replacement costs
- In-house or subcontracted maintenance
- Selection of exterior and interior materials and surfaces
- Selection of light fixtures with minimum routine repair and replacement requirements
- Type of preventive maintenance programme.

Financing costs and revenues

The objective here is to deal with WLCC input parameters of discount, inflation rates, taxes, expenses, etc. Critical analysis of investments must include both initial and ongoing costs and returns over the period of the investment. This will allow stakeholders to compare different options and decide which offers the best return for the investment. Usually discount rate is used for computing the value of future revenues. This includes a large degree of risk return. For example, if the discount rate is set too high or too low then future costs may appear insignificant; this could result in high operational costs and capital costs, which will discourage investment. Also, if inflation is different from the selected rates this



may lead to inappropriate investment choices. The financing cost objectives that need to be assessed include assumptions about:

- Inflation rates, interest and taxes
- Level of returns and risks
- Optimum discount rate
- Economic activity. This has a direct effect on the economic obsolescence of facilities
- Level of risk financing
- Cash inflows versus outflows
- Different rates, time periods and cash flows.

Asset characteristics

The characteristics (i.e. physical and functional) of new or existing facilities are very important aspects of WLCC computation. The research community has largely ignored this aspect of WLCC. For example, a relationship may exist between building function and mechanical services costs, a particularly important feature of modern facilities. Little research has been published with regard to the impact of building characteristics on WLCC. Experience shows that an indirect link exists through many aspects, including energy costs for example. A poorly insulated building will consume more energy, thus increasing WLCC and possible downtime costs in maintenance (Department of Industry 1977). The characteristics that should be assessed and included in the computation of WLCC include:

- Layout and location
- Functionality
- Construction technology
- Gross floor area
- Number of storeys and storey height
- Glazing area
- Occupancy (m²/person)
- Shape of the facility
- Aesthetics
- Energy-saving measures
- Quality of components
- Type and quality of public health systems
- Type and quality of superstructure building fabric
- Type and quality of internal fabric
- Type and quality of electrical and mechanical services
- Extent of site works.

Economic performance measures

The procurement of building facilities involves a variety of decision makers who decide on alternatives that generate capital and ongoing costs during a project's life. These capital costs generate value for different stakeholders and potential for returns to the project owner which should be durable over the life-cycle of the asset. Conventional investment appraisal techniques, which focus on cash

flows represented by the costs and expected returns of a project discounted to a common base period, do not reflect the total value of capital expenditure choices which include intangible and non-monetary benefits as well as reduction of future costs and financial returns (Plenty *et al.* 1999). Usually these economic measures are not supported by any risk assessment analysis. Therefore, economic performance measurement in WLCC is very important for decision makers to evaluate and allocate identifiable value from capital and continuing costs to relevant stakeholders in the life-cycle of a facility. This will allow the consideration of different stakeholders' objectives in the assessment of the WLCC. The objectives that should be assessed under this heading should include:

- What type of performance indicators should be used to aid in the selection of alternatives
- The boundaries of these indicators, i.e. minimum and maximum values that the stakeholders are prepared to work to
- The best measures of performance in terms of WLCC outputs
- Mechanisms for WLCC benchmarking
- Measures for mitigating economic risks.

A framework for whole life costing risk management

WLCC risk management is one of the important issues facing building assets executives today. As spending on building assets rises, asset owners become increasingly worried about WLCC optimisation throughout the life span of facilities; consequently, they become highly vulnerable to the risk of operational costs. Usually, when decision makers are faced with an investment choice under uncertain conditions, their main concern is to avoid projects whose actual economic outcome might be less favourable than what is acceptable, resulting in the risk of missing out on potential investment opportunities.

Thus, the objective of WLCC risk management should be to assist decision makers in evaluating whole life alternatives so that investment success is maximised. Usually traditional methods are used to optimise this process. However, traditional approaches to risk management have failed miserably because of their demand for mysterious statistical data that the end user does not have (Koller 1999). The key to successful WLCC risk-process and risk modelling is to build a WLCC framework that requires from the user nothing more than they presently can provide. This can be a challenge that can be addressed through the use of a variety of techniques. That is why it is important to use a combination of risk management techniques (depending on the stage of assessment) for risk assessment in WLCC, ranging from simple deterministic approaches to uncertainty assessment (e.g. sensitivity and break even analysis methods which are easy to use and understand and require no additional methods of computation beyond the ones used in LCC analysis), to very sophisticated methods based on probabilities, artificial intelligence (AI) and a hybrid of both techniques.

There has been a great emphasis on the techniques that are used to model risks but there has been little work on the integration of the whole process of risk identification, quantification, response and management strategies. We believe strongly that these interlinked processes are essential ingredients for any successful risk framework in the life-cycle of assets. Figure 2.2 shows the interaction between these processes.

The whole life-cycle risk process for each stage of the project might be divided into five interactive steps, as shown in Fig. 2.2. This framework does not emphasise any one particular component (though identification is deemed to be the most important) of the WLCC risk management process but concentrates on the sequential and iterative linkage of the five components to make up the entire process of WLCC risk management. If WLCC risk is addressed in this fashion it should enable stakeholders to smoothly move forward and backward from one component to another by identifying and understanding the possible courses of action in the different steps. Such a framework should provide whole life risk managers with a comprehensive view of the overall WLCC risk management

strategies. The framework, integrating the five iterative steps, is presented in Fig. 2.2 and explained in the following sections.

Whole life risk identification

The process starts with a qualitative stage that focuses on identification of risks related to each of the whole life-cycle processes. Risks that are unidentified and not quantified are unmanaged risks that can have a significant negative outcome on projects and organisations. If any of the unidentified risks occur at any stage of the project life-cycle, this may have serious consequences on stakeholders' financial status. Hence, perhaps the most important step in the whole life-cycle risk process is the process of risk identification. The quality of this process has a direct effect on the quality and accuracy of risk analysis, quantification, and development of risk strategy responses, and on the management of risk throughout the life span of projects. The output of risk identification will inform the second quantitative analysis process that focuses on evaluation and assessment of risks associated with each aspect of the life-cycle span of projects.

Whole life risk analysis

Several methodologies are available to deal with WLCC risk analysis. The techniques that can be used in WLCC risk assessment decision making might be summarised as deterministic, probabilistic and AI. Deterministic methods measure the impact on project outcomes of changing one uncertain key value or a combination of values at a time. In contrast, probabilistic methods are based on the assumption that no single figure can adequately represent the full range of possible outcomes of a risky investment (Fuller & Petersen 1996). Rather, a large number of alternative outcomes must be considered and each possibility must be accompanied by an associated probability from a probability distribution, followed by a statistical analysis to measure the degree of risk. Using a deterministic approach, the analyst determines the degree of risk on a subjective basis. AI methods differ from the above approaches and use historical data to model cost and uncertainty in WLCC analysis. None of these techniques can be applied to every situation. The best method depends on the relative size of the project, availability of data and resources, computational aids and skills, and user understanding of the technique being applied. We have not provided here a detailed explanation of all the risk analysis methodologies as these are adequately discussed in Chapter 5.

Whole life risk responses

Developing responses to reduce WLCC risks is the third step in the integrated WLCC risk management framework. Once the building assets and the many different risks and threats to which they are exposed are identified and quantified and the related life-cycle vulnerabilities assessed, necessary steps should be taken to ensure that the entire investment is protected from all sources of external and internal threats. Thus, the third stage is concerned with the identification of strategies that mitigate the effect of anticipated threats to the greatest extent possible. This should be based on the following universal rules: risk avoidance, risk reduction, risk absorption and risk transfer. The various risk responses that may be implemented to mitigate WLCC risks are explained in Chapters 9, 11 and 12.

Whole life risk management plan

Following the identification, quantification and development of risk responses, the related vulnerabilities of building assets need to be determined and planned for. This provides the basis on which risk management plans and decisions are made. The risk management planning process is concerned with putting in place the procedure for:

- What response actions are needed
- When these response actions are needed
- How these actions are implemented
- Who is responsible for the implementation, control and monitoring of the actual progress of risk responses and management strategies that have been developed to deal with the identified risk.

Whole life risk monitoring and feedback

The issue of risk monitoring is essential for ensuring effective implementation of risk control measures. Active risk monitoring ensures that effective response measures to manage the risks are appropriately implemented. Since we are dealing with the life-cycle of projects, the initial decision conditions may change over time, which could lead to the change of risks. Hence, a feedback and continuous assessment of risk through the entire life span of the project is very important in the process of whole life-cycle costing. This process should include tracking the effectiveness of the planned risk responses, reviewing any changes in priority of response management, monitoring the state of the risks, updating the whole life-cycle analysis accordingly and reviewing the economic performance indicators to check whether the investment decision is still valid or otherwise. In this way risk monitoring not only evaluates the performance of risk response strategies but also serves as a continuing feedback or audit mechanism.

The application of the above framework should take place during the early stages of asset development as well as at every project milestone, and should continue throughout the whole life of the asset. The information generated from the WLCC risk management framework should inform decision makers on which input data has the most impact on the WLCC result and how robust the final decisions are.

Summary

Evidence from research and practitioners alike has indicated strongly why WLCC has been treated with mistrust – the failure of models to adequately deal with uncertainty. Forecasts by their very nature can be risky to varying degrees, and stakeholders will imperil investment in capital projects if they are not fully equipped with the facts surrounding this uncertainty. It is therefore the responsibility of the analyst to ensure that the WLCC framework deals effectively with risk and provides the necessary information required to make effective decisions. In later chapters of this book we will look at the techniques and procedures that are available to the analyst to develop well-rounded WLCC models that are reliable and accurate.

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This image shows a full page of blank, lined paper. It features approximately 20 evenly spaced horizontal grey lines across its entire width, typical of notebook or composition paper. The background is white, and there are no margins, text, or other markings present.

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This image shows a full page of blank white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page, providing a template for writing or drawing. There are no margins, text, or other markings present.